REVISED ERG COMMON POSITION ON REMEDIES
Explanatory Memorandum

1) Introduction

In April 2004, following public consultation, ERG published document ERG (03) 30 Rev1, setting out its common position on appropriate remedies in the new regulatory framework to be applied with players found to have a position of Significant Market Power (SMP).

Although this was a substantial document, it was recognised nevertheless that it would need to evolve in line with the experience of applying the new framework and with the development of the market.

Therefore, ERG decided at its Plenary in February 2005 to set up a project team to review the document with a view to consulting on revisions at the end of the year. The document "The approach to appropriate SMP remedies in the ECNS regulatory framework – revised ERG Common Position (ERG (05) 70 Rev 1)" was published for consultation. Because the original document was fairly recent, it was recognised that a root and branch review of the whole document would be inappropriate. Instead, ERG decided at its Plenary in May 2005 that a limited review concentrating on a small number of topics was the appropriate approach. The topics selected for review, based on the experiences of NRAs so far and some suggestions by the services of the European Commission were:

- Emerging markets and incentivisation of investment
- Ladder of investment
- Coherent price regulation
- Non-price discrimination
- Variations of remedies within a market or between termination markets
- Linkages between markets
- Removal of remedies

Outside these areas, amendments have been made only to align the text with recent publications (including selected comments of the Commission's Art.7 Task Force on notifications by NRAs) or to correct minor errors in the original document.

Following a public hearing in Brussels attended by more than 60 representatives, the ERG consultation ended on 13 January 2006 with 30 written contributions from the stakeholders. On 18 May 2006, ERG approved a Revised Common Position (ERG (06) 33), in the light of those comments. The present document outlines changes to the Common Position agreed by ERG and also provides an explanation for rejecting input received from stakeholders on various issues.

ERG is very grateful to all those who have contributed by direct submissions, by interventions at the public hearing or through informal input during one of the phases of the work. Those contributions have all been considered and, where possible, taken into account. The main comments are covered in this paper with an explanation as to why they have – or have not – been reflected in the revised Common Position.

2) Changes since the 2004 Common Position

This section deals with all changes agreed by ERG from the 2004 Common Position and the reasons for them. In some cases, stakeholders requested changes which would have led in the opposite direction to the changes adopted. These are also commented on below.

Incentivisation of investment

Changes made to the original text in Text Box 1 (Chapter 1) are fairly modest and are simply for clarification. According to Recital 27 of the Framework Directive, emerging markets are not to be subject to inappropriate regulation and the Text Box was created so as to illuminate this doctrine.

ERG has noted that there is some confusion over what is an emerging market. Comments made during consultation have been drawn upon so as to clarify the position. In ERG's view, the distinguishing feature of such a market is that there is a high degree of demand uncertainty and entrants to the market bear higher risk. In such a situation, a definitive finding that the criteria for suitability of markets for ex-ante regulation (the "3 criteria") laid down by the Commission ("Recommendation on Relevant Markets" – C(2003)497) are satisfied is not possible. Therefore, the question of SMP remedies cannot arise.

ERG has also noted that public discussion of this area sometimes confuses the separate (although related) issues of regulation of emerging markets and regulation of new infrastructure. Where wholesale services provided over new infrastructure substitute for services provided over existing infrastructure (or amount to an evolution of such services), the new services would normally fall within a market already defined (in the Commission's Recommendation on Relevant Markets susceptible for ex-ante regulation). In such cases, the question of regulation of an emerging market is not relevant. See Text Box 4 in section 5.6.1 for discussion of this area.

Where new downstream services are provided over existing infrastructure, the text clarifies that it may be justified to regulate access to the relevant wholesale access services in order to prevent foreclosure of the emerging downstream service.

Where new infrastructure is used for the provision of wholly new retail services, the corresponding wholesale access services might properly be regarded as forming a new market which might (or might not) satisfy the 3 criteria. In the former case, ex ante regulation is considered to be justified if a position of SMP is established. In the latter case, it is not. Where ex-ante regulation is appropriate, the NRA retains a range of regulatory options so as to strike the right balance between incentivisation of investment and innovation (of all market players) and protection of consumer interests.

