Contribution of France Telecom Group

to the Consultation

on the Report on ERG

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

ERG GM CP 2008

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The European status of competition in the telecommunications market has evolved, but differences exist in infrastructure competition between geographical areas.

A continuous dynamic in the implementation of the regulatory framework towards transition from ex ante regulation to common competition law must be present on the market to translate the on-going development of competition and to give to all the undertakings a single perspective.

There are essentially three ways to deregulate:

1. lighten the type of remedy imposed: from cost oriented reference offer with accounting separation to non discriminatory obligations,
2. reduce the list of relevant markets subject to possible *ex ante* regulation, as was done at the end of 2007 with the new Recommendation on Relevant Markets,
3. reduce the geographical footprint of the regulation as a result of regulatory measures that is subject to local conditions.

In order to decrease regulatory pressure, national and European regulators have proposed to use the concept of geographic markets. The Commission, in the Explanatory Note related to the Recommendation on the Relevant Market, refers to geographic market with some tentative of guidelines.

There are several ways to implement the concept of geographic market:

- In UK, the Wholesale Broadband Access Market is no longer national. Three different levels of geographic markets have been defined allowing for the removal of regulation where four or more scale competitors are present.
- In Portugal, there is currently a consultation about different possible geographic markets for broadband.

- In Austria, the approach is different. As mentioned in the ERG report, the regulator has used the geographically differentiated remedies on the WBA market that remains national in scope.

These examples show the variety of possible implementations around the concept of geographic regulation. However, it should be said that if possible outcome of geographic regulation could be less regulation in certain zones and more regulation in other zones.

In order to assist NRAs to analyse under which circumstances a geographically differentiated approach is warranted and how such an analysis should be performed, the ERG proposes some guidelines.

The ERG document submitted for consultation ("ERG Document") is rather balanced and adequately sets out the general principles staying at a rather general level.

Still, the France Telecom Group wishes to underline that the process leading to the definition of geographical regulation must be very strict and documented and at the same time must:

- stay simple and transparent in order to be predictable and consistent with common sense,
- avoid to artificially create irreversible discontinuity in market conditions, producing digital divide and circular regulation.
- be consistent with market definition in competition law.

As per the analysis process, the conclusion must be without any ambiguity.

As proposed by the ERG Document, there is also an alternative for geographical markets in the form of "national" but conditional remedies that could apply only if certain conditions, characteristics of local market power, are locally met. The France Telecom Group agrees on the possible adaptation to various local access competitive circumstances under the conditions that the market situations are really geographically differentiated and that there is no more dominance of the incumbent.

The geographical analysis should take into count the state of development of services or networks. It cannot be the same for legacy copper networks which have a national coverage and are notably used in case of VDSL roll-out and for new networks which are still to be deployed.

The ERG omits to remind that the objective of the regulation is the welfare of the consumer. In this respect, risks of disparities could arise through bad implementation of geographical markets. So, in the framework of the analysis, possible consequences on digital divide must be also assessed.

As per these general comments and following the different chapters proposed in the ERG's document, France Telecom Group will make complementary remarks. The main points are related to the products concerned by the proposed analysis and the method used for assessing the necessity of detailed geographic market analysis, the possible drawbacks of a wrong choice of the geographic unit, clarifications related to the assessment of competitive conditions, the choice between geographic market and differentiated remedies and further implications of this "local policy".

France Telecom comments on the different steps proposed by the ERG document

The ERG proposes a sequential process that must remain coherent with the regulatory framework and competition law.
The global overview and understanding of the national market must remain the basis for the analysis.

1 - Preliminary analysis: is there a need for detailed geographic analysis?

The first step is to define the product that may be concerned by this analysis. As far as geographic markets could apply, France Telecom considers, in line with the concrete European applications, that only the wholesale bitstream products are relevant.

Legacy passive infrastructure and in particular the copper local loop should remain opened for access to all operators under non discriminatory conditions as well as a transitory period established in order to guarantee a reasonable migration of services in case of migration of services at the subloop level.

