

ECTA response to the ERG Broadband market competition report
November 2006

Summary

ECTA welcomes the opportunity to comment on ERG's Broadband market competition report. ECTA is supportive of ERG's conclusions regarding the ladder of investment and agrees with ERG's finding that the more complete the chain of available access products is, the higher the competitive dynamic. This is corroborated by research such as that carried out by SPC Network which found that the more intense competition is amongst different routes to offering broadband¹, the greater the growth in broadband penetration.

This link is also evident from following recent progress in certain broadband markets such as the UK and France, where pro-active interventions by the regulator have clearly been followed by a boost in competitiveness and investment (eg 15% growth rate in the UK from Q4 2005 to Q1 2006 from a relatively high base). Equally, in most markets where a broadband regulatory holiday has been pursued whether by design or accident, broadband penetration rates have typically fallen behind – an interesting international example is New Zealand, which decided against LLU and now has a penetration of around 8%, well below the EU average.

ECTA believes the key message that would be useful for the ERG to deliver is that in order to achieve the positive results generated by a well-functioning ladder of investment it is particularly important to make sure that mandated remedies work in practice for all customers' broadband needs and not just on paper. This means in particular making sure that:

- improvements are carried out to **processes and monitoring** by NRAs to ensure that all necessary levels of the ladder are accessible
- the approach to **pricing the ladder is consistent** with sufficient headroom between each rung to encourage progression up the ladder
- attention is paid to the **retail level** (the bottom of the ladder) where monitoring and safeguards against anti-competitive behaviour may be necessary
- an appropriate ladder is constructed for **business customers** – as business provision often involves different service levels and geographic coverage requirements

The ERG should also give serious and immediate thought to implications for the broadband ladder of investment from **developments in next generation access**, which will both add further possibilities to the ladder and affect existing rungs.

These issues are discussed in further detail below.

¹ Broadband markets in the EU: the importance of dynamic competition -
http://www.spcnetwork.co.uk/uploads/EU_Broadband_Markets.pdf

Promoting investment and sustainable competition

Broadband is considered crucial to European competitiveness and the Commission has been particularly active in promoting broadband developments. According to the i2010 initiative adopted by the EC, broadband take-up is considered an important factor for the emerging digital economy and competitiveness.

In her speech at the ECTA conference on November 16, 2006, Commissioner Reding pointed out that even though the presence of alternative infrastructures, in particular cable, is considered a significant factor enabling broadband growth, regulation through the ladder of investment plays a very important role, especially in Member States with no or weak alternative infrastructures. Further, Reding noted that in Member States where there has been more effective implementation of the framework, including enforcement of full or shared access rules, there has also been more progress up the investment ladder. Conversely, ineffective regulation leads to continued dominance of the retail market by incumbents.

A key concern frequently raised by incumbents is that concepts like the ladder of investment promote service, but not infrastructure competition. We disagree fundamentally with this assertion. Evidence quite clearly shows that the ladder of investment in broadband has been used by entrants to gradually increase their infrastructure base with the result that unbundling products now account for a significant proportion of competitive broadband lines (43% in Q1 2006). During this process, fixed entrants have routinely spent a far greater proportion of their revenues on investment than incumbents (eg in France entrants invested nearly 18% of revenues vs just 6% for incumbents in 2004²).

It is also crucially important to identify the real goal in this exercise – which is consumer benefit. Competition is vital in delivering consumer benefits, and the more sustainable the competition, the less need for regulatory intervention. However, sustainable competition cannot be ‘imagined’ or bought ‘at any price’, nor is the ‘cost’ of regulation infinitely expensive. Rather the most effective solution for consumers will be ‘efficient’ investment – where investment is made to the extent that it is economically viable and capable of generating a sufficient return, with effective and targeted regulation where needed elsewhere.

Inefficient investment can create as many problems as under-investing as it drains financial resources from the markets (and ultimately consumers as shareholders) and could undermine confidence in more worthwhile investments in the telecoms sector. It is important also to remember that investments can be made not just in physical infrastructure, but also in innovative services developed over it. The consumer benefits from such innovation can be just as great if not greater than those created through the duplication of infrastructure – and are certainly more valuable than investing in infrastructure where there is no economic justification for replication.

