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European Regulators Group
Secretariat

**ERG draft Common Position on Geographic Aspects of Market Analysis
(definition and remedies) – ERG GM CP 2008**

Dear Sirs,

On July 7th, 2008 the ERG has published the draft of a position paper regarding the geographic issues of market analysis. With this position paper, the ERG wishes to develop criteria for a consistent handling of a possible regulatory approach under four different aspects:

- Ø Criteria under which a geographic market analysis might be taken into account
- Ø Criteria for assessing a uniform geographic area
- Ø Criteria for assessing competitive conditions as homogeneous
- Ø Criteria for assessing whether the competitive conditions of different areas are significant enough to define a separate local market or whether it is sufficient to implement different remedies within a uniform national market.

I. General Comment: Regionalisation endangers the progress in competition achieved so far

Before referring to the individual issues of the ERG-paper BREKO wishes to challenge the general assumption, according to which the implementation of a more regionalised regulatory approach qualifies to enforce the liberalisation of the telecommunication markets and to achieve a rapid transfer to the general competition law. It is just the opposite: By a premature regionalisation of the regulation, the success in liberalisation achieved so far can be considerably endangered.

As shown by the current discussion in Portugal, there is a certain probability that a regionalisation could not be restricted to the market for pre-services. Therefore, the significant interactions caused by a regionalisation must be considered all the more.

- Ø **End-customer markets:** An abandoning of the „tariff unit in one region“ enables the incumbent to apply cross-subsidies, since the higher income out of rural areas, which in general are less competitive, can be used for decreasing the end-customer prices in the more competitive urban regions. A current example for this is the latest pricing policy of the Telekom subsidiary „Congstar“. This company offers access as well as a 2MB-double-flatrate in urban areas for € 24.99, whereas the same service costs € 5.00 more for customers from rural areas. In Spring 2007 there have been attempts by DTAG to achieve a regional differentiation of the end-customer prices with the product „IP-one“ as well as by a decrease of the tariff „Call & Surf“ for „highly competitive local area networks“ announced this summer. This pricing policy is not at all indicated by the fact that the price level of the competitors in urban areas would significantly differ from that in rural areas and therefore DTAG respectively Congstar would be under a considerable pricing pressure. However, the competitors would be forced to adjust their end-customer prices for urban areas as well. In so far as service provider based on infrastructure are concerned, the profits from the end-customer considerations are required for the implementation of modern broadband infrastructure (FTTB/H or FTTC). A decrease in profits from end-customer considerations from urban areas could consequently lead to a delay of FTTX projects and thus to a slow down of competition dynamic.

Even if the end-customer prices of DTAG are no longer subject to a direct pricing control they can still be indirectly controlled within the control of the price/costs-gap in connection with the relevant pre-services. In so far as

the incumbent will implement regionally differentiated end-customer prices, the control of the price/costs-gap will have to done with a regional view. Herewith a relation between regionally differentiated end-customer prices and the pre-services required by the competitors already exists.

- Ø **Markets for pre-services:** The issue of regionalisation has so far been discussed particularly in connection with the next turn of the market analysis for the broadband access market/IP-bit stream. In the UK, OFCOM has already conducted a regionalised market analysis and separated individual highly competitive MDF; in Austria and France, the national regulatory authorities (NRA) still assume one national market for broadband access but apply a regional differentiation with regard to remedies. At the occasion of the ongoing market analysis in Portugal, a regional differentiation of the bit stream and access line market seems to be considered.

However, a regional view can even from the perspective of consistency be hardly restricted to a single pre-service. The incumbent's regionally differentiated end-customer prices respectively a regional differentiation of the access to certain pre-services will rather have an impact on other pre-services.

This might have the effect that, e.g., (as the Portuguese regulatory authority has already considered) the pre-service considerations for the access to the local loop would have to be regionally differentiated, too. According to previous system, which, in spite of different piece costs in urban and rural areas, determines an area-wide uniform consideration for the access to the local loop, the companies requesting access to the local loop and operating mainly in urban areas bear a share of the costs for local loops in rural areas. This concept also serves the regulatory purpose of bringing forward competition in rural as well as urban areas (sect. 2 sub-sect. 2 No.2 German Telecommunications Act). A regional differentiation of the Incumbent's end-customer prices respectively of other pre-services would endanger this regulatory concept. As a result, the price for local loop would decrease in urban areas and increase in rural areas and a significant gap between rural and urban areas emerge. As the prices for local loop are a part of the price for IP-bit stream, higher prices for local loop would also lead to an increase of the bit stream prices in rural areas. Herewith, in rural areas the competition with DTAG would become more difficult in general und independent of the relevant pre-service.