The ERG Document suggests the use of the hypothetical monopolist test in order to assess the necessity of detailed geographic market analysis. However, the opinions vary on the relevance of the hypothetical monopolist test for defining the existence of geographic markets.

Ones state that it is relevant for goods markets but not for the telecommunication market[1], others consider that this test leads to too narrow geographic areas… Furthermore, it could happen that the outcome of such a test leads to different results for upstream and downstream markets (for example for the retail market on the one hand and the related wholesale market on the other hand).

As far as analysis of demand and supply-side substitution is concerned, according to Amendola and Pupillo[2]: "*it needs to be recognized that in defining the geographic dimension, geographic demand-side substitution is either a very weak or non-existent constraint. In fact a wholesale purchaser would only be able to switch its demand to*

[1] Colin Garland- Ofcom, Vienna, June 2008 – Worksop on sub national markets

[2] "The Economics of Next Generation Access Networks and Regulatory Governance: Towards Geographic Patterns of Regulation"
Giovanni Battista AMENDOLA & Lorenzo Maria PUPILLO. Communication&Strategies N°69, 2008

an alternative area if the retail customer is willing to move to that alternative area, a condition very difficult to be met. The same is true on the supply side, due to the high cost and long time associated with deploying new network infrastructure as response to SSNIP at wholesale level. It follows that, in assessing the geographic scope of a market on the basis of homogeneity of competitive conditions, it should be more helpful to concentrate on narrow areas – ad hoc geographic units- and focus on specific factors enabling similar conditions of competition."

Even at this stage, a deep analysis is necessary. When offer and demand rely on a network with sunk costs and switching costs for the operators, the test will always conclude to the need of further deep analysis because of the limited geographic mobility of the offer and the demand.

Ofcom has used the Homogenous Competitive Conditions approach for the first step. This approach takes into account behavioural criteria like pricing behaviour, consumer preferences, marketing strategy, buyer power and structural criteria like number of buyers, number of sellers, entry and expansion conditions, regional limitation of service offerings.

Moreover, in the Explanatory Note of the Relevant Market Recommendation – 2007, the Commission has stated that there should be evidence that the pressure for regional price differences comes from customers and competitors and is not merely reflecting variations in the underlying costs.

These elements suggest the importance of the method to be used in order to better reflect the reality. Moreover, it shows that the ERG Document requires further thoughts around this test which is not sufficiently comprehensive for an analysis on geographical markets.

In this regard, we believe adequate attention should be given to elements such as:

- State or local authority intervention (aids) that may introduce a bias in the market equilibrium.
- Possible temporary aspects should be considered also that could introduce some bias in the analysis (temporary commercial policy, evolution of market shares in the last years, new acquisitions market shares, comparison of market shares with other EU countries…..).

2 - Choosing an appropriate geographic unit

The importance of the size of the unit cannot be underestimated; not too small, neither too large, as mentioned in the ERG Document. A too narrow segmentation makes no sense in respect of the economic equilibrium and would not reflect the actual state of competitive pressure.

The ERG document states at page 9: "*with the transition to NGA networks unbundling at the MDF might not be possible any longer. In such cases the street cabinet might become the smallest area which can be addressed by an ULL operator*". Yet, it is a question whether this point is technically and economically efficient to make it the base for geographic market definition. For instance, it has been demonstrated that the street cabinet is very likely to be irrelevant in most circumstances for alternative operators providing ADSL, because not feasible from a technical and economic point of view.

An example of the difficulty of defining the perimeter of a geographic zone is illustrated by the leased line product. The demand for this business offer will be higher in zones where there is an important concentration of large companies and it could be logic to suppose that these zones will support a good level of competition.

So, the regulation could be removed, totally or partly, from these zones. The neighbouring zone could remain regulated.
In this case, the unit could be, for example, the postal code or other administrative frontiers like the commune/district for density and company concentration reasons.

What about the fibre line starting from one zone and deployed in the other zone, these two zones having two different regulatory statuses? The situation is ambiguous and could lead to some bias in the overall configuration. At least, it suggests that the case per case will be the base of the analysis.
For a same case, risks could also be an important heterogeneity between countries and inconsistency with market definitions under competition law.

