ERG Report

on the Public Consultation

of the ERG Common Position on Geographic Aspects of Market Analysis (definition and remedies)

September 2008

Contents

1 Introduction and general points

This document, ERG (08) 20b final, provides a summary of the consultation responses to the ERG Common Position on Geographic Aspects of Market Analysis (ERG (08) 20rev1). The consultation period was between 7 July 2008 and 11 August 2008.

Responses to this consultation were received from 21 respondents:

1	AIIP	Italy
2	Albertis Telecom	Spain
3	ARCOR	Germany
4	Belgacom	Belgium
5	British Telecom (BT)	UK
6	BREKO	Germany
7	Colt	UK
8	Deutsche Telekom (DT)	Germany
9	ECTA	
10	ETNO	
11	Fastweb	Italy
12	France telecom group (FT)	France
13	ISPA	Austria
14	Platform Telecom Operators & Service Providers	Belgium
15	OTE	Greece
16	Portugal Telecom (PT)	Portugal
17	QSC AG	Germany
18	Telecom Italia (TI)	Italy
19	Telefonica	Spain
20	VAT	Austria
21	VATM	Germany

ERG welcomes all contributions. Most of the inputs were received on time, however some arrived late. Nevertheless, all contributions have been duly taken into account. The purpose of the following summary is not to list all points raised in the written submissions but to give a summary of the most significant points raised by the parties. ERG would like to emphasize that the fact that some inputs are not pointed out individually does not mean that the contents have been disregarded.

Almost all operators welcome the work of ERG on this issue and view it as an important step towards harmonisation. There is, however, a difference in the general tone of the inputs with regard to incumbent operators[1] and alternative operators: While most incumbent operators are in favour of geographic differentiation, alternative operators are much more sceptical about it and view geographic differentiation only appropriate in very specific/exceptional circumstances and if a number of tests (often in addition to what is described in the Common Position) are passed.

ERG wants to point out that it is neither pro nor against geographic segmentation of markets or a geographic differentiation of remedies. However, experience of NRAs showed that such a segmentation/differentiation might be appropriate under particular circumstances. Since the approaches which have been applied are complex, ERG identified a need for further guidance in order to promote harmonisation across Member States. Any geographic

[1] The term incumbent operator refers to the formerly state owned monopoly operator.

differentiation has to be based on evidence and a thorough analysis and has to be in line with the principles of competition law and the regulatory framework.

It has been pointed out in particular by alternative operators that ERG should highlight the goals of Art 8 Framework Directive and that any segmentation should only be made where it can be demonstrated that these goals are supported. ERG recognises the goals of Art 8 Framework Directive and added a sentence to the introduction. ERG believes, however, that a correct application of the tools for market definition and SMP-analysis will guarantee (as in every other case) that these goals are pursued and that therefore an additional demonstration as requested is not necessary.

Also in this context, alternative operators stated that NRAs should provide evidence that the level of effective competition in a specific area would be at least maintained if regulatory obligations are lightened or removed. ERG wants to point out that geographic markets follow the same principles as every other markets which have been defined according to the principles of competition law and in line with the Recommendation on relevant markets and the SMP-Guidelines. This means that, based on the SMP-Guidelines, NRAs will either find an SMP-position (of one or more operators) or effective competition. If an SMP-position is found, appropriate remedies will be imposed in line with the ERG common position on remedies, while if effective competition is found, no obligations can be imposed. A new or additional test which is specific to geographic markets does not appear appropriate to ERG.

In light of the experiences from the UK and Austria on wholesale broadband access and leased line markets, geographic segmentation seems to be viewed as a tool for deregulation by most operators/organisations. ERG wants to point out in this context that it does not view geographic analysis as a tool for deregulation, but rather for *appropriate* regulation. It is important to recognise that a geographic segmentation (if appropriate) might not only lead to deregulation of areas where an operator would have incorrectly found to hold SMP in an “averaged” assessment but might also lead to regulation in areas which would have incorrectly found to be competitive in an “averaged” assessment.