Surcharges on bit stream pre-services in rural areas – as a consequence of an increased consideration for local loop – would again enable the incumbent to apply cross-subsidies for achieving a low-price bit stream pre-

service in congested urban areas. The fact that the incumbent due to a regionalised regulatory approach might not be obliged anymore to offer bit stream in congested urban areas does not necessarily prevent the incumbent to voluntarily offer bit stream in these regions for lower prices and thereby considerably damage the implementation of alternative infrastructure. Such an offer could hardly be controlled by the regulator if the regionalised differentiation is conducted by the definition of a separate regional market and not on the remedies level.

These scenarios show the complexity of a regionalisation as well as the reciprocal effects in regard to the different pre-services and to the end-customer servicers of the Incumbent. In view of this complexity, a premature regionalisation of markets or even of remedies is a considerable risk for the competition and could even set back the competition achieved so far. This danger is briefly referred to at the end of the ERG-paper, where it demands the necessary instinct from the national regulatory authorities. According to the ERG-paper, the evaluation of the considerable risks of a regionalisation must be conducted in advance from the perspective of “if” and “when” of a regionalisation; it had also to be discussed which markets seem to be the most suitable for an experimental regulation. Logically, these are the markets with the fewest risk potential, that means those markets which are the least probable to cause a chain reaction to other markets. This would mean, however, that a regionalised regulation should not be attempted on the bit stream market but, e.g., rather on market for lease services, which already have a tendency to be looked at from a regional perspective as of today.

Consequently, before commencing a discussion about the design and possible criteria of a regionalised regulatory approach, the reason of such an approach should first be discussed unrestrictedly and the chances and significant risks diligently evaluated.

Therefore, the following comments in regard to the suggestions of the ERG are made with the reservation that the discussion about the general question of „if“ and „when“ of a regionalisation has still to take place.

II. Comments to the suggestions of the ERG

1. When does a market qualify in general for a geographic market analysis ?

According to the concept of the ERG, the first step is to check whether a market qualifies for a geographic market analysis. This should be the case if a „hypothetical mo-

nopolist test“ does not indicate the existence of a national market and if the competitive conditions are not sufficiently homogeneous.

a) hypothetical monopolist test

The „hypothetical monopolist test“ is a method for establishing the convertibility on the provider' and consumer' side and therewith for an objective market definition. This test raises the question what would happen if a hypothetical monopolist maximizing its profit increases the price for a certain service slightly but nevertheless noticeably (by app. 5-10 %) while all other prices remain unchanged. If the profit of the hypothetical monopolist did nevertheless not increase, the sufficient convertibility of the services and, consequently, their belonging to one objective market should be indicated by this.

Is this concept applied to the geographical market definition, a national market is according to the ERG-paper (page 8) supposed to be indicated if due to an increase of the hypothetical monopolist's prices by 5-10 % in a certain area, either a sufficient amount of consumers would move into another area or competitors from other areas would enter into the market, so that an increase of prices would not lead to an increase of profit.

The hypothetical monopolist test is - apart from the fact that it is a very static view on the consumers' and competitors' side at a certain moment – generally confronted with the justified objection that it cannot provide reliable results in regard to the measurement of the convertibility, in case the decision of the consumers is based (at least partly) on other motives than the price. However, the quality of the bandwidth required for the relevant application plays an important role particularly for the choice of broadband services. Should this be taken into account, different bandwidths would require the definition of different objective markets, which as a result would lead to a very narrow market definition. Regarding the geographic market definition, it has to be considered further that no consumer would move because of a price increase of 5-10 %. This would – as even the ERG admits – lead to very narrow geographic markets on the MDF level or to “street cabinets”. The speculative character of the hypothetical monopolist test becomes even more speculative when applied on the geographic view. Therefore, the hypothetical monopolist test seems not to be able to lead to suggestive conclusions concerning the question whether a market generally qualifies for a geographic market definition.

b) Homogeneity of competitive conditions

Since even the authors of the ERG-paper allow for the defects of the hypothetical monopolist test with regard to the geographical market definition, they amend it by the

criteria of the “homogeneity of competitive conditions”. If the competitive conditions in a national market are not sufficiently homogeneous a regional definition is indicated.

The most important indicators for a lack of homogeneity of competitive conditions are according to the ERG:

- Ø The existence of one or several alternative operators whose networks have a significant, but not an area-wide coverage and which put a significant competitive pressure on the incumbent in those areas in which they operate
- Ø Geographically different end-customer prices of the incumbent or considerable divergences between the competitors prices in a certain area and the uniform end-customer price of the incumbent

The first criterion necessarily contains several ambiguities concerning the “area-wide network coverage” as well as the “significance” of the competitive pressure. Since these are basically questions of evaluation, this criterion can only add very limitedly to the assessing of the homogeneity of competitive conditions.