Regarding the legacy and the business offers, we would advise against differentiating geographic markets when wholesale regulated prices are cost oriented. Deregulation in certain zones may lead to variable prices following artificial frontiers. The creation of such artificial frontiers, not aligned with the market dynamic, could induce deformations of the demand like, for instance, the delocalisation of companies having important spending in telecommunication services… This market deformation could generate circular regulation on one hand and digital divide on the other hand.
This migration to lower price zones is more sensitive in the business service than in consumer products.
So, in order to not jeopardize the business services, geographic segmentation should not apply on legacy offers dedicated to business.

If different types of units are used for different products, the NRAs must ensure the coherence of the different typologies in order to avoid confusion or contradiction in the regulation deployment. For instance, a regulatory obligation such as cost accounting may become impossible to apply.

Maybe a progressive approach in the implementation of this process would be a good one. The idea would be to start with large geographic unit, coherent with the services provided and the network architecture. Then, after the necessary period of time, the granularity could be defined differently if necessary.

3 - Assessing the homogeneity of competitive conditions

Before assessing the homogeneity of competitive conditions between zones, the competitive nature of the market must be analysed on facts and not on assumptions.
In this regard, France Telecom cannot agree with the ERG Document stating that *"the goal is not to perform a fully fledged market analysis, but to form a hypothesis about significant differences in competitive conditions…"*. The overall process of geographic markets analysis must be rigorous, well documented, based on economic evidences and it must lead to appropriate and non-ambiguous decisions. The objective of the analysis must be to avoid, as far as possible, errors that would be detrimental to the market (both operators and consumers). In this respect, this type of statement makes this report less strict than it should be in the guidelines definition.

It is a right approach to suggest a list of clear and unambiguous criteria's definition according to which the geographic units are grouped and to apply them cumulatively.
Several criteria are mentioned as the base to assess the possible homogeneity of the zones: barriers to entry, number of suppliers, distribution and market shares, pricing and price differences and others. It is indeed important to have various and complementary criteria such as the evolution of the market shares and the comparison to other EU countries.

Nevertheless, France Telecom has a remark about the way to assess the criteria in the document.

While the document is mentioning that "*as it is generally the case in ex ante regulation, the analysis of the criteria should also be forward-looking*", it seems to apply it for some criteria and not for others, that is not coherent. Concerning the number of suppliers, the document proposes to "*exclude niche operators, which do not address the mass market and therefore may only exert a limited competitive constraint on other operators*". Therefore, the approach is not forward-looking as today's niche operators could be important operators in the future. Concerning distribution of market shares, "*it is important for NRAs to try to gauge how market shares might be expected to change over the period of the market review*". This change could come from niche operators whereas they are not in the analysis.

Pricing and prices differences are important in this analysis. If there could be some reasons to explain significant differences between competitive and non competitive areas despite a national uniform price of the incumbent operator, the reason given page 14 (2& "*The reason for this can be as follows:…*") is neither clear nor convincing. In any case, this phenomenon should not be overestimated.

In respect to the Greenfield approach mentioned in the document page 15, it still remains a question. If the analysis of geographic market is done in the framework of the market analysis process, it is done outside the process related to the obligations due to the Universal Service (for example). So, it should take these parameters as exogenous data and not analyse the situation without these obligations. The Universal Service is not part of the perimeter of the analysis, so it seems that the Greenfield approach is not possible as suggested in the Document.

About the requirement of submitting information concerning future network or service developments to NRAs, it is worth mentioning that these plans may change continuously with developments in market trends. Also referring to the amendment of the ITRE committee on Art. 5 FD, the extensive right to request information by NRAs on NGA roll-out plans that could in the future affect wholesale offers for competitors is disproportionate and difficult to conciliate with the need to safeguard business confidentiality.

The ERG could also consider the efficiency of modifying the regulation when an undersized part of the territory is concerned. Maybe, some guidelines could be given in term of critical mass to be reached before introducing important regulatory modifications.

3 - Local geographic market or differentiated remedies?

