

## **BEREC Report on self-supply**

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## Executive Summary

The issue of how to deal with self supply within the context of market analysis arises frequently, namely on the review of wholesale markets. In this context, and using as an input the answers received to the questionnaire that has been drafted and sent to the National Regulatory Authorities (NRAs), this report describes how and under what circumstances the NRAs have included (or not) self supply in the analysis of relevant wholesale markets set out in the European Commission (EC) revised Recommendation, with a focus on market 5 (wholesale broadband market) in order to make some comparisons.

In this context, the reports primary focus point is a description of how NRAs have taken into account self supply at the market definition and SMP analysis stage on market 5, specifying the arguments NRAs have applied to either include or exclude self supply.

The report also deals with competitive constraints relevant in the context of self supply, especially indirect constraints and the Commission's three step test on indirect constraints. Furthermore the report deals with aspects on geographical coverage in relation to self supply and market analysis.

The report concludes that a majority of NRAs have applied a similar approach at an overall level to deal with self supply, addressing self supply at both the market definition and SMP analysis stage.

Due to the report's descriptive nature it should be stressed that it does not set out a common approach to deal with self supply in relation to market analysis.

## 1. Introduction

An issue that may arise in the context of market definition and market power assessment concerning wholesale inputs is how to deal with self supply by vertically integrated firms. In retail markets, all the services offered are usually traded to third parties. However, at wholesale level, this does not need to be the case. Vertically integrated companies that provide wholesale services to third parties might also provide the same services to their retail divisions or might even not sell them at all to third parties. The question then is whether these self supplied services, although they are not sold to third parties, should be included (or not) in the analysis of the relevant market.

This question is relevant as, when assessing market power, one of the main indicators is market shares. It is therefore important to ensure that market shares are calculated properly and one of the stages to achieve this is to determine which services are part of the market and which are not. One of the characteristics that can determine whether a service is to be included is the relationship with the customer. Services can be provided to third parties, in other words traded in the merchant market, as they can be provided to an integrated downstream division or to affiliated companies. The consideration of self supply has the final aim of describing in the most appropriate manner the relevant competitive constraints faced by operators in the relevant market. In some circumstances, considering only services provided to third parties could mislead the conclusions of the analysis.

Within the context of self supply and its relation to market analysis, one can find the concepts of “direct” and “indirect constraints”. A company providing inputs at the wholesale level may be constrained “directly” at that level by other companies that are operating at the same level. Alternatively, that company may be indirectly constrained by the “customers of their competitors” i.e. that company may be indirectly constrained by competition that exists on the retail level. The likelihood that self supply exerts a direct pricing constraint can depend on whether self supplied services are “captive” or can be diverted to the merchant market. The finding of direct or indirect pricing constraints in a market may condition the decision to take self supply into account on that market, depending on the strength or immediacy of those indirect constraints<sup>1</sup>.

An issue that has been raised within the context of market analysis is where self supply can be taken into account: at the market definition stage and/or at the SMP assessment stage. This issue will be discussed in this report.

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<sup>1</sup> For a more in depth explanation of the concept of self supply and related issues, see the report from CRA International prepared for OFCOM about “Indirect Constraints and Captive Sales – Overview of regulatory practice and competition case law with regard to indirect constraints and captive sales in market definition and market power assessment”, 3 May 2006. The report is available here: [http://www.crai.com/ecp/assets/Indirect\\_constraints\\_and\\_captive\\_sales.pdf](http://www.crai.com/ecp/assets/Indirect_constraints_and_captive_sales.pdf).

This report on the application of the concept of self supply in the market definition and the SMP analysis is developed by the SMP Project Team within the context of the ERG Working Programme for 2009.

The main goal is to describe why and under what circumstances NRAs have included (or not included) self supply in the analysis of relevant wholesale markets set out in the EC revised Recommendation on relevant product and service markets (from December 2007). Therefore the report aims to describe the principles and methodologies that NRAs have adopted in relation to the treatment of self supply in their market analysis. In this context not only the simple description of the practices is relevant for the project but also the main points and arguments of the analysis.

In order to find out how NRAs have treated self supply a questionnaire has been drafted and sent to the NRAs (it is available in Annex 1). In order to allow a comparison between NRAs' approaches for one market, but also a comparison within NRAs where they have taken an alternative approach for other markets, the questionnaire focused on how self supply has been applied in the analysis of market 5, but also examined if self supply has been applied differently on other markets. Answers to the questionnaire have served as input to this report.

This report focuses mainly on market 5, as almost all NRAs considered the inclusion of self supply in one stage or another of this market review. Moreover, only six NRAs took a different approach in market reviews concerning other markets and only four of them in a review on a market listed in the 2007 Recommendation.

## 2. Regulatory background

In 2007, the EC adopted a revised Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications and services (2007/879/EC)<sup>2</sup> (the "2007 Recommendation"). This Recommendation replaced the earlier Recommendation adopted back in 2003 (the "2003 Recommendation").