² Source: IDATE - http://www.aforstelecom.fr/IMG/pdf/Chiffres-Cles_Comparaison_2003-2004.pdf

The market situation in Europe

In practice in Europe, infrastructure duplication through cable plays a significant role in some areas in some countries whilst fixed wireless access shows particular promise for addressing some of the broadband needs in rural areas (although is likely to continue to lag wireline networks in bandwidth and reliability). However, it should be recognised that in the current environment in Europe, the dominant technology used to offer broadband access to end-users has increasingly shifted to the use of incumbents' metallic loops and the DSL share of fixed broadband lines in March 2006 was more than 83%³.

This (together with the fact that multiple high-speed infrastructures have not in practice emerged in markets which were not regulated such as New Zealand – or new member states in which LLU is not yet effective) provides powerful evidence that the access network is unlikely in reality to be replicated on a nation-wide basis. In addition, since the dot com bubble in which inefficient telecoms investments were made diverting resources from other more (comparatively) worthwhile sectors, investors have also become increasingly cautious about large-scale infrastructure investments in telecoms.

Against this backdrop, for further investment to be supported, it is of utmost importance that alternative operators achieve access to those aspects of the incumbent's networks where they retain SMP on equal and competitive terms.

The structure of the ladder

ECTA's view, based on the experience of its members who have been relying on the ladder to break into otherwise dominated broadband markets, is that, except in very particular circumstances where competition is sufficient to deliver market needs downstream, regulators need to ensure that simultaneous access to *all* necessary levels (i.e. ULL incl. sub-loop ULL, BSA and resale products) of the investment ladder are available at consistent and reasonable costs in a way which gives the alternative operators the right incentives to invest by climbing further up the ladder, one step at a time as well as allowing national coverage of the broadband market.

The justification for ULL is well understood. However, the **role of some of the downstream rungs** are often less well understood, and it would be helpful for the ERG to make this in particular – clear. There are two primary justifications:

- Allowing for a full ladder reduces investment risk and increases the likelihood that competitors will receive financial backing, because competitors can build up a customer base (eg through resale) before making investments further in the network. This is vital to counter-act some of the benefits accrued to incumbents, which have a very extensive existing customer base and cashflows, and thus face much easier access to capital with lower risks.
- Given the variation in competitive intensity between urban and rural areas, bitstream may be the only commercially viable option in certain – likely to be rural areas.

³ ECTA Broadband Scorecard Q1 2006

It is also important for ladders to be designed so as **to meet the needs of business** and not just residential customers. In particular this means that:

- Coverage requirements for business contracts (which often involve obligations to service dispersed premises nationwide) should be taken into account when examining the scope of the market. One implication is that, to enable proper coverage, business bitstream offers may remain essential in some areas even where LLU is economically feasible for mass-market residential use.
- Different products or product variants may be needed to meet business requirements for resilience, service levels etc.

In addition to addressing wholesale elements of the ladder, it is vital for NRAs to recognise that **retail represents an additional rung which needs to be examined**. This is critical both in ensuring proper enforcement of non-discrimination and a reasonable margin for the most downstream rung of the ladder, but also to ensure that during the period whilst competition is developing, the dominant player does not foreclose the market. In order to address these issues, it is vital that NRAs ensure they effectively make use of:

- (i) the ability to require the provision of information in downstream markets on prices and supply conditions (KPIs) in order to enforce wholesale conditions of non-discrimination and to protect against margin squeeze
- (ii) the ability to prohibit behaviour in downstream markets which could foreclose those markets (such as unreasonable bundling, the launch of products which cannot be competitively supplied, anti-competitive discounting practices, or extended contract tie-ins) until such time as wholesale measures (typically access and non-discrimination) are demonstrably effective such that competition can develop.