ERG has noted the views of some fixed incumbents that unless "regulatory holidays" are granted in respect of major new infrastructure investments (in particular relieving the incumbents of any obligation to offer network access to third parties), there will be insufficient incentive for them to make those investments. ERG considers these views to be surprising and is of the opinion, reflected in the text, that regulatory holidays cannot be justified where the access services fall within an existing SMP market. ERG is currently developing its thinking on appropriate ways of ensuring that access remedies properly reflect investment risks.

Proportionality

A number of fixed and mobile operators criticized the "tick-list" approach to imposition of remedies which they felt was prevalent amongst NRAs. One association also emphasised the need to avoid an increase of regulatory burden, and in general to avoid micro-management. Section 4.2.1 of the original common position already deals fully with the need for objective justification for the remedies imposed. Nevertheless, a further paragraph has been added covering the need for NRAs to focus their attention on anti-competitive behaviour which would reasonably likely in a specific market situation in the absence of regulation, rather than imposing a wider range of remedies, not all of which would be likely to be relevant in practice.

Ladder of investment concept

A number of changes have been made in sections 4.2.3 and 5.2.2.3 dealing with the so-called "ladder of investment". These changes incorporate thinking already published by ERG in its Broadband Report (ERG (05) 23) and underline the importance of coherence in regulatory policy across the value chain. They also clarify the circumstances in which regulated access at more than one point of the value chain may be necessary for some time.

The concept of the ladder of investment was widely criticized by some respondents to the consultation, in particular by a number of fixed incumbents. Some deem it to be a purely theoretical approach, others an artificial construct which cannot possibly be used as the basis for regulation. It was also stated that there was no evidence that regulation based on the ladder of investment philosophy was effective. Finally some respondents commented that the ERG's use of the concept is akin to micro-management and market shaping.

While these comments have been considered in making a number of detailed improvements and clarifications to the Common Position, ERG does not generally accept them. ERG notes that ensuring the availability of dynamic choices of wholesale access points and setting consistent prices is a sound regulatory practice which increases consumers' welfare. Competition resulting in market differentiation also improves market efficiency and wider penetration of broadband. A more detailed critique of these comments is attached.

In response to other comments by a range of stakeholders, further amendments were made to the consultation text for the purposes of clarification. The text now provides a number of examples of real-life application of the concept, in interconnection at the core network level and LLU access (bitstream). This also takes into account comments made by one association in particular with regard to the need to specify circumstances which would guide the imposition of remedies such as bitstream access.

In paragraph 5.2.2.3, ERG points to the data of the 11th Implementation Report as evidence to confirm the working of the concept of the ladder of investment particularly in the broadband market.

Coherent price regulation

As noted above, this is an important issue in the context of the ladder of investment. More

generally, there is a need for a degree of coherence across the entire range of regulatory responsibilities. This helps to give all market players confidence in the consistency of regulatory approach which, in turn, reduces the risk in their investment decisions and, accordingly, promotes efficient investment.

The revised text deepens the previous discussion about choice of approach for controlling prices. It examines more fully than previously the advantages and disadvantages of the various commonly-employed approaches and discusses the theoretical and practical criteria which need to be considered in making the choice in a particular case.

The main discussion of access pricing is to be found in section 5.2.2 but some changes have also been made, for clarification, to the sections on termination prices in sections 5.5.2 and 5.5.3 (and covered below).

The most significant changes in this area were already included in the consultation text.

Regulation of mobile call termination charges

A number of comments were received in respect of the justification (or not) for differences in termination charges within a member state and on the use of glidepaths. In paragraph 5.5.2 some text has been added to distinguish between assistance to entry and ongoing differences in costs and the need for NRAs to distinguish between the two. Objective criteria for the use of glidepaths are proposed.

Following stakeholder comments, in particular from MNOs, paragraph 5.5.3 has been substantially re-written. The text now deals substantively with the efficacy (or not) of non-discrimination remedies for dealing with 2 possible regulatory concerns, foreclosure of the market for mobile calls and suppression of competition in the provision of bundles of voice and data services to corporate customers.

