Telefónica Group comments on the ERG Broadband market competition report

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Introduction

Telefónica welcomes this consultation on the BB market report. This report contains important principles and Recommendations on policy and regulation that makes it more than a report on the market situation, and deserves a deeper reflection and analysis.

As a general comment, Telefónica is concerned with the fact that it seems from the Report itself that ERG is, to some extent, defining and guiding EU electronic communications policy, which should be understood as a much broader discipline than the sectoral regulation applied to achieve political goals. The latter include market competition, but also other issues such as industrial policy objectives (i.e. Information Society development). It is of utmost importance to reach an equilibrium amongst such objectives, with the regulator´s role being limited to the establishment of the regulatory conditions that lead to a sustainable competition model between market agents.

The main issues that contain policy principles and that are commented in this document are the following:

- The assumption that the Ladder of Investment (LoI) concept is working in practice and leads to inter-modal competition
- The conclusions about the drivers of investment
- The geographic variation of regulation and the overlap of the rungs of the ladder
- Introduction of new technologies

About the LoI concept

The LoI concept is a theoretical concept that intends to make compatible both the service-based and the infrastructure-based competition models while moving progressively from the former to the latter. Whether this is working in practice is highly disputable, in any case, the key issue for discussion and for making it work is the price charged for the access to the infrastructure, a price which should take into account the investment effort made by new entrants as well as the risk faced by infrastructure operators.

The report recognises the complexity of laying down a consistent pricing regime, and the difficulties encountered by NRAs[1]. However, it does not provide a solution to the issue. On the other hand, there is no mention of the negative effects that access regulation can have on infrastructure competition.

In this sense, Telefónica fully disagrees with the interpretation made by ERG about the fact that "*inter-model competition (mainly between DSL and cable networks) is a result of intra-modal competition on the DSL platform pushed by access regulation according to the concept of the `ladder of investment'*" (page 1). Indeed, Telefónica considers that access regulation is limiting inter-modal competition. A regulatory framework that tries to promote inter-modal competition should limit access regulation in scope and extent to clearly justified cases (after a proper market definition process and analysis) in order to send the right signals to market agents about the importance of investment in network infrastructure. In particular, this directly affects cable operators which, after investing high volumes of money in deploying their own infrastructure, have to face competitive pressure from service-based operators that do not assume a comparable risk when entering the market. Moreover, this regulatory-driven pressure is responsible for lowering network operators´ financial margins, leading them to reconsider further investment in the up-grade and/or deployment of infrastructure. Unfortunately, Telefónica believes that this approach is limiting future users´ possibilities in the context of NGNs development.

About this issue of access regulation and inter-modal competition, on page 36, the document reads:

> *Given the recent fall-back of the share of cable modem connections, the requirement for technological neutrality and the fact that the limited regional extent of cable networks might also limit their ability to compete, NRAs may apply appropriate measures to cable operators in order to promote (inter-modal) competition further.*

[1] Page 43

Later on, the report proposes to introduce bitstream services on cable platforms in order to stimulate further inter-modal competition. In this context, it would be necessary to assess if the recent fall-back of the share of cable is more due to the fact that access regulation is favouring business models based on wholesale services and hampering business models based on alternative infrastructure.

The country chapter of Spain contains an interesting statement:

> *Although the focus of regulatory activity has been bitstream and unbundled access, the main source of competition so far has been the presence of alternative operators who provide cable modem services using their own infrastructure designed to offer triple play services.*

In fact, Telefónica considers that this reflects a general tendency at EU level: the focus of regulatory activity has been on bitstream and LLU, and this has encouraged business models based on wholesale services, given the favourable conditions that NRAs have laid down. Meanwhile, very little attention has been given to cable. That is one of the main reasons that explain the recent fall-back of cable.

It is worthy to note that in Spain, the main cable operator is using LLU to complete the offer in certain areas, because LLU is more attractive than laying down own infrastructure. When an infrastructure operator with a vocation of investment in own infrastructure turns to LLU, this reflects that LLU is really more attractive.