An example of why such provisions are needed – particularly in countries where the access regime is not yet fully effective is **Poland** where, coinciding with the Regulators decision to mandate bitstream in May 2006, entrants have alleged that the incumbent launched a widespread campaign offering substantial discounts for new broadband subscribers with contracts extending for 2 or 3 years. The promotional price is significantly lower than the standard prices for broadband and the offer was clearly aimed at locking in customers prior to market entry.

Operational and pricing issues

Another important role for the ERG is assisting in providing best practice cases and guidance to ensure that the ladder is effectively introduced in practice, and not just in theory. The situation in the majority of the Member States is far from satisfactory in this regard. In many countries ULL and/or BSA are simply ineffective, and this is evidenced by lower take-up than otherwise expected and lack of a robust competitive dynamic.

Serious problems, such as incorrect and/or inconsistent pricing, lack of information in order to make risk evaluations and market analysis, denial of the necessary co-location due to e.g. an allegation of lack of space, the inclusion of unclear additional charges in the offers for ULL and co-location, defective ordering processes and delaying tactics, have a detrimental influence on investments and the possibilities for alternative

operators to compete under equal conditions as the incumbents on the retail market around Europe today.

For example, it is common for wholesale services to be offered at an inadequate margin in comparison with more basic services as the incumbent tries to provide an incentive for competitors to rely on their network rather than rolling out to local exchanges. This problem, which has been experienced in many countries, also leads to the incumbent being overly compensated for its costs to own and maintain the access network resulting in a transfer of funds from the end-users and competitors to the incumbent.

The urgency of dealing with these problems is particularly acute since the broadband market is currently in a phase of dynamic growth around Europe with possibilities for suppliers to attract customers. Consequently, there is a risk that the market shares that are established during this phase will endure for a long time into the future. The limitations for the development of competition during the growth period therefore risk creating serious consequences for end-users and society also in the long-term. Thus, it is of utmost importance that obligations imposed on the incumbents are enforced as a matter of priority.

We would particularly like to highlight the following issues where our members have identified specific cases of pricing inconsistency, gaps or operational issues with the ladder of investment:

The **German** situation is a good example of how inadequate regulatory control of consistent pricing can be exploited by the incumbent. The strategy of the German incumbent, i.e. to promote the resale products by decreasing the price of such products without adjusting the ULL price, has resulted in a defective ladder of investment where wholesale competition is systematically suppressed by the former monopolist. In addition, there is still no BSA product available in the German market.

Another example of such a strategic behaviour by the incumbent is in **Hungary** where theoretically all the wholesale products are available (and by now regulated). The regulator has however not taken into account the distortion of the market structure. Almost the entire DSL penetration is based on the wholesale DSL product, the contracts of which have a binding period of at least one-year, locking in customers whilst others strive to enter the market. Furthermore, alternative operators have in practice avoided using bitstream access or shared ULL, which are too expensive compared to wholesale DSL, but rely instead on wholesale DSL or full ULL. Consequently, the elements of the ladder of investment exist but some of them are not used for the above mentioned reasons.

In **Belgium**, regulated offers exist for both bitstream and ULL services. However, since the wholesale prices are not cost oriented, alternative operators have difficulties to enter the broadband market. ULL is almost made inaccessible through the pricing of tie cabling which is more than 100 EUR/line. This is 5 to 10 times more expensive than in other EU countries. As a result, after more than 5 years of ULL, less than 0.1% of the lines are unbundled.

The current situation in **Sweden** illustrates the problem with gaps in the ladder of investment caused by paralysis in the appeals system. In order for alternative operators to achieve a reasonable geographical coverage and hence be able to offer access to

broadband services on a nationwide basis, an alternative operator needs not only access to ULL but also a bitstream service. However, the fact that the Swedish BSA decision has been stayed in court means that there is no wholesale BSA offer available in the market and there is additionally a great deal of legal uncertainty stalling progress. In addition to this the ADSL resale product has been altered by the incumbent, which means that the wholesale service will not be further developed and no further investments will be made for this product.