In the Explanatory Note accompanying the 2007 Recommendation<sup>3</sup>, where the EC sets out in greater detail the reasoning behind the proposed changes to the Recommendation, the EC highlights some "horizontal issues" as relevant when applying market reviews, including, among others, the self supply issue<sup>4</sup>.

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<sup>2</sup> OJ L344/25 of 28 December 2007.

<sup>3</sup> Commission's Explanatory Note (Accompanying document to the Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services), SEC (2007) 1483 final.

<sup>4</sup> Section 3.1 of Explanatory Note (page 15).

The EC states, in this document, that *“self-provision of wholesale inputs arises frequently in both defining and analysing markets. In some cases, what is under consideration is the self-supply of the incumbent operators. In others, it is the self supply of alternative operators. In many cases the incumbent is the only firm that is in a position to provide a potential wholesale service. It is likely that there is no merchant market as this is often not in the interest of the incumbent operator”*.

Moreover, the EC says that *“where there is no merchant market and where there is consumer harm, it is justifiable to construct a notional market when potential demand exists. Here the implicit self-supply of this input by the incumbent to itself should be taken into account.”* Additionally the EC states that *“in cases where there is likely demand substitution, i.e. where wholesale customers are interested in procuring from alternative operators, it may be justified to take the self-supply concerned into consideration for the sake of market delineation”*. However, the EC considers that *“this is not justified if alternative operators face capacity constraints, or their networks lack the ubiquity expected by access seekers, and/or if alternative providers have difficulty in entering the merchant market readily”*.

Regarding the indirect constraints in the context of wholesale inputs to broadband Internet access, the EC notes in the same document<sup>5</sup>, that *“the presence of cable (or other broadband-capable networks) in a given Member State may, however, exercise an indirect constraint on the provider of DSL-based wholesale broadband access, through the substitutability between both products at retail level. Broadband subscribers may have a choice between the services provided by the integrated incumbent, by other vertically integrated companies (such as a cable operator), or by firms using inputs supplied by the incumbent. If alternative integrated undertakings have high market shares compared to firms exploiting inputs, (and the former choose not to offer wholesale inputs), it is likely that indirect constraints will be more important than direct ones. Such indirect pricing constraint, where it is found to exist, should be taken into account when assessing if the incumbent DSL operator has SMP on the relevant market.”*.

I/ERG has already commented on these issues – self supply and indirect pricing constraints – in the document *“I/ERG Opinion on the draft Recommendation on relevant markets”*<sup>6</sup> presenting the understanding that these subjects would be better placed in the Guidelines on market definition and SMP assessment<sup>7</sup>. Regarding the position taken by the EC, *“I/ERG, however, does not see why such an indirect pricing constraint may only be taken into account when assessing whether an incumbent has SMP on the wholesale market”* and I/ERG is of the opinion *“that the purpose of defining a relevant market is to analyse the different competitive constraints in relation to a particular product. This assessment should*

<sup>5</sup> Section 4.2.2 of Explanatory Note (pages 34-35).

<sup>6</sup> IRG (07) 25.

<sup>7</sup> Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, (2002/C 165/03); OJ C 165, 11.7.2002, p. 6.

*take into account all the relevant constraints (including indirect constraints)”, considering that “this approach is consistent with the SSNIP-test”.*

In the sequence of some market analysis notifications of wholesale broadband access markets under the Article 7 procedure (e.g. from OFCOM in case UK/2007/0733, CMT in case ES/2008/0805, ANACOM in case PT/2008/0851 and other cases), the EC reiterated that indirect constraints should usually be taken into account when assessing if the incumbent operator has SMP on the relevant market. In this context, the EC has proposed a test NRAs can apply to correctly assess the degree or strength of the indirect constraint posed by vertically integrated operators – this test will be analysed in the following sections.

### **3. At what stage has self supply been taken into account by individual NRAs?**

From the answers to the questionnaire, it seems that the majority of the NRAs took self supply into account in their latest analysis of market 5 (or previous market 12, of Recommendation 2003/311/EC). It should be noted that the expression “taken into account” used in this questionnaire means that the NRA explicitly considered the issue. It does not necessarily mean that self supply is ultimately included within the definition of the market. Only three NRAs said that self supply was not taken into account<sup>8</sup>.

When asked at what stage of the market analysis self supply has been taken into account (market definition and SMP analysis stages), the majority of NRAs answered both stages. A few NRAs took self supply into account only at the SMP analysis stage and only one answered that it took self supply only at the market definition stage.

### **4. Reasons individual NRAs have taken self supply into account**

A particular problem which arises in the context of NRAs market reviews under the Framework is when a merchant market is the result of a regulatory obligation. This is because under the modified Greenfield approach NRAs have to assume that no SMP-derived regulatory obligations are in place (on the market to be analysed) when conducting the market review, in order to avoid circularity in their analysis.