Drivers of investment / penetration

The report presents the following causal relationship as a foregone conclusion:

Regulation $\Rightarrow$ competition $\Rightarrow$ investment $\Rightarrow$ penetration

It is clear that competition implies lower prices and increased marketing efforts, which contribute to BB development. But the report seems to attribute all the merit to "regulatory driven" competition. Economic literature shows that there are other factors that can also explain investment and penetration, such as: GDP per capita, previous presence of other infrastructures easily adaptable to provide BB (such as CATV networks), computer literacy, PC penetration, demographic and cultural factors, …

The danger of market orchestration

As mentioned above, the report presents regulation as the key element to develop competition and investment, but does not mention any qualification of the type of regulation applied, or any possible shortcoming of regulation, such as the tendency to “manage” the market and shape it.

It is clear that regulation has a profound impact on market developments, as can be seen by the differences in the take-up of the different wholesale services and the type of competition that develops. For example, in countries where LLU was available since the beginning, and no bitstream product has been provided, competitors have concentrated on LLU. In countries where bitstream access was available since the beginning, LLU development has been slower, especially in the first period of LLU availability.

In Spain, regulation of capacity-based interconnection (CBI) has had a clear impact on market development[2], in countries such as France; VoB is used by competitors to offer flat rate packages, including voice, based on LLU. In Spain, the approach of competitors so far has been to use CPS and CBI to offer the voice part of the package. This fact, combined with the existence of BSA since the beginning have diminished the incentives to develop LLU.

The danger of inefficiencies and market orchestration introduced by regulation does not seem to be recognised by the report, which suggests that NRAs lay down a ladder of investment that provides the conditions for an efficient investment in infrastructures.

For this purpose, the report assumes that NRAs can lay down a ladder setting the right prices for all products, with all prices satisfying a margin squeeze test in each rung, and setting the right distance between rungs *in order to incentivise new entrants to reach the*

[2] As is recognised in the country chapter about Spain, when explaining the reasons for the low take-up of VoIP

highest point of the ladder at the maximum speed consistent with efficient investment by both incumbent and new entrants[3].

According to the report, this regulatory design can be done **even in the long term**:

> *The emphasis on the encouragement of efficient investment in the ECNS framework can be seen as a new paradigm … Now as the market is further developed, naturally NRAs must look on long term/dynamic issues to ensure that the process of emerging competitive market structures continues to evolve in the right direction with a stable level of competition*[4]

Telefonica would like to stress that, given the dynamic character and complexity of today's electronic communications markets, a regulatory design of the ladder such as that foreseen in the report is not possible to accomplish in practice.

This approach would lead to micro-management of the market, with business plans, returns and investment decisions driven by regulation rather than by the market. It would rather be more feasible and efficient if regulation is directed towards providing access to the non-replicable network legacy asset and set the right access price[5]. This approach, accompanied by a continuous monitoring of the market, to find out if network assets are evolving towards replication would provide a more consistent and less interventionist approach of regulation of BB markets.

In fact, this approach seems to be more close to the ERG remedies document. A reading of points 4.2.2 and 4.2.3 of the revised remedies document seems to attribute a preference

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[3] Part of the extract is from the remedies document

[4] Page 44

[5] This approach was reflected in the studies undertaken in the context of the review of the EU regulatory framework. The London Economics study (page 121) highlights among the measures to encourage infrastructure competition … *the mandating of intermediate access products (such as wholesale bitstream or wholesale line rental) only where it is clear that there would be no business case for the development of downstream competition through the use of unbundled local loops. This may mean differential obligations within national markets.*

to allow infrastructure competition where possible, and to the difficulties to apply remedies for the medium/long term:

> *In a dynamic innovation driven market with the constant potential for disruptive technologies emerging, it is often impossible to predict with any degree of confidence the likely direction the market may take. The possibility that infrastructure may be replicated may have implications for how NRAs design remedies and on access prices for the current review period[6].*

The lessons from the past mentioned above make clear that operators focus their strategy and business plans around the regulatory products available, and the attractiveness in terms of costs plays a decisive role. This highlights the need to undertake serious cost-benefit analysis before the introduction of any regulatory measure for access to networks, a tool that has been hardly used so far, and that is not mentioned in the report.