Effectively this means that ULL is the only form of access available in Sweden today in practice and thus that two important rungs of the ladder are missing, depriving a large section of the community from competitive access. These circumstances, which have been confirmed and underlined by the Swedish NRA in a report regarding broadband competition in Sweden⁴, are a real threat to competition in the broadband market.

In the case of **Greece**, the NRA (EETT) mandated only two wholesale broadband access options : IP bitstream access behind the BBRAS and unmanaged IP hand-over (essentially broadband resale). The EETT decision amounts to completely excluding bitstream access options 1 and 2 that are indicated in ERG (03)33rev1, and denies alternative operators the ability to differentiate their broadband services from those of the incumbent operator OTE.

Given the limited development of local loop unbundling at this time (only 15000 loops have been delivered since 2001 out of 5.600.000 lines), objective issues of economic viability of unbundling across major parts of the Greek territory, the fact that the retail broadband markets have national characteristics, etc. the likely implication is that alternative operators will continue to be restricted to competing only on price, on retail markets for which all essential parameters (speed, quality, possible bundles) are determined by OTE, resulting in poor market dynamics that are unlikely to contribute to the development of broadband in Greece.

In addition, the reference offer in Greece is not sufficiently comprehensive to allow for negotiation of necessary services. The experience of our Greek members is that making requests outside the reference offers has been impossible in the Greek legal and regulatory environment. There are no precedents in Greece of access having been secured on the basis of the general obligation to meet reasonable requests. Some operators have filed requests, and complaints upon refusal of their requests, which has led to a chain of events as follows: (i) complaint to the EETT, (ii) hearing at the regulator, (iii) a fine is imposed on OTE, (iv) OTE does not pay the fine, (v) OTE files for an annulment of the fine before the High Court, a procedure which takes several years to run through.

ECTA notes that the instrument of the reference offer has proven to be the most efficient way (and in almost cases the only way) of ensuring that access is effectively granted, and for viable technical and economic conditions to emerge. This has also been confirmed by the ERG Remedies Paper.

Even in countries where LLU is seen to be successful, this has been against a backdrop of difficult operational and commercial scenario's that have made the process more

⁴ "Preconditions for sustainable competition in the broadband sector", by Post- och Telestyrelsen, REPORT NUMBER PTS-ER-2005:39 ISSN 1650-9862, December 8, 2005.

painful that it may otherwise have been. In **France** for example, LLU was mandated since the entry into force of the EC Unbundling Regulation (Jan 2001), but significant take-up only really occurred from 2004 onwards.

Guidance on the ladder

To avoid these kinds of problems ECTA urges the ERG to clearly express the ladder of investment principle including the following key aspects:

- Provision that regulators should ensure that in mandating access they address the need to provide a mechanism to facilitate gradual investment by competitors and allow nation-wide coverage for both business and residential consumers (bearing in mind the different characteristics of each).
- Specification of a detailed reference offer for the relevant products (including associated facilities), which also includes clear processes as to how to request items which may not be included on that offer.
- Non-discrimination at all levels of the value chain to ensure consistency of pricing and prevent price or non-price squeeze between rungs.
- Accounting separation should reflect the ladder of investment and support the non-discrimination requirement by showing transfer pricing between each step on the ladder.
- Notifications and/or publication should facilitate the undertaking of an ex ante price squeeze test between rungs (up to and including retail level). Secure that a consistent pricing exists between the different rungs of the ladder, i.e. the necessary investment to climb from e.g. BSA to ULL has to be reflected in the price that alternative operators have to pay to the incumbents in order to get access to the services in question. Further, as a starting point, the copper has to be realistically priced (i.e. not with a premium as an incentive to a never occurring full replication of the access network). This has an impact on all services provided on the legacy network.
- Application of any necessary measures to prevent behaviours at retail level which would foreclose the market during the period whilst access remedies are ineffective (eg extended contract tie-ins, targeted discounts) or the launch of new bundles or products which could not be offered on a level playing field by others.
- Provisions ensuring the necessary means to climb the ladder including migration processes and the synchronisation of mechanisms such as number portability with naked bitstream or LLU.