As a result of a regulatory obligation, usually one market player, the incumbent, on whom this obligation has been imposed before, is for some time alone active in that market. In those cases, the incumbent would appear to typically have a market share of 100% and this situation is likely to last forever if the merchant market rule is applied strictly (by including only the sales made to third parties) and in the absence of alternative providers of the services in question. However, under the modified Greenfield approach neither the

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<sup>8</sup> In the case of Swedish NRA, PTS has not made any difference between self supply and external sales in any part of the market analysis, since there is presently only a very limited external supply of bitstream products (so the supply essentially consists of self supply).

incumbent nor alternative operators might offer merchant sales and as such the wholesale market could be considered to be notional.

Moreover, in countries where such an obligation never existed, as in some accession countries, those merchant markets may not exist at all. In such a case, a notional market has to be defined, where self supply is taken into account, usually by considering that the market shares in the downstream retail market reflect the market shares in the notional market.

In terms of the arguments applied in the context of the analysis of market 5 for taking self supply into account, a number of reasons were presented by NRAs.

One argument referred by several NRAs (e.g. AGCOM, ANACOM, CMT, ComReg, CTU, EETT, MCA, OFCOM, OPTA) was the strength of indirect constraints that result from retail broadband services that are provided based on self supply inputs. For example, ANACOM and OFCOM included in the definition of the wholesale market cable and local loop unbundling (LLU) based services on the basis of indirect constraints from the retail level.

Some NRAs (e.g. AGCOM, BNETZA) took self supply into account because it helped to analyse geographic differences in competitive conditions. AGCOM assessed the level of homogeneity of competitive conditions on the wholesale broadband access market through calculation of operators' market shares using all internally and externally provided broadband lines of all operators active on the retail market. BNETZA included self supply in bitstream access markets due to the fact that this wholesale market is still immature in Germany and in order to measure the potential of every wholesale provider and these providers' contribution to competitive pressure at wholesale level.

Another argument that was raised (e.g. APEK, NPT, OPTA, RTR, UKE) is the need to take into account all competitive pressure at the retail level from vertically integrated operators in order to properly assess whether (wholesale) regulation is necessary to promote/create effective competition at the retail level.

Some NRAs have applied either a mechanical rule or referred to direct constraints to conclude that self supply is considered as a part of the market (e.g. NITA) and other NRAs did not distinguish self supply from external sales as they concluded that self supply was the only form of wholesale access available on their markets (e.g. PTS, OCECPR).

Self supply was also taken into account in order to measure (at SMP analysis stage) the competitive advantage of a vertically integrated operator on the market (e.g. ARCEP).

The merchant market rule was also applied as a justification not to include self supply in the market (e.g. BIPT), i.e. self supply was taken into account but it was not included.



## 5. Application of the EC's test on indirect constraints on the market for wholesale broadband access markets

As it has been noted in the section above, one of the reasons why NRAs have considered issues pertaining to self supply relates to the strength of indirect constraints that result from retail broadband services provided over different technologies at the wholesale level. Taking self supply into account is thus – in these cases – a way to assess the competitive impact of alternative services that are available at the retail level but that may not be traded at the wholesale level. However, beyond indirect constraints, there are other ways to take self supply into account in the market definition stage, such as the strength of direct constraints. Therefore the approach applied by the EC is relevant for the assessment of indirect constraints but it is not the only relevant test to deal with self supply.

Keeping this in mind, in a number of market 5 (wholesale broadband access market) cases dealt with under the Article 7 procedure<sup>9</sup>, the EC has referred to the importance that NRAs correctly estimate the degree or strength of the indirect constraint posed by vertically integrated operators. In this regard, the Commission has referred to a three-part test, on which basis NRAs should demonstrate that

- (i) ISPs would be forced to pass a hypothetical wholesale price increase on to their consumers at the retail level based on the wholesale/retail price ratio;
- (ii) There would be sufficient demand substitution at the retail level to retail services based on indirect constraints such as to render the wholesale price increase unprofitable;
- (iii) The customers of the ISPs would not switch to a significant extent to the retail arm of the integrated hypothetical monopolist, in particular if the latter does not raise its own retail prices.

When describing the test on indirect constraints in case UK/2007/0733, the EC noted "*Ofcom appears to consider sources of indirect constraint at the wholesale market definition stage of the analysis because of a perceived risk of market power being overstated if indirect constraints are not included in the relevant market. Conversely, however, if weak constraints are automatically taken into account at the market definition stage, then there is also a risk of prejudging the SMP assessment and understating the real extent of market power at the wholesale level by including self-supplied market shares for all vertically integrated competitors irrespective of whether they are actually constraining the market behaviour of the incumbent.*"

The test has been applied by NRAs in several instances, although – on the basis of the arguments noted below – a number of NRAs have put into question the adequacy of such test to assess indirect constraints.