Geographic differences / overlap of the rungs of the ladder

According to the draft report, more than one rung of the ladder may be necessary to be used complementarily. The reasoning is linked to the fact that new entrants need the lower steps in order to have national availability. This is also used to justify that geographical limitation of the bitstream remedy would not be appropriate as different players may be relying on national availability.

> ***Especially in countries with large differences in population density** between the various areas of the national territory … **Nevertheless, this does not imply that geographical limitation of the bitstream remedy would be appropriate** as different players may be relying on national availability.*

It is surprising that the report underlines that **geographical limitation of BSA is not appropriate, especially in countries with large differences in population density.** Precisely in these countries competition develops in different ways in the different geographic areas:

[6] Revised remedies document ERG (06) 33

- In areas with high population density, new entrants have a better business case to invest in unbundling or even in new network infrastructure. In these areas the initial steps of the ladder are already obsolete (because competitors no longer use them).

- At the same time, in other less densely populated areas new entrants will **always** stay on the initial steps of the ladder, because economies of scale do not justify investment in unbundling or own infrastructure.

It is in these cases, **where geographical differences exist, where it is more necessary to differentiate regulation according to geography as soon as possible**, in order to promote a fair and efficient regulatory environment.

Regarding the maintenance of BSA obligations in densely populated areas, it is necessary to point out the basics of regulatory intervention, which should be promoting infrastructure competition where feasible[7]. A player relying on wholesale services for providing broadband access to retail customers, does not need more than one wholesale product in a certain area or switch. Once a provider is using LLU in a certain area or switch, it means that the only non-replicable asset is the copper local loop, and then regulation of the other rungs of the ladder will have to be reviewed. This does not mean that bitstream access will necessarily disappear, as it can still be offered on a commercial basis.

If the obligation to offer bit stream on a regulated basis depends on the existence of some providers still using the service, it could imply the perpetuation of bitstream regulation even in cases where there is only one provider using it for a few final users, while other providers are already using ULL. It is of utmost importance for regulators to avoid this kind of protection of certain specific business models (or models based on a non-risk assumption by certain market players), especially in a new regulatory era that should acknowledge a new broadband market reality in a liberalised environment. Otherwise, there is a serious risk for regulation to perpetuate in time.

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[7] This seems to be the approach of the revised remedies document (point 4.2.2), "There is general agreement that a great potential harm to welfare occurs when replication is feasible but not promoted. This will delay the roll out of new and innovative services and, particularly in relation to broadband, may have large negative consequences on the general economy.

Furthermore, in cases where new entrants are using LLU, the market demonstrates that in many cases commercial bitstream access offers arise from the providers using LLU, and regulation of the initial steps of the ladder becomes obsolete.

Introduction of new technologies:

The report refers to the "danger of remonopolisation" in the advent of new technologies, (ADSL2+, VDSL), and highlights the importance of their pro-competitive introduction through appropriate regulatory measures such as availability of "suitable wholesale access products".

This approach seems to skip an in-depth analysis of the most appropriate regulatory approach for the introduction of new technologies and new investments. The spirit of the document, read by a company willing to invest and innovate, is that new technologies will be regulated, without any distinction of the services that will be provided, the prospects of replication of the infrastructure or the degree of competition. For example, from Telefónica's viewpoint, the presence of cable infrastructures provides a different picture about the prospects for replication and the potential for a healthy, market-based and infrastructure-based competition, rather than regulatory-driven competition.

Therefore, Telefónica would rather prefer, in alignment with main regulatory objectives, to lower regulatory pressure on infrastructure operators where other competitors with their own networks exist (i.e. cable) instead of applying additional wholesale regulation to the latter. In line with this, regulators should start to acknowledge that alternative wireless/mobile technologies might become an appropriate source of competitive pressure on traditional infrastructure operators, leaving market forces to modulate this process without additional regulatory intervention.

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