Two other points of general nature have been raised by BT: First, BT states that ERG seems to endorse the view that CATV is part of WBBA market. ERG wants to clarify that although CATV can be an important driver of geographic differences in competitive conditions for wholesale broadband access services (as in the UK and Austria), this will heavily depend on country-specific circumstances and any conclusion for market definition and SMP analysis has to be based on careful assessment of direct and indirect constraints. Second, BT proposes an alternative methodology for determining geographic markets based on demand side analysis, supply side analysis and regulatory assessment. ERG believes that the main elements of the approach suggested by BT are also part of the approach suggested in the Common Position and that a fundamental change is therefore not required.

ECTA does not agree to the point made in the introduction of the Common Position that developments in cable, FTTH and WLL significantly alter the conditions for competition between regions in local access and opposes the assertions on effects of NGA-rollout. ERG wants to clarify that such developments are only mentioned as examples, and that any geographic segmentation has to be based on a thorough analysis by the NRA.

The rest of the document summarises the comments received according to the sections of the Common Position they are related to.

2 Is there a need for detailed geographic analysis?

ETNO and some incumbent operators (e.g. Belgacom) state that the step of a preliminary analysis is not needed and that NRAs should always make a detailed assessment of geographic differences in competitive conditions. OTE and Telecom Italia, for example, states that ERG should explicitly recommend geographic analysis for particular markets. ERG is of the opinion, however, that a preliminary analysis with easily accessible data is useful and necessary. Since a detailed geographic analysis requires data collection on basis of the relevant geographic unit, it implies additional work load for the NRA as well as for the operators. Such additional work can only be justified if there are indications that significant differences in competitive conditions do exist across the area covered by the network of the incumbent operator. The preliminary analysis serves to look for such indications.

ECTA, VAT and some alternative operators on the other hand state that a number of additional criteria should be considered:

- ECTA: Several competitors (and not just one) should be present. ERG does not believe that this should be a necessary precondition. Rather it will depend on the circumstances and is subject to an assessment by the NRA.
- ECTA: Differences in competitive constraints are actual and not speculative. Differences in competitive conditions should not be due to regulation. ERG wants to clarify that the assessment – as every analysis for the purpose of ex ante regulation – should be based on actual conditions but also be forward looking. It also has to be based on the “modified Greenfield approach” where regulation on the market under consideration is disregarded, but regulation on other markets is treated as exogenous.
- ECTA: Differentiated conditions apply across all relevant customer-types (particularly business and residential), otherwise a customer-based market segmentation should be carried out first. VAT: The Market for business users should not be segmented. ERG recognises that if differences in competitive conditions do not apply across all consumer groups, this may indicate that separate product markets have to be defined. A respective statement in the context of business services and wholesale broadband access markets was added to section 2 of the Common Position. Whether a market for business users (if such a market is defined) is national or sub-national in scope is subject to the assessment by the NRA.
- VAT: Consider market share of incumbent on national level. ERG does not believe this to be a useful indicator if geographic differences in competitive conditions are considered since such differences are “averaged out” in a national market share.
- VAT: Is functional separation implemented? In ERG’s view this is clearly not a precondition for the existence of geographic differences in competitive conditions.
- VAT: Would ex post control be effective in case of deregulation? ERG wants to point out that such an assessment is required by the three criteria test and is necessary for every market which is analysed by an NRA.

Some respondents also state that the size of the market should be an additional element. FT, for example, states that there should be no differentiation if only a very small part of territory would be concerned. ERG does not believe that a “de minimis” rule is appropriate. Differences in competitive conditions are unlikely to be constrained to very small areas. ISPA further states that a geographic segmentation is not appropriate in small countries, because the areas would be closely linked. ERG believes that this depends on the result of the analysis by the NRA and that the possibility that a geographic segmentation may also be appropriate in small countries cannot be excluded. Links between areas such as demand- and supply-side substitution, common pricing constraints or demand for multi-site connectivity are already recognised in the Common Position.

BT states that it is not evident that the HM-test would result in 1,000s of markets since a monopolist could not price discriminate between these areas. ERG believes that even if a hypothetical monopolist could not price discriminate, there might still be no supply- and demand side substitution between neighbouring areas. A strict application of the HM-test might therefore lead to a large umber of markets.