In addition, detailed guidance and case studies on how to identify and address problems such as those described in our case studies could be helpful.

The Next Generation ladder of investment

It is important in examining the broadband ladder of investment to complete the picture by looking to the next generation of broadband. Just as competition has been the primary driver for ADSL broadband services, in areas where competition for traditional broadband has been most effective eg through unbundling), incumbents have been stimulated to roll-out next generation access networks in a manner which excludes competitors , giving them an opportunity to monopolise the 'broaderband' space by

providing higher speeds, e.g. (VDSL) to the end-users, while alternative operators are effectively limited in the services they can offer.

The rationale for incumbents is clear, as – whilst they may be in a position to selectively roll-out with the advantage of existing underlying infrastructure, cashflows and customer-base -- each DSL-enabled site will be significantly smaller and hence it will be more difficult for alternative operators to make viable business cases to expand their network reach. This development is a current and real threat and necessitates a re-examination of the ladder of investment.

In the first instance, it is important to remove any barriers that might exist for further roll-out by competitors – although bearing in mind that this is likely to be economically feasible in very few areas. For this, it is vital for regulators to assess whether sub-loop unbundling can be made effective – which would involve co-location at street cabinets and the availability of suitable backhaul. Duct access could also, where feasible, remove barriers to full fibre roll-out, although again, the potential should not be over-estimated. We understand duct access was mandated in Portugal in 2005, but has not yet of itself resulted in any dramatic changes to the competitive dynamic.

Next generation access developments also require a re-examination of existing rungs, since some types of development pose a significant threat to the structure of the existing ladder of investment.

One of the most serious consequences that derives from the NGN roll-out is that the investments in ULL (own DSLAM equipment at the MDF), which have been promoted by the NRAs and already made by alternative operators, become completely stranded over time, through removal of the copper altogether or failure to appropriately maintain it. The mere risk of such developments can have a seriously detrimental impact on the overall investments in ULL in a country.

In the **Netherlands** for example, the incumbent has come very far in its roll-out plans that includes the closure of the buildings housing the MDFs that are used for local loop unbundling by alternative operators. By "cutting off" the original copper lines, which run from the collocation to the concentration points, the alternative operators are not able to utilise their already considerable investments in ULL and DSLAMs. As a consequence of this development the local loop unbundling rollouts by alternative operators have significantly decreased.

Witness also the developments in **Germany**, where the legislator is willing to approve a "regulatory holiday" for the incumbent's VDSL network. This is a very serious threat to all infrastructure investment made by alternative operators in the past.

In these circumstances – and even where the copper access network remains in place – in order to provide a level playing field where all operators have the same opportunity to compete and innovate, regulators will need to review the availability of bitstream access so that it is available in locations that permit full use of competitors infrastructure (including at locations closer to the customer than are currently available such as at or close to the MDF site) and in a manner that permits innovation and competition with the dominant player.

In order to ensure that these next generation broadband ladder of investment issues are included in analyses, regulators will need to pay particular attention to ensuring that regulation is technologically and materially neutral (eg between copper and fibre). This should mean for example that regulators should assess the competitiveness in the provision of loops and bitstream regardless of the material used or underlying structure of the network.

Further it is of utmost importance that a robust and commercially viable transition and upgrade to NGN is secured in order for alternative operators to be able to migrate on fair and reasonable terms and that they are allowed sufficient time to do so.

In order to provide this Framework, NRAs will in turn need to be aware of and in a position to evaluate on a forward-looking basis the consequences of NGN in order to find sustainable solutions for alternative operators in the market and also that they act promptly in order to ensure stable prerequisites for continuous competition and growth in the broadband market.

The process of assessing problems and finding solutions will need to be co-ordinated among the different stakeholders in the market and, above all, under the regulatory authorities control. We also underline the importance of the “time” factor, as technology and markets developments run very fast, and a failure to reach a decision will result in a de facto situation imposed by the incumbent which is then difficult, if not impossible, to address ex post.