The second criterion contains the risk of a circular reasoning. If geographically differentiated end-customer prices of the incumbent are used as a benchmark for the necessity for defining regional markets, it would be up to the incumbent to considerably contribute by a respective strategic pricing to a regionalised definition, of which the incumbent might even profit due to a regionally loosened regulation. To put it bluntly, the incumbent could significantly influence the extent of its regulation. Not every geographically differentiated pricing of the incumbent must be the consequence of a regionally particularly high competitive pressure, as obviously assumed by the ERG-paper. For an example, we would like to refer to the pricing of “Congstar” / DTAG which implemented a consideration reduced by 5.00 € in urban areas. This price reduction was not indicated by the fact that the level of end-customer prices in urban areas would have been significantly different and DTAG therefore under a particular pricing pressure. DTAG rather tries to put pressure on its competitors, which might be legitimate – as long as this does not cause a price/costs gap – but does not allow a conclusion regarding the suitability of a certain area for a regional segmentation.

Therefore, both criteria which the ERG considers as particularly important for the evaluation of regional market segmentation are not unproblematic and are by themselves not sufficient to provide a reliable statement on the suitability of certain areas for a regional market definition.

Several other criteria are mentioned in the ERG-paper, which should be considered for the question whether the definition of a regional market might be appropriate. These are, in accordance with the statement of the Commission in the Art. 7 proceedings for the British market, specific barriers to entry, number of competitors, long-term development of market shares, general level of end-customer resp. pre-service pricing.

ing, specialties of demand and offer in certain areas, differences in regard to function or types of services offered by the incumbent as well as by the competitors and regionally specific marketing strategies.

In the opinion of BREKO, the more intensive observation of that objective market which has been referred to for the regional market segmentation must be added to this list. In this context, it must be considered that if this is a more isolated market or rather a strongly integrated market, in which a regionalisation could cause a chain reaction on other markets, so that the risk contained in the regionalisation of the relevant market could be multiply itself and thus effect relating markets. It must be further reviewed if it a “young” and still unsettled market, as, e.g., the bit stream market in Germany, or an established market with settled structures. The impact on a regionalisation of a young, still unsettled market is certainly more difficult to foresee than on an established market, so that such markets do rather not qualify for a regionalisation.

It is important that the different criteria must be met cumulatively. A review only focusing on, e.g., the number of competitors in a certain region is not appropriate. In fact, it must then also refer to the development of market shares, and that from a long-term perspective in order to avoid a static observation.

II. Local geographic markets or differentiated remedies

The discussions lead in the different EU member states concerning the question of regionalisation offer a colorful picture. Whereas some NRA, as e.g. the Belgian, for the time being seem to prefer with good reasons a uniform national market with uniform remedies, the exception of segmentation of regional markets on the MDF level can be found in the UK. A compromise can be found in Austria, where a uniform national bit stream market shall remain, but a distinction between highly competitive (= urban) and less competitive (= rural) areas on the level of remedies take place.

According to chapter 5 of its position-paper, the ERG generally considers both ways as possible. A differentiation on the remedies level has the advantage of enabling the NRA to react quickly to false developments resp. to allow safeguards to be implemented in advance. If, e.g., the access obligation for a bit stream offer in a highly competitive area was abandoned, it would still be possible to determine that a review on price / costs gap shall be applicable in case of the incumbent nevertheless making a voluntary offer of bit stream, in order to prevent the incumbent's strategy to hinder successful competitors in this region. In this way, the dependency from the incumbent's strategy without the possibility to react at short notice, which would be very awkward for the NRA as well as for the competitor, could be avoided.

However, there are some legal doubts concerning the admissibility of a regional differentiation of remedies within a uniform national market. Consequently, there is a risk that until the national courts will have reached an appealable decision, a considerable legal uncertainty would have been created. If need be, the legal requirements for this would have to be established resp. clarified during the coming EU review in the first place.

If, according to this, the segmentation of regional markets is the only – from a legal perspective – sufficiently certain possibility of a regionalised regulation, it must be taken into account that this option does not enable the regulatory authority to react reasonably fast to false developments of the regionalised markets resp. does not allow for the pro-active implementation of safeguards. The regulatory authority would rather have to commence a further Art. 7 proceedings, notwithstanding the fact whether this would be politically enforceable in market which has just been deregulated. This “all or nothing” situation cannot remain without an impact on the question of “if” regarding regionalisation as well as on the choice of regionalised markets. The lack of controllability of possible false developments is rather a further argument for a careful proceeding in regard to a regionalised regulatory approach.

BREKO 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.

Consequently, it is the opinion of BREKO that the discussion concerning a regionalised regulatory approach has only just begun and must be conducted unprejudiced by all parties. We are, of course, available at any time for a more detailed explanation of the mentioned issues.

Yours sincerely

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