Non-price discrimination

The additional text falling in sections 5.2.3 – 5.2.5 can be characterised under 3 headings. First, the text points out that it is often unclear in practice what types of behaviour would be regarded by the courts as “discrimination”; that such uncertainty detracts from efficient investment and innovation; and that therefore the regulator should make efforts to reduce that uncertainty as far as possible.

The text goes on to illustrate that point by discussing a number of practical ways in which non-price discrimination often takes place in practice and identifies suitable regulatory solutions to those specific problems which the NRA can put in place where justified and proportionate.

Finally, there is a discussion in section 5.2.5.7 of the important issue of network migration, not dealt with substantively in the previous Common Position. Efficient and effective migration processes are often a pre-requisite to effective competition between an SMP player’s downstream business and third party service providers and are likely to underpin a functioning ladder of investment.

The new text gave rise to a strong polarisation of views. Some incumbents argued that some of the remedies (for example the “equivalence of input” remedy, para 5.2.4.8)

discussed went beyond the powers granted to regulators and the relevant text should be deleted. On the other hand, altnets tended to praise the new text and even called for it to go further in several respects. In particular, some called for organisational or structural separation remedies to be discussed.

In the light of these conflicting views, ERG has decided to maintain the text, largely as in the consultation version, with some expansion (for clarification) of the text on network migration. It is not clear to ERG that the provisions in the Framework provide the legal basis for imposition of organisational or structural separation remedies. Therefore, discussion in this document would be inappropriate. On the other hand, ERG disagrees with the views expressed by some incumbents as to the lack of legal basis for some of the remedies already covered in the new text, for example the "equivalence of input" remedy. The justification for any such remedies is fully discussed in the document.

Wholesale International Roaming

Following the publication of the ERG Response to the European Commission's II Phase consultation, the former Text Box 4 dealing with this area has been deleted (see http://erg.eu.int/doc/whatsnew/erg_response_11_may_2006.pdf),

Variations in remedies

The new section 5.6.1 sets out some considerations for the situation where it is appropriate to consider varying remedies within a single service and geographic market, either as between different services or between different geographic areas. A number of stakeholders expressed scepticism that this situation could arise, arguing that it would be appropriate in some circumstances to segment the market. ERG does not accept that this is necessarily the case. It does accept, as noted by one association, that a balance needs to be struck between a theoretically optimum approach which incorporated variation in remedies and considerations of practicality.

Removal of remedies

A short new section (5.6.2) deals with an issue not covered in the 2004 common position - the responsibility of the NRA to consider disruption to market players when proposing to remove or substitute an existing SMP remedy. An association commented that the consultation text had the unfortunate effect of appearing to make it harder to remove a remedy than to impose one. The text has been adjusted accordingly.

Remedies in linked markets

A further new section (5.6.3) consolidates guidance which has already been published elsewhere about the circumstances in which remedies which apply to services in markets or areas adjacent to an SMP market may be imposed in order to complete and make fully effective a package of SMP remedies. Again, the consultation text polarised opinion. A number of incumbents argued that remedies may not under any circumstances be applied to services within SMP markets. ERG disagrees with this view for the reasons expressed in the consultation text.

On the other hand, an association argued for expansion of this section in several respects. These comments led to the insertion of Text Box 5, dealing with the need to make

transparent in advance the cost standard to be used in any price squeeze test which would derive from a non-discrimination obligation. Further, the new text notes that such an obligation may be ineffective unless it is accompanied by remedies which apply, in whole or in part, to relevant services in markets adjacent to the SMP market.

3) Comments received and reasons for not accepting them

This section outlines a list of substantive comments which could not be accepted, other than those which are covered by the headings above.

A number of stakeholders made comments which, if reflected in the Common Position, would suggest that NRAs should act in ways inconsistent with the Framework. While interesting, such remarks are clearly outside the scope of the current exercise and generally appear to be directed towards the Commission's Review of the Framework. They are not discussed further here.