According to ETNO and Telefonica, the analysis at the wholesale level should be mainly based on the market situation at retail markets and should also include self-supply. ERG believes that the question whether self-supply is included in the market and the influence of related retail markets should be considered in the analysis, but this is an issue independent of geographic markets and therefore will not be elaborated in the Common Position.

ETNO further states that a national uniform price should not be a justification for not making a detailed analysis and other factors than price also need to be considered (quality, speed, type of package). ERG recognises that (as explained in section 4 of the Common Position) a uniform pricing constraint can be but is not necessarily an indication for a national market. The text in section 2 has been changed to better reflect this. Differences in product characteristics have also been included in section 2 as a relevant criterion.

3 Choosing an appropriate geographic unit

Some respondents commented on the importance of the geographic unit used in the analysis. FT and PTO commented that they consider that ERG should not consider the street cabinet to necessarily be the appropriate geographic unit with the transition to NGA. They argue that unbundling at the street cabinet will likely be uneconomic and as such would not be the appropriate geographic unit. ERG would like to make clear that it does not consider that the street cabinet will necessarily be the appropriate geographic unit with the transition to NGA. This was only used as an example to show that the geographic unit may change through time. The appropriate geographic unit for geographic analysis in a particular market will need to be informed by the specific circumstances of the market being considered at the time.

FT and PTO also questioned how geographic delineation would work in practice in leased lines markets. ERG has sought to clarify the text in this regard in the Common Position to make clear that in trunk markets the routes between two points could be the appropriate geographic unit.

BT encouraged the ERG to bear in mind that there could be benefits of having the same geographic unit (and boundary) across a number of different markets. ERG agrees that there can be benefits of such an approach. However, this will not always be possible or appropriate, particularly where different markets have different structures, such as wholesale broadband access and leased lines markets.

4 Assessing the homogeneity of competitive conditions

There were a wide range of views on the issue of how NRAs should assess homogeneity of competitive conditions when defining the geographic boundary of a market. Given the broad number of issues ERG has considered these separately.

<u>Wholesale provision and self-supply</u>

ECTA, ISPA and QSC raised the issue of the relevance of self-supply and the importance of the provision of wholesale services in the analysis. ECTA and ISPA argued that the Common Position should discuss the issue of wholesale provision of services and self-supply, making the point that the ladder of investment needs to be maintained. In ERG's view, the Common

Position is not the appropriate arena to discuss the question of self-supply which is an empirical product market definition question. ERG also notes that an NRA can only impose regulation in a market if it can establish an operator or operators with SMP in a market and thus it may not be appropriate or possible to maintain all points on a ladder of investment. Moreover, ERG notes that this is not specific to the geographic dimension of the market.

QSC makes a point that if wholesale supply is mandated on the basis of LRIC then this may lead to the exit from the market of other operators. Therefore, geographic differentiation of remedies may be a more appropriate outcome. ERG notes that it is possible for NRAs to differentiate remedies by geography, including the setting of LRIC-based prices in some areas but not in others.

Number of operators

ETNO, DT and FT considered that when assessing the number of operators it is also appropriate to consider small and niche operators in the analysis. ERG agrees that to the extent that NRAs consider that such operators exert a competitive constraint then it would be appropriate to include these in the analysis. ERG has amended the Common Position to make this clearer.

Common pricing constraints and price in relation to costs

A number of respondents noted that the presence of a common pricing constraint does not necessarily mean that the geographic market is defined on the basis of such a pricing constraint. ERG agrees that although the presence of a common pricing constraint can be indicative of a broader geographic market, it does not necessarily determine the boundary of the geographic market. There may be differences in conditions of competition even where there exists a nationally averaged price. This is already pointed out in section 4.1 of the Common Position.

BT suggested that all exogenous pricing constraints, including those derived from USO obligations should be excluded when defining markets. ERG disagrees with this proposed approach. To the extent that these pricing constraints are not derived from the finding of SMP in the market then, when adopting the modified Greenfield approach, it would not be appropriate to exclude the presence of these constraints from the analysis. Only pricing constraints which are dependent on or derived from an SMP obligation in the relevant market should be excluded.