<sup>9</sup> See Cases UK/2003/0032, NL/2005/0281, AT/2005/0312 and UK/2007/0733.

With regard to the first part of the test, in most cases the issue of the wholesale/retail price ratio and the pass-on of the price increase to the retail level have been deemed critical to reach a conclusion on whether self supply should be considered within the market definition process.

In Case CZ/2008/0797, the Czech NRA took into account indirect constraints at the SMP assessment stage when analysing the *wholesale broadband access market*. The EC noted that *"because any price increase at the wholesale level is diluted when it is passed through to the retail level, substitution may occur on a smaller scale in response to the smaller retail price increase. This however depends on the degree of customer responsiveness at the retail level. Thus, caution should be afforded when interpreting indirect constraints stemming from the retail level."* In this particular case a 60% wholesale/retail ratio (thus, where the cost of the wholesale product amounts to 60% of the retail price) was said not to represent a significant proportion of the price of the relevant retail product, and thus should not necessarily lead to the conclusion that any potential wholesale price increase could not be absorbed and would have to be passed on.

Also regarding the first part of the test, the impact of price regulation (including retail-minus price regulation, on which basis a wholesale price increase would necessarily lead to an adjustment of the retail price set by the incumbent) has also been considered by some NRAs in the context of the analysis of the prospects of customers switching to a significant degree to the monopolist's retail arm.

With regard to the second part of the test, the strength of alternative means of broadband provision (including e.g. services based on LLU, cable, or new means of access such as fibre) has been generally analyzed.

Last, with regard to the third part of the test, the issue of the geographic coverage of alternative means of access has in general been assessed by the NRAs that followed the test proposed by the EC, as it may have an impact in determining the real prospects of substitution at the retail level to sources other than the retail arm of the hypothetical monopolist<sup>10</sup>.

When the EC opened the phase II investigation (pursuant to Article 7(4) of Directive 2002/21 EC) regarding case ES/2008/0805, IRG commented on these issues (through the IRG Expert Group Report) by declining the EC's view that indirect constraints should be taken into account on the SMP analysis stage rather than on the relevant market definition stage and the idea that SMP assessment involves only assessing whether the "incumbent" has SMP in the market – IRG argued that limiting the market definition to the activities carried out by the incumbent and limiting the assessment of SMP to this operator risks an erroneous outcome of the market analysis.

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<sup>10</sup> The links between geographic coverage and self supply are further discussed below.

In particular, the test set by the EC has a number of drawbacks that should be also weighted. For example, the test appears to pre-suppose the provision of wholesale products to ISPs. However, under the modified Greenfield approach, in order to avoid circularity pertaining from existing SMP findings, it is necessary to conduct the *ex ante* market definition analysis assuming the absence of regulatory obligations at the level of the market being considered. In such a scenario, it cannot be presumed that wholesale services would be provided by the incumbent operator<sup>11</sup>.

Application of such an approach may therefore mean that only vertically integrated operators are present in the market<sup>12</sup>. In conducting a modified Greenfield approach analysis along these lines, it would thus not be possible for an NRA to satisfy the first or third part of the Commission's test as there would be no ISPs present in the market.

Moreover, it cannot be assumed that there is a pre-established threshold on which basis it could be understood that the wholesale/retail price ratio might be accomplished. In particular, in addition to the wholesale/retail price share, retail price elasticity is another key factor which will determine the strength of indirect constraints. The more elastic the retail demand is, the smaller the wholesale/retail price ratio may need to be, while still resulting in a sufficiently strong indirect constraint assuming that there is full pass-through of the wholesale price increase.

On the second part of the EC's test, this requires an NRA to be able to demonstrate that sufficient demand substitution would occur at the retail level in response to a SSNIP at the wholesale level to render the wholesale price rise unprofitable. However, it is not certain that an NRA will have available concrete evidence to demonstrate such a point. This is because such relative price changes are very unlikely to have occurred in practice. Therefore an NRA, when conducting a SSNIP analysis to assess demand-side substitution, will likely have to hypothesize, in reference to other available evidence that such substitution would occur. As a consequence, any results of the test should not be overstated, but be weighted according to the hypothetical nature of the test.

In relation to the third part of the test, some NRAs argued that a price increase at the wholesale level will have to be passed on to the retail level in competitive markets, which are the starting point for the hypothetical monopolist test.

According to the answers received many arguments were defended by NRAs to look into self supply within the context of market 5 (or market 12) analysis, namely to take into account direct and indirect pricing constraints, to evaluate the potential geographic differentiation of competitive conditions, to measure the competitive advantages of vertically integrated operators in the market, to assess the potential market evolution, to take into account the availability of spare capacity, etc.

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<sup>11</sup> In fact, in many countries, bitstream products have only been made available when there has been a regulatory obligation to do so.