Some stakeholders observed that the comments they made at the time of development of the previous Common Position were not taken into account then and requested that they should be reconsidered. This has been done. ERG believes that objective reasons have been given for the lines taken in the Common Position. Where comments are not reflected in the text, this is because ERG does not agree with those comments.

A number of stakeholders considered that the Common Position is insufficiently prescriptive and that the range of flexibility should be reduced. Another suggestion was that NRAs should be required to justify explicitly any departure from the Common Position.

ERG rejects the notion that there should be a uniform set of remedies applied to a particular service market in which SMP has been found, irrespective of national circumstances. NRAs were granted reasonable discretion over remedies under the Framework, precisely because the legislator realised that national circumstances were not uniform throughout the EU and that variations in remedies would be necessary to reflect those differences properly. There are moreover a number of safeguards built into the Framework which deter regulators from applying remedies which are not objectively justified.

Nevertheless, given that the primary expertise over choice of regulatory remedies is found within the NRA community, rather than within the Commission Services or other bodies, ERG recognises its special responsibilities for dissemination of best regulatory practice on remedies. It does not believe that this is best achieved by arbitrarily reducing the range of discretion expressed in the Common Position. It has decided to take forward work on a number of ideas aimed at complementing the general guidance in the Common Position with focused guidance which applies to specific markets and situations. It expects to report on progress on this work later in 2006.

4) Future work

ERG considers that its Common Position on Remedies should continue to be a living document and will therefore need to be updated from time to time to reflect the development of the markets and of best regulatory practice. As part of its responsibility for

promoting consistent application of the European Framework, it will also consider complementary methods of disseminating practical guidance on remedies. One particular idea is discussed briefly in section 3.

The following factors will influence the timing of any further revisions to the remedies Common Position:

1) the completion and build-up of the first cycle of market analysis and remedies proposals. This will provide new insights on how NRAs viewed their markets and which remedies were imposed (or not imposed);

2) the adoption of the revised Recommendation on relevant markets, which is likely to take into accounts significant technological change and market evolution, thereby also affecting some of the possible approaches to remedies included in the present document;

3) specific changes to or innovations to the existing regulatory framework, such as the recently announced regulation on international roaming;

4) the completion of the Review process with the preparation and the adoption of a new regulatory framework.

Attachment: Analysis of arguments against the concept of the ladder

First, the nature of ex-ante regulation (as opposed to ex-post competition law intervention) needs to be recalled: for a market susceptible to ex-ante regulation, the risk of abuse of SMP is considered to be too great to be taken in a still "fragile" market situation. While the transition to general competition law is the ultimate aim, for the time being at least in those markets classified as markets susceptible to ex-ante regulation, the market failure can only be remedied with obligations imposed ex-ante. Therefore, if there are different markets identified as ex-ante markets along the broadband value chain and an operator is found to have SMP on most or all of them, obligations need to be imposed, at least one obligation on each market where SMP was found. This concept – SMP as the trigger for any regulatory intervention – at the same time also implies an "automatic" timeline for removal of obligations, i.e. when the market is found to be effectively competitive, according to Art. 16.3 FD obligations shall be withdrawn.

Therefore imposing access obligations on an operator found dominant in markets susceptible to ex-ante regulation, is a consequence and necessary to resolve market failures and address the specific competition problems identified in the market analysis. Nonetheless it seems some commentators misunderstand the nature of the regulatory concept of the ladder of investment. It is argued that "ERG does not restrain itself to remedying proven market failures but does actively try to shape the structure of the markets…".

However it is explained at various occasions that the concept of the investment ladder as making available a dynamic choice of wholesale access points for new entrants will work only if prices are set consistently across these access products. NRAs need to ensure that relative prices are consistent with each other, i.e. respect the difference of cost or in other words satisfy the margin squeeze test (para. 4.2.3,; "the rungs must be rightly spaced"; para. 5.2.2.3) in order to avoid distortion and regulatory arbitrage; e.g. because a product is priced too low, there is no incentive to move up the ladder and a new entrant remains sitting on "his" rung. Setting consistent access prices however should not be confused with "micro-management" as it is necessary to keep the process as a whole going without looking selectively at single rungs.