BT also suggested that when considering differences in prices that differences in costs also need to be considered. ERG agrees that where price differences are observed then NRAs should assess whether these are due to differences in competitive conditions or due to differences in costs. It may also be helpful for NRAs to consider historic pricing decisions and whether there may have been changes in underlying costs. This could help to inform whether any geographic differentiation in pricing is being driven by differences in competitive constraints.

Market share boundaries to inform which market a particular area should fall

VAT suggests that there should be market share boundaries which would determine whether a geographic area should be deregulated or not. VAT suggests that areas where an operator’s share is greater than 40 per cent then it should not be deregulated and deregulation should only occur where market shares are less than 25 per cent. ERG disagrees with this suggestion. While ERG recognises that these market shares reflect the Commission’s guidance on the presumption of dominance in a market it notes that these only lead to presumptions and that a full market power assessment is necessary to assess whether an operator has SMP within a market. Such assessments have to be done on a case by case basis and in conjunction with other criteria which can indicate the presence or absence of SMP.

Accumulative application of criteria

PTO stated that it is not clear whether the criteria identified by ERG should be applied cumulatively. ERG has sought to clarify this issues in the Common Position. As is the case when conducting an analysis of market power, ERG's view is that the identification of appropriate criteria in each case will be for the NRA to determine, with all of the appropriate criteria applied cumulatively.

Business versus residential markets (in particular multi-site businesses)

Colt and QSC raised the issue of the potential for business services to have different geographic boundaries. Colt suggested that services serving multi-sited businesses are by definition national markets. While ERG recognises that such services may be in a national market, this will not necessarily be the case. In addition, this is largely first of all a question of the scope of the relevant product market. Where the product market has been defined correctly and if business services are found to be in the same market as residential services then they will necessarily have the same geographic market boundary. However, where business services are defined to be in a separate product market from residential services then there may be a different geographic boundary of the markets. However, such assessments have to be made on the basis of a thorough analysis of the available evidence.

QSC suggested alternatively that residential and business services are not too different and that it is appropriate to have a similar application of the criteria used in the assessment. Again, ERG notes that while it may indeed be the case that business and residential services are similar, this has to be assessed by NRAs based on a thorough analysis.

Other issues

There were a number of other issues that have been raised by respondents.

- ECTA warned that future investment plans might not materialise if there is geographic market differentiation which leads to local deregulation. ERG considers that as long as NRAs conduct the required analysis taking into account all relevant considerations, including past market developments then such problems should not arise. The text was adapted to better reflect this.
- FT and PTO did not agree that the role of the geographic analysis is not to perform a full fledged market analysis, arguing that the process must be rigorous, well documented and based on economic evidence. ERG agrees with these respondents that the analysis has to be rigorous and based on economic evidence. However, the ERG does not consider that the geographic market definition, while including elements which may be associated with an SMP assessment, is required to be such an assessment. It of course remains the case that NRAs will have to conduct a full SMP assessment after the definition of the relevant economic markets. ERG has amended the text in the Common Position to clarify this position.
- Colt did not agree that if a market is defined to be national when it should have more correctly been defined to constitute local geographic markets then this leads to larger errors. Colt suggested that this needs to be substantiated. The point ERG is making here that if it is the case that there are significant differences in competitive conditions, while it may be difficult to precisely identify the correct market boundary, this problem it is less problematic than not defining any market boundary at all. The first outcome may lead to some areas either being subject to regulation when they should not be or vice versa. The second outcome will lead to much larger areas being subject to an inappropriate regulatory outcome.

- ETNO considered that socio-economic factors of demand should be a key element of the geographic analysis. ERG agrees that this potentially has a role to play, but it is for NRAs to consider how such elements can fit an analytical framework for individual markets and what data and evidence is available to them. It may also be the case that these factors have a weak explanatory power.
- ETNO considered that NGA developments need to be taken into account in the forward-looking assessment. ERG agrees that where there is evidence of NGA developments then it will be appropriate for NRAs to consider how these have an influence on their geographic assessment. However, it is for NRAs to consider these impacts for individual markets.