<sup>12</sup> Notwithstanding the fact that the 2007 Recommendation allows for the possibility of constructing a notional market comprising self-supply where pent-up demand exists, as noted in this Report.

In any event, it should again be recalled that the issue of indirect constraints is not the only reason why NRAs have referred to self supply in the context of their market 5 reviews. The discussion above, and in particular the test applied by the EC, will therefore not be applicable to other instances – aside indirect constraints – where self supply has also been considered.

## 6. Whose self supply was included?

As noted, NRAs have to decide if the self supplied services of vertically integrated operators are included in the relevant market. In this regard, and within the context of market 5 analysis the competitive pressure exerted by alternative infrastructures such as cable, fibre, mobile connections or other technologies will normally have been addressed by the NRA in the context of a retail market assessment, and will thus be determinative of the products that need to be considered when dealing with indirect constraints. For instance, the conclusion by an NRA that cable does not have sufficient competitive weight at the retail level will lead to non-consideration of the pressure exerted by cable operators in the context of market definition via indirect constraints. According to the “ERG Common Position on Geographic Aspects of Market Analysis”<sup>13</sup> when assessing the homogeneity of competitive conditions on a (geographic) market the NRA should bear in mind – among other criteria – *“that competitive conditions may not only differ with the number of existing operators but may also be related to their size. One way to account for this could be to look only at operators which have a certain market share or coverage on the national market. This criterion will be easy to apply and will also ‘exclude’ operators, which may only exert a limited competitive constraint on other operators”*.

Once the vertically integrated operators whose self supply should be considered has been identified, NRAs will need to ascertain, on the basis of the arguments set out above, the relevance of self supply in the context of market definition, given the strength or immediacy of its effects, and in particular with regards to the size of the market (number of lines).

On the other hand, although it is not readily apparent from the existing practice for instances of self supply (which has focussed on issues pertaining to self supply of third party operators), it appears logical that the indirect constraints analysis also can assess the self supply of the incumbent operator who is after all providing – normally due to an *ex ante* obligation – the same resources as those used by its retail arm. Therefore, NRAs will have to decide also on the inclusion of these lines that are self supplied by the incumbent operator.

In fact, NRAs answers to question 8 (see Annex 1) indicate that once it has been determined that self supply should be factored in the market 5 analysis, most NRAs have taken into account self provisioning by both the incumbent and alternative operators when calculating market shares. Indeed, most NRAs do not differentiate between incumbent and alternative operators at the market definition stage and therefore include (or possibly exclude) all internal sales.

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<sup>13</sup> ERG (08) 20.

As a consequence, the determination of which types of self supplied lines should be considered belongs to the broader analysis of the strength of competitive constraints exerted by vertically integrated operators, taking also into account the indicators described above such as capacity constraints faced by alternative operators, lack of ubiquity expected by access seekers; or instances where alternative providers have difficulty in entering the merchant market readily.

## **7. Geographical coverage of alternative networks**

For several NRAs, self supply treatment and geographical aspects of network coverage are closely related despite the different approaches observed. This relationship is especially clear in the case of market 5 as alternative operators self provide wholesale broadband services over their own infrastructure. However, investments in alternative infrastructure are often uneven across the territory and therefore, NRAs could find it relevant to take into account the lines provided by alternative operators according to their network coverage.

In some cases, network coverage is taken into account by NRAs in a very first step of the analysis to determine the strength of indirect constraints. Thus, if alternative networks are present in a small part of the country, they are automatically excluded from market definition and, consequently, self supply of these networks is also excluded<sup>14</sup>. The reasoning behind this exclusion is that limited geographical coverage reduces the competitive pressure exerted by alternative operators and therefore, the strength of indirect constraints will be also limited. In this scenario such self supply will thus not be included in the relevant market.

However, other NRAs have taken into account geographical aspects of self supply in a subsequent stage of market definition. In these cases, self supply is included in the product market definition regardless of the overall coverage of alternative infrastructures. This was considered justified by those NRAs on the basis of the indirect constraints exerted by self supply at the retail level. These constraints were considered by those NRAs to not depend on the overall size of the whole network but are directly related to the individual location of customers.

Alternative operators' coverage will in those instances be relevant to the assessment of the geographical scope of the relevant market. As it has been stated by ERG<sup>15</sup>, segmentation of the relevant market on a geographical basis requires the identification of areas where competitive conditions differ substantially from neighbouring areas. It is in this analysis where the coverage is more relevant, as it will trigger these differences and obviously the size of the potentially different geographic markets.

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<sup>14</sup> And of course their external supply is also excluded.

<sup>15</sup> ERG Common Position on Geographic aspects of market analysis (definition and remedies), ERG (08) 20.

It must however be noted that this last approach increases the burden on NRAs, as they will have to deal with a higher amount of geographically segmented data, even in those cases where coverage figures would in principle lead to the definition of a national market.

