

Response to ERG draft common position on geographic aspects of market analysis

Telefonica welcomes the opportunity to comment on this ERG draft common position and considers that geographic segmentation (GS) will significantly contribute to have a more proportional and targeted regulation in the EU. Having a sound set of principles at EU level can contribute to a better application of the concept.

General comments:

The ERG document highlights that the importance of geographical aspects of market analysis has arguably increased in recent years. Telefónica agrees with this idea, and would like to highlight that it deserves careful attention. Especially with the ongoing development of competition and the forthcoming development of NGANs it is necessary to ensure that regulation is carefully tailored to the different competitive conditions arising across and within different geographies.

Telefónica would like to highlight some basic issues for a proper application of the concept:

- The focus and **methodology** of the market analysis process should duly consider competition in retail markets. Current criteria applied to define and deregulate, especially in the case of geographic markets, is too restrictive, as the focus is mainly trying to find competition in so-called “artificial” or “notional” wholesale markets. Finding competition in these types of notional markets would not always be possible, despite a higher degree of competition in retail markets. **A more flexible approach to consider indirect constraints and self-supply is needed.**
- The main cases of full or partial deregulation that have arisen up to now have been focused on bitstream over traditional copper networks, and represent positive steps towards achieving a deregulation of the sector. However, the most interesting and **challenging application of a geographic approach to regulation will be with regards to the development of NGA networks.** Having a proportional and tailored regulation in the different geographic areas can substantially contribute to provide the right signals for investment for all players.
- A key aspect to be considered is the existence or prospects of infrastructure competition where national situations are so different. Bearing in mind the history¹ and the development of previous access products, it would appear that not all forms of access products will be necessary and /or feasible in all geographic areas, as the prospects of replicability of networks vary geographically. Regulation should recognise these facts and provide the necessary regulatory signals in order **not to obstruct or delay the flourishing of infrastructure competition** where this is deemed feasible by the market.

¹ E.g.: In Germany would have little sense to focus GS on recently launched wholesale products when cable presence is limited

Comments on the different parts of the ERG document

Sequential process

- Preliminary analysis
- Choice of an appropriate geographic unit
- Assessment of the homogeneity of competitive conditions
- Aggregation of geographic areas where competition conditions are sufficiently homogeneous
- Decision on local geographic markets or differentiated remedies

Telefónica basically agrees with the sequential process outlined, but would like to highlight that in many cases, the “preliminary analysis” for some of the markets is clearly not needed, as there are some such as market 5 or market 6 that show clear geographic differences, and the first step (preliminary analysis) would probably not be needed.

Introduction

Telefónica welcomes the introduction to the document, especially the recognition of the fact that the importance of GS has increased in recent years and that GS is important to better ensure that ex-ante regulation is targeted and proportional. Telefonica would like to point out that the importance of taking into account geographic differences in market analysis is likely to increase over the coming years, as competition develops and important investment decisions regarding NGANs are taken by different players.

The ERG opinion on NGANs quoted in the document recognises that: “...*the economics of NGA networks are likely to vary across different technologies and different geographies ... and may lead to significantly different competitive conditions...*”. This crucial fact should be further recognised and more widely reflected in other parts of the document.

The list of examples of markets that are susceptible to be studied in this context could also include market 4, as there are areas where 2 or 3 access network infrastructures compete.

Is there a need for detailed geographic analysis?

Telefónica agrees with the principle of aggregating areas according to the “homogeneity of competitive conditions”

Regarding the example of mobile markets quoted in page 9, Telefónica shares the approach that a detailed geographic analysis will probably not be necessary. In fact, a geographic approach to mobile markets will not be needed, as the only market is voice termination. However, depending on the cases, it would be necessary to study coverage and volume of connections of 3G data networks. Competition of data cards with other broadband offers is growing, and the trend is increasing.

The document lists (page 9) certain cases that may arise and which might indicate that the relevant geographic market is national and therefore a detailed geographic analysis is not required. One of them is when a **national uniform price** of an operator with national coverage might result in the competitive pressure in certain areas being felt on a national level, implying

that a detailed geographic analysis is not required. This case introduces a high uncertainty as to when a geographic analysis would be needed, and could be used in the future to skip a proper geographic market analysis.

A typical situation in many Member States will be that a regulated operator is subject to average wholesale price regulation that makes it very difficult to de-average prices also at retail level. With this situation, movements of prices in competitive areas will have some type of impact on other areas, but this does not mean that competitive pressures are homogeneous. It would be mainly the consequence of having average regulation.

Also on page 9, two cases are identified as indicators of the need of a geographic analysis. It could be added as another indicator when there are differences in the types of products and bundles offered in the market (either by the incumbent or alternative operators). Sometimes, competition is not focused only on price, but on other parameters, such as quality, speed or type of package (including content) offered.

Choosing an appropriate geographic unit

Telefonica agrees with the approach outlined and the two types of geographic units. The choice will probably depend on the particular features of the country and market under analysis.

Assessing the homogeneity of competition conditions

There is a reference on page 12 to the consideration, in some cases, of:

- where ex ante remedies are required, and
- where there are differences in the competition problems

From the text it is not totally clear in what cases this study will be applicable. In any case, it is important to highlight that the study of these two issues would be useful to delineate geographic markets (or differentiate remedies), but that study should be made in the retail market concerned, as the primary goal is competition for end users.

Regarding the list or criteria, a further one could be added to also cover the differences in the types of services offered speeds, bundles, etc. (see comment above: competition sometimes does not focus only on prices, but on the types of products available). This is in line with one of the criteria listed in footnote 20: the nature and characteristics of the products or services concerned.

Barriers to entry: Telefonica agrees that a proper assessment of barriers to entry should include an analysis of factors related to demand, such as total income, household density, business site density, and further factors such as age, buying power, etc. Experience over recent years shows that these type of socio-economic factors influence the distribution of the investments undertaken by market players and the extent of deployment of alternative infrastructures.

The forward-looking analysis to be undertaken should include the study of these factors, and additionally the plans of the different operators to unbundle switches or buy wholesale services.

Number of suppliers: Telefonica agrees that this a key factor to be taken into account. However, the draft ERG CP mainly highlights the importance of unbundlers for wholesale BB access and “other forms of network reach” analysis for terminating segments of leased lines.

While the number of unbundlers is certainly important for an analysis of market 5, it is important to bear in mind that the final goal is competition at retail level. That is why competition provided by alternative infrastructures, such as cable operators should be given a key role, as the competitive impact on retail competition is usually more important than other operators that rely on wholesale services.

The two main national cases of a geographic approach to wholesale BB that have arisen to date have considered on equal footing presence of unbundlers and CATV operators²

However, the **presence of cable operators should not only be taken into account in this market, but its importance should be more broadly recognised**, as it reflects a lower level of entry barriers, and a more sustainable type of competition.

The issue of taking into account only important players or those that have certain coverage at national level should be reconsidered. For example, in many places there are “local” cable operators, which cover a particular city or a province, but exert significant competitive pressure in their coverage areas. (Examples: Three cable operators that may be considered “local” in Spain have more than 40% BB market share in their provinces³).

Pricing and price differences: We basically share the ERG analysis of the issue of price differences: they are a good indicator of variation in competitive pressures, but there are some cases where a uniform national price does not mean that the market is necessarily national. We welcome the development made of this point on incentives to set a national price, as well as when the existence of a uniform price is the result of SMP regulation.

We fully support taking into consideration not only the SMP operator prices, but also the prices of other operators.

The ERG document says that in wholesale markets prices