5 Local geographic markets or differentiated remedies?

Several contributions (Albertis, FT, BT, ETNO, VAT, TI) asked for more guidance as to when there will be sub-national markets and when there will be a national market with geographically differentiated remedies. E.g., ECTA points out that in its view, the removal of access obligations would have to be based on a non-SMP finding in a geographic area and subsequently also to sub-national markets. A segmentation of remedies could only apply to nature, terms and conditions of the access obligation.

As a consequence of these contributions, ERG has adapted section 5 to give more clarity on which situations might occur. Since competitive conditions within a geographic market have to be sufficiently homogenous, a removal of all obligations in a certain area should be based on a finding of effective competition and should not be the result of a “differentiation” of remedies in a wider market. If, on the other hand, the same operator was likely to have SMP in all areas if they were considered individually, competitive conditions may be considered sufficiently homogenous so that the areas can be grouped together into a national market. However, it could still be the case that there exist geographic differences in competitive conditions which do not vary so much that it undermines the finding of a national market but may result in differences in identified competition problems and appropriate remedies. In such cases any geographic differentiation of remedies needs to be based on a thorough analysis of the market power including potential competition.

FT stated that differentiated remedies were less complex to manage compared to sub-national markets. Colt is of the opinion that geographic markets were more rigid than differentiated remedies. ERG thinks that this is not yet predictable. The decision to define sub-national geographic markets should be based on the evidence from the analysis.

According to VAT, the decision to have either sub-national markets or differentiated remedies might have an effect on the SMP finding. E.g. in case of local markets, ANOs might also have SMP. As mentioned in the Common Position, geographic segmentation of markets and geographic differentiation of remedies should not be viewed as two alternative, equally applicable options, but as being determined by the evidence from the analysis. If the market definition and analysis is done correctly, the SMP finding will also be correct.

6 Possible implications

A number of possible implications were discussed in the inputs. The most important ones are listed below.

Some inputs (ECTA, Arcor, Colt) suggest that the costs of geographic differentiation should be weighed against the benefits in the analysis. The reasons given are a risk of premature deregulation and the additional burden for the regulator. ERG is of the opinion that this is not a criterion relevant in the market analysis. As for every other (product) markets, the appropriate remedies (if any) will be based on the result of the market analysis and the identified competition problems.

ECTA suggests tightening obligations such as price control in non-competitive areas alongside lifting them in competitive areas. Some inputs point out that there is a need for strict margin squeeze tests. The Common Position explicitly mentions implications of geographic differentiation on price regulation and also points out that there might be a need for margin squeeze tests or control of cross-subsidisation. Furthermore, the principle that remedies should be proportionate to the competition problem also counts for geographic markets.

ECTA sees a need for continued monitoring and review in deregulated region. ERG agrees, however, thinks that this is true for every deregulated (product or geographic) market.

Some inputs (FT, Arcor, AIIP, ISPA, VAT, FastWeb, VATM, BREKO) see problems in pricing structures and the de-averaging of both wholesale and retail prices, especially if the prices are cost-oriented. In their view, this could e.g. lead to market deformation, price squeezing and a digital divide. There could be effects on adjacent markets, like the incumbent using predatory prices in unregulated areas that are cross-subsidized from regulated areas.

ERG recognizes that the consequences of such a differentiation will have to be considered carefully both for the relevant and for adjacent markets, and may require changes in the costing methodology, additional price squeeze tests and/or control of cross-subsidization between different geographic markets. Even without geographic differentiation, there is often no obligation of the operators to charge a uniform price when costs vary geographically.

Colt points out that there was insufficient consideration of the additional regulatory burden. OTE, on the other hand, states that the increased burden of geographic differentiation for both NRAs and operators and probably more complex regulation should not discourage regulators. ERG believes that it is worth mentioning the increased work load and complexity which may follow from a geographic analysis. The result of the analysis in only determined by the evidence, however.

ETNO is of the opinion that if an analysis has been done properly, an assessment of implications has already been made there. ERG in principle agrees that this might be correct, but still thinks that is it worth to highlight on some possible implications of geographic differentiation.

AIIP points out that inefficient investment would be induced as ANOs invest in ULL which would become obsolete with NGA. ERG recognizes the implications of NGA in the Common Position on several places ant therefore thinks that this point is sufficiently addressed.