In conclusion, NRAs differ on the approach taken in relation to self supply. While some NRAs use coverage as a criterion to include or exclude self supplied broadband lines, others include these lines in the market product definition regardless of the overall coverage, postponing the geographical issues to the assessment of differences in competitive conditions.

## **8. Consequences of including or excluding self supply regarding the outcome of the decision**

The inclusion of self supply in the relevant market may have several consequences on the analysis carried out by NRAs. On the one hand, it affects the size of the relevant market, as lines which are not purchased by third parties would be included. On the other hand, as it is translating the retail competitive conditions to the wholesale level, the final conclusion of the market analysis could also change. In some cases, self supply could even lead to changes regarding the relevant products included in the relevant market, such as self supplied cable connections.

In general terms, answers from NRAs with regard to market 5 indicate that final conclusions have not changed regardless of whether self supply is considered either in the relevant market definition stage or in the market analysis stage. In their answers, some NRAs emphasize the importance of correctly estimating the strength or immediacy of any such indirect constraints when considering their inclusion in the relevant wholesale market, while other NRAs indicate that the risk of misjudging the competitive situation prevailing in the relevant market is higher if self supply is not included in the market definition context. In addition, in terms of transparency, including or excluding self supply from market definition could lead to conflicting results. For example, in general terms, the incumbent will normally exhibit high market shares in wholesale markets if self supply is excluded from the relevant market which could lead to a presumption of dominance. In this scenario, the burden of proof could be higher at the SMP analysis stage for an NRA to conclude that the market is effectively competitive. To avoid these unclear situations, NRAs might want to consider broadening the market definition so as to include self supply in it. Conversely, incorrectly including self supply at the stage of market definition where only weak constraints exist could over-state the market share data and the magnitude of its competitive impact at the SMP analysis stage.

In some cases however self supply may be relevant for the outcome of the decision. This is in particular the case in those instances where the wholesale input that is the subject of the market 5 analysis is not being traded in the market, neither by alternative operators nor by the SMP operator itself. In those instances, it would be necessary to create a notional

market, where the self supply of the operators (derived from sales at the retail level) would be determinative for the market analysis that needs to be undertaken. Consideration of self supply when constructing a notional market is expressly referred to by the EC in its Explanatory Note to the 2007 Recommendation on relevant markets.

Self supply may also be relevant when taking into account issues of geographic segmentation. In these cases, the assessment of self supply where such constraints are sufficiently strong, may assist the NRA in determining the existence of areas where competitive conditions diverge, this leading to the consideration of different wholesale markets within the same national territory (determination of competitive vs. non competitive areas). The issue of self supply could also be assessed in the context of the election of appropriate remedies. In particular, regarding geographic segmentation of remedies, the inclusion of self supply may be deemed critical since competitive pressure from alternative infrastructures is one of the main reasons for this differentiation.

On a final note, although most NRAs consider that the stage where self supply is considered should not affect the final result of market analysis, its inclusion in the market definition stage seems more transparent to a number of NRAs, as the probability to misjudge the competitive situation is considered to be less apparent. On the other hand, other NRAs emphasize that it will be the strength and immediacy of potential constraints that should determine whether self supply is considered within the relevant wholesale market or at the SMP analysis stage.

## **9. Experiences with self supply at the SMP analysis stage**

The purpose of this section is to describe how self supply has been dealt with at the SMP analysis stage.

At an overall level 13 NRAs<sup>16</sup> have taken into account all operators' self supply when determining market shares and 5 NRAs<sup>17</sup> have only taken the incumbent's self supply into account and 3 NRAs did not take self supply into account at all when determining market shares at the SMP analysis stage.

A couple of NRAs mention that in order to adequately reflect market conditions they found it necessary in their individual market decision to take self supply into account to enable a description of the market potential of a provider.

Due to the fact that the individual cases differ with regard to whether self supply has been included or excluded in the market definition the next part of this section will assess this separately in subsection 9.1 and 9.2.

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<sup>16</sup> 25 NRA's responded to the questionnaire on self supply.

<sup>17</sup> One of the five NRA's stated that since only the incumbent provides relevant wholesale services and has a market share of 100% no other self supply could be taken into account.

### **9.1. If self supply is included at market definition stage**

In general when an NRA has included self supply at the market definition stage each NRA has included this self supply when analysing market shares with regard to assessing actual and potential competition at the SMP analysis stage.

However what is included is also dependent upon which products each individual NRA has included within the definition of the relevant wholesale market and also whether submarkets have been defined. Since answers to the questionnaire pose a picture where the products found to be substitutable differ between countries, differences in national circumstances will affect which self supply is taken into account.

The market shares assessed will also be dependant upon whether only the incumbent's self supply is taken into account or whether also alternative operators' self supply is included. Determining whether the incumbent's and other operators' self supply is to be taken into account is also dependant upon the competitive conditions in each country.

### **9.2. If self supply is excluded at market definition stage**

If self supply is excluded at the market definition stage this does not necessarily rule out that the competitive constraints that arise from for instance self supply relating to broadband over copper, cable and fibre cannot be taken into account. At the SMP analysis stage it is possible to assess potential competition which could come from for instance products based on broadband over cable.

A way that NRAs who excluded self supply in the market definition looked at the potential competition was on the basis of indirect constraints. ARCEP state that self supply was explicitly considered at the SMP analysis stage and in particular with respect to competitive pressure of vertically integrated operators and that self supply may constitute an important competitive leverage impacting price levels on the market. ARCEP also stated that self supply is an important part of the total volume of broadband access produced in France (40% in 2007). Furthermore ARCEP state that self supply has contributed significantly to France Télécom being designated as having SMP on market 5.

ARCEP also notes that given the fact that it did not take into account self supply at the market definition stage (with respect to the 2005 position of the NCA), the Commission asked ARCEP to conduct the market definition considering and including self supply. ARCEP carried out this test and proved that the inclusion of self supply at the market definition stage would not affect the conclusion of the SMP assessment.

As other NRAs, CMT excluded self supply from the relevant market due to the weight of wholesale prices on retail prices in addition to other indicators such as the evolution of retail tariffs, and demand for bitstream services. Thus, CMT analyzed operators' provision of self supplied broadband products at the SMP analysis stage in relation to assessing entry



barriers and potential competition. CMT noted in this assessment that operators who could provide bitstream services externally within a short period were those operators already self providing bitstream services through LLU.

It can be concluded that some of the NRAs who did not include self supply at the market definition stage have chosen to assess the impact of self supplied wholesale broadband products at the SMP analysis stage, and that a few NRAs chose not to take self supply into account at all.

The Commission reiterates in its comments letters<sup>18</sup> regarding market 5 that competition at the retail level from vertically integrated undertakings may be such as to exert an indirect constraint on the market for wholesale access services and that such indirect pricing constraints, where they are found to exist, should be taken into account in the context of the SMP assessment.

## 10. Conclusion

The analysis of the questionnaire shows that NRAs find it relevant to deal with self supply when carrying out market definition and SMP analysis. Most NRAs have therefore assessed whether or not to include self supply. NRAs have analysed self supply on the basis of both direct and indirect constraints, sometimes excluding the latter on the basis of indirect constraints not being strong enough.

Even though a couple of NRAs state that they have not taken self supply into account, a majority of NRAs seem to have applied a similar approach at an overall level to deal with the concept of self supply, addressing self supply at both the market definition and the SMP analysis stage.

However, when analyzing the questionnaires further, it becomes apparent that, also depending on the situation at hand, different arguments for including or excluding self supply have been applied. It also differs between each NRA whether only the incumbent's self supply is taken into account or whether also self supply of other operators is included.

Furthermore geographical coverage of a product could be different between countries and can lead to a conclusion that a product due to its geographical coverage is not part of the relevant market, which in turn may rule out the need to address whether self supply that relates to this product is to be included.

Despite of the described differences with regard to self supply and how self supply is to be taken into account in market decisions, on an overall level a majority of NRAs seem to apply quite a common approach. In particular, a majority of NRAs take self supply into account at both the market definition and SMP assessment stage.

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<sup>18</sup> E.g. in case PT/2008/0851.

## **Annex 1 – Questionnaire on self supply**

**SMP Project team**

**PRD: ERG report on the application of the concept of self supply in market definition/SMP analysis**

**To be returned to**

**patricia.teodoro@anacom.pt and [thk@itst.dk](mailto:thk@itst.dk)**

**no later than Monday the 30<sup>th</sup> of November 2009**

In the context of the ERG Working Programme for 2009, the SMP Project Team will develop a report on the application of the concept of self supply in the market definition and the SMP analysis. This project aims to set out the principles and methodologies that NRAs have adopted in relation to the treatment of self supply in their market analysis. Not only the simple description of the practices is relevant for the project but also the main points and arguments of the analysis.

This questionnaire intends to gather information on the underlying principles of the concept of self supply and how this concept has been applied by individual NRAs in their market analyses. The data collected from the questionnaire will be used for the above mentioned ERG report. In order to allow a comparison between NRAs' approaches for one market, but also a comparison within NRAs where they have taken an alternative approach for other markets, this questionnaire will focus on how self supply has been applied on market 5, but will also examine if self supply has been applied differently on other markets. The primary focus of the report will be on the new recommendation from December 2007. Finally the report will deal with how the Commission has commented on the individual NRA's application of self supply. The report is not expected to reach a common position.

**Questions relating to market 5 (of  
Recommendation 2007/879/EC)**

- 1.) Please state the date of your NRA's latest market 5 notification to the Commission.