It is true that, with the national market view, an operator can be dominant but with a market power varying from one zone to another.
Even if we have some doubt about the existence of national market for civil work, let's assume that it is considered as national. The dominant operator could hold differentiated market power from one zone to another due to the existence of multiple, completed and available civil work solutions in certain zones.
As well for the ADSL market, the actual situation of alternative offers and the market shares are fundamental criteria for possible differentiated remedies. If, in certain unbundled zones, the cumulated market shares of the alternative unbundling operators were higher than the incumbent market shares, no more dominant on these zones, the national remedies could be adapted to this proven competitive situation.

Differentiated remedies present advantages and should not be limited only to situation where the existence of geographic market is unclear. It should be used as an actual tool for allowing the regulatory burdens to evolve. In fact, differentiated remedies may be less complex to manage than geographic markets. The risk for heterogeneous market conditions due to regulation is also reduced.

It is preferable to avoid fixing "regulatory" frontiers that could vary with the market dynamics. This can be overcome through a national analysis of the market and with the definition of criteria that would allow NRAs to determine in case of dispute whether or not there is a need for remedies in certain zones.

The document is imprecise about the conclusion between geographic markets or geographic remedies. It indicates the definition of a national market depends on the conditions of competition with no more indication: "*the conditions of competition differ but are nonetheless sufficiently homogeneous to define a national market*". All of this would be a question of interpretation by NRAs and a same case could face different conclusions. France Telecom considers such imprecision and discretion inappropriate and calls for much more precise and rigorous process to select geographical markets, geographical or conditional remedies in national markets, or national remedies in national markets.

4 - Possible implications:

France Telecom agrees with the possible implications mentioned in the report:
- increase of the complexity of regulation,
- increase of data requirement,
- sensitiveness of price and cost,
- difficulty to manage accounting separation with geographically disaggregated basis.

Those difficulties concern also the quality of service in terms of data requirement or geographically disaggregated basis.

Anyway, the overall process complexity must not be an alibi for extending the length of the market analysis.

As indicated in the document, the assessing of homogeneity of competitive conditions looks like an SMP analysis for each local zone (with sometimes potentially several thousands local zone). It would necessitate a lot of information to study each criterion in each zone. The burden for NRAs and operators could be very important. For example, the first criterion (barriers to entry) concerns "*the degree of economies of scale and sunk costs*". To investigate this criterion, it needs information on cost and "*factors related to demand*" for each zone. If each MDF is a zone, the NRAs will have to ask the number of accesses of each operator. In France, the incumbent only will have to give this information for each NRA about its own accesses but also about the alternative operators' ones. Consequently, the burden would only be on the incumbent.

As far as costs are concerned, we believe that the remedy of cost orientation is incompatible with geographic market.

Indeed, a system of differentiated remedies adapted to certain geographies would entail an incalculable risk for network operators and for customers: the regulatory de-averaging of wholesale prices according to potentially different costs in different geographies. To deregulate entire market segments would cut the link to the still regulated prices in other areas. Moreover, NRAs may indeed be unable to properly implement a differentiation based on underlying cost-differences in view of the complexity of cost accounting which is already visible in current access regulation.

Furthermore, operators offering nationwide services are faced with higher complexity and potential problems in communication and marketing/sales if they want to offer the same products at geographically different prices. Therefore a decision to de-average prices in certain geographies is primarily a business strategy decision of the company.

Regulated cost orientation will lead to wholesale price de-averaging that will create artificial discontinuities and possible digital divide.

Harmonisation of the regulation implementation is an important European stake. For geographical segmentation, this implies that similar market situations should be handled in a consistent manner, irrespective of the country in which they occur.

If market conditions are similar in different geographic areas irrespective of the country, it could help to foster the internal market to apply similar regulatory principles to homogeneous regulatory conditions in different sub-national markets throughout the EU.

It would be the condition for the players with businesses across several Member States or a pan-European business to face more homogeneous regulatory conditions in the EU as a result.

So, the Regulatory Authorities will have to be careful in the use of either geographic markets or differentiated remedies in order to not increase disparities in this domain.

Moreover, the new rules will have to be comprehensive and transparent; uncertainty due to changes in the regulatory implementation is detrimental to the business and could slow down investment projects.