Comments on the "ERG draft Common Position on Geographic Aspects of Market Analysis"

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Summary

- Geographic analysis is and was always a component of market analysis
- Until now the result was usually one national market
- Advantages and disadvantages of geographic differentiation have to be discussed
- Economic consequences of differentiated rates at the wholesale level
    1. Prices for bitstream access decline in urban and rise in rural areas
       Consistently also prices for ULL decline in urban and rise in rural areas
    2. Retail prices in rural areas are not expected to rise
    3. Consequently no incentive to invest for alternative carrier in rural areas
    4. Retail prices in urban areas are expected to get lower in a price spiral caused by declining ULL and bitstream access prices
    5. Consequently no incentive to invest for alternative carrier in NGA (FttC and FttB/H) in urban areas, and
    6. Consequently predatory pricing by incumbent in urban areas
- Additional burden for NGA and operators in conducting market analysis / regulatory procedures

General Comments

Arcor AG & Co. KG (Arcor) wishes to thank the ERG for the careful and advanced analysis of the regulatory challenges of geographic market definitions. Arcor appreciates the thorough considerations about the methodology how to differentiate regulation geographically.

However, the difficulty of the draft is not so much about the deduced methodology, but what is missing. Hereafter we suggest to elaborate on several issues and to phrase the final document more concisely in some paragraphs. We strongly believe that our proposals will be applicable not only from a German point of view but also in the wider European context.

The recent development of geographic analysis

Geographic analysis is and was always a component of market analysis. Therefore it is not new and legitimate if NRA employ a more detailed and differentiated analysis.
Until now the result of geographic market analysis was usually that there is one national market. A new development was firstly introduced in UK, where the outcome of the geographic analysis are several clusters of regional markets in the market for bitstream access. This was followed by a similar analysis in Austria. These differentiated results are based on a very detailed analysis that has not been deployed before.

Before introducing such a detailed analysis in every market, advantages and disadvantages have to be discussed. Arcor will show some difficult issues that are related to a differentiated analysis:

Economic consequences of differentiated rates at the wholesale level

If several geographic units result from a geographic analysis, it can be expected that competitive conditions are not homogeneous across all units. If a NRA follows this approach consequently, cost structures of each defined unit will become important. Cost structures can not be expected to be at the same level across all units. Usually this is not really important, since in a national market costs are treated as (national) average costs. If price regulation follows costs in each unit different prices are likely to arise:

1. Under a regime of regional differentiation and reflected cost structures, prices for bitstream access will decline in urban and rise in rural areas. If SMP in not found in a certain area, this result will prevail because competing operators set prices near to (marginal) costs. If SMP is found, a price structure following the cost structures in the SMP-region will be the result of price regulation.

   Following the same rational prices for unbundled local loops (ULL) will decline in urban and rise in rural areas.
2. Retail rates in rural areas are not expected to rise. Consumer in rural areas probably will not accept rising rates. They will bring this issue on the agenda of politicians, who are often willing to advocate "consumer protection". Rising rates would also make negative headlines, which operators want to avoid.
3. Constant retail rates and increasing wholesale rates make it impossible for alternative carrier to enlarge investment in rural areas.

   If retail rates would increase, the gap between rural and urban retail rates would widen. This is political not feasible, see no. 2.
4. If SMP is not found and therefore remedies are not obliged to an operator in the urban markets for ULL or IP-bitstream access, not only wholesale but also retail prices are expected to decline in a pricing spiral. If SMP is found the same result will prevail because of price regulation, see no. 1.
5. Decreasing wholesale rates especially for ULL in urban areas is a strong disincentive for alternative carrier to invest in NGA-infrastructure. Consumers have no incentive to change to NGA-based products if ULL-based products are offered at low prices. It will simply more economic to rely on ULL or IP-bitstream access than to invest in own in FttC and FttB/H infrastructure. NGA might become an incumbents' technology.
6. If retail rates get lowered by a price spiral in urban areas, predatory pricing of the incumbent is possible. There is the risk that retail rates might even fall below costs, since the incumbent might have the possibility to cross-subsidise from rural areas to urban areas. This scenario even increases the gap between rural and urban retail rates.

Increased complexity and additional burden for NRA and operators

Arcor agrees that a geographic segmentation would increase the complexity of market analysis and regulation drastically. Data requirements will increase the additional burden for NRAs and operators. Altogether, market definition and analysis will take more time and lengthen the process of implementation. NRAs should always keep the cost-benefit-ratio in mind before starting a geographic market definition.