Date of notification:

- 1.a.) If market 5 has not yet been notified, please state the publication date of the latest consultation on market 5 analysis.

Date of publication:

- 1.b.) If market 5 analysis has not yet been consulted, the notification date of the previous market 12 analysis (of Recommendation 2003/311/EC).

Date of notification:

**Description of application of self supply**

- 2.) Please specify at what stage of your latest analysis of market 5 (or market 12) self supply was taken into account (at the market definition stage or the SMP analysis stage or both). Note that "taken into account" throughout this questionnaire means that the NRA explicitly considered the issue. It does not necessarily mean that self supply is ultimately included within the definition of the market.

- ☐ At market definition stage
- ☐ At SMP analysis stage
- ☐ At both stages
- ☐ Self supply was not taken into account

If self supply was not taken into account in either stage, please specify why, and then go to question 10.

- 3.) Please describe the specific arguments your NRA applied and any other relevant details of how self supply was taken into account in your NRA's market notification on market 5 (i.e. the relation to indirect constraints, captive sales and a possible merchant market rule).
- 3.a.) Did your NRA consider any of the three step test relating to indirect constraints described by the EC in relevant cases related to market 5 (see e.g. UK/2007/0733<sup>19</sup>)?
- 3.b.) If yes to 3.a), did your NRA consider the weight of wholesale price (wholesale/retail price ratio) in the retail tariff? Which threshold (wholesale/retail price ratio) did your NRA estimate to be sufficient to justify the inclusion of self supplied wholesale inputs in the definition of the relevant wholesale market<sup>20</sup>? Please explain.
- 3.c.) If yes to 3.a), Did you consider whether ISPs would be forced to pass a hypothetical wholesale price increase on to their customers at the retail level based on this wholesale/retail price ratio? Please explain.
- 3.d.) If yes to 3.a), did your NRA consider whether there would be sufficient demand substitution at the retail level to retail services based on indirect constraints such as to render the wholesale price increase unprofitable?
- 3.e.) If yes to 3.a), did you consider whether retail customers would not on a large scale switch to the retail arm of the hypothetical monopolist?

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<sup>19</sup> See page 10 of EC letter comments on this case. According to Commission comments "when assessing the effect of indirect substitution through a SSNIP (small but significant non-transitory increase in prices) test it needs to be demonstrated that:

(i) ISPs would be forced to pass a hypothetical wholesale price increase on to their consumers at the retail level based on the wholesale/retail price ratio;

(ii) there would be sufficient demand substitution at the retail level to retail services based on indirect constraints such as to render the wholesale price increase unprofitable; and

(iii) the customers of the ISPs would not switch to a significant extent to the retail arm of the integrated hypothetical monopolist, in particular if the latter does not raise its own retail prices."

<sup>20</sup> For example, in Spain the European Commission considered that rates below 50% were insufficient to justify the inclusion in the market of self supply.

- 4.) When defining the relevant product market on market 5, what was the starting point of your NRA's assessment (the incumbent operator's retail offers, all xDSL retail offers, all vertically integrated operators' retail offers, other...)?
- 5.) Once your NRA applied the relevant arguments described in answer to Question 4 above, what was included within the definition of the relevant wholesale market (incumbent's wholesale inputs, all xDSL operators' wholesale inputs, all operators' wholesale inputs...)?
- 6.) Was your NRA's assessment regarding self supply related to the geographic coverage of different operators' networks?
- 7.) If your NRA's analysis of self supply led to the exclusion of self supplied wholesale inputs from the definition of the relevant market, did your NRA consider the competitive pressures of vertically integrated operators at the assessment of market power stage of the analysis? If so, how?
- 8.) Did your NRA take self supply into account when determining market shares? (Please specify if only the incumbent's self supply or also other operators' self supply was taken into account?)
- 9.) Does your NRA consider that the inclusion or exclusion of self supplied wholesale inputs modified your NRA's conclusions on the SMP designation compared to what would have been the case if an alternative conclusion had been reached?

Commission's feedback on self supply
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- 10.) Did the Commission comment on your NRA's adopted approach in its comment letters or through a request for information regarding your NRA's market 5 analysis? If yes, please describe how and provide a reference to the relevant Commission's comment letter.

Alternative approach on market 5?
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11.) Is your NRA planning an alternative approach to the issue of self supply in market 5 in the future than the one applied in your latest analysis of market 5?

☐ Yes

☐ No

If yes, please describe this new approach and the reasons behind it, with reference to Questions 3 to 9 above.

<b>Questions relating to other markets</b>
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12.) Has your NRA used a different approach regarding self supply in its analysis of other wholesale markets in the Commission's new recommendation on relevant markets (other than market 5)?

☐ Yes

☐ No

If yes, please describe:

12.a.) in which markets your NRA has taken an alternative approach:

12.b.) how the approach differs from the one used on market 5:

12.c.) the justification given for taking a different approach:

Thank you for your answer.