In conclusion by setting access prices consistently NRAs are not pursuing any "positive market structure aims", but implementing properly and coherently effective access regulation across the value chain in order to achieve the objectives of the framework, namely promoting competition to the benefit of the end-user who must be given the chance to choose between offers from different operators which in turn requires the availability of wholesale access products for new entrant operators to enable them to retail their services.

Also, if the market is defined as a national market, and SMP found, in order to remedy the identified market failure on this national market, the availability of access products can not be regionally limited, which does not exclude however that new entrants may use the access products regionally to a different extent depending on economies of density to ensure national coverage. Thus depending on the region a new entrant may sit on different rungs using e.g. bitstream access and LLU complementarily.

The framework's concept of the ladder of investment[1] links a pro-competitive regulation with investment which in turn is pushing broadband penetration, in other words a virtuous circle is created. This positive interaction of

regulation → competition → investment → broadband penetration

has now successfully taken off and is working in practice as recognised by the following statement

[1] 11th Implementation Report, Annex I, COM (2006)68, SEC(2006)193, p. 9.

of the Commission: "While there are many factors that contribute to broadband rollout and take-up, competition is one of the most important"[2] as it stimulates investment of both incumbents and new entrants[3].

Recent data indicates that in those countries with more competitive markets, the acceleration of broadband penetration is most marked, in particular for the increase in DSL lines in France, UK, and Netherlands, cf. COCOM05-34 for data as of 1-July-2005).

Thus while on the basis of the data available for the ERG BB competition report (ERG (05) 23 published in May 2005), the relationship between competition and broadband penetration was statistically only weak[4] but could be seen in principle, more recent evidence proves the positive interaction between effective regulation promoting competition in turn driving investment and penetration. The 11th Implementation Report published on 20 February 2006[5] states that effective regulation is crucial for broadband roll-out.[6] Notably shared access has been a "catalyst" for broadband growth in the UK, France and Denmark[7], showing that unbundling obligations can promote investment.[8]

Regarding the process of climbing the ladder, the data of the 11th Implementation Report clearly indicate that the mechanism is working as predicted theoretically by the model as the use of LLU (fully unbundled lines and shared access) increased tremendously, LLU now being the main wholesale access for new entrants[9] that are more and more using access products that require investment in deeper levels of infrastructure (substituting lower rungs for higher forms of access). This also clearly shows that for the movement up the ladder it is not necessary to remove the rungs, but that new entrants progressively move up the rungs out of "self-interest" ("vital interest") once they have acquired the necessary customer base/volume to make it economically sensible to move up, i.e. when the additional capacity can be filled. The latter behaviour reflects a general economic rationality when deciding on investment: this will be done stepwise in line with the customer base as it makes sense to add additionally capacity only when it is likely that the increment can be filled. There is no difference here between incumbent and new entrant operators: both will gradually roll-out networks rather than in one big jump.

The removal of rungs ("tough love") must be carefully prepared as the example of Canada made clear where the originally devised expiry of the LLU obligation in certain areas had to be postponed, because the thresholds set for alternative access offers proved unrealistic and were largely missed.

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[2] 11th Implementation Report, Annex I, COM(2006)68, SEC(2006)193, p. 36.
[3] According to recent data of Infornetics, alternative carriers invest at a faster pace than incumbents. Cf. Infornetics, December 2005 Biannual Service Provider Capex Analysis: Europe (H1 2005).
[4] For various reasons, e.g. there are some outliers that impinge on the robustness of the statistics.
[5] Available at: http://europa.eu.int/information_society/policy/ecomm/implementation_enforcement/index_en.htm.
[6] 11th Implementation Report, Annex I, COM(2006)68, SEC(2006)193, p. 32.
[7] 11th Implementation Report, Annex I, COM(2006)68, SEC(2006)193, p. 37.
[8] 11th Implementation Report, Annex I, COM(2006)68, SEC(2006)193, p. 9.
[9] 11th Implementation Report, Annex I, COM(2006)68, SEC(2006)193, pp. 37, 56/57 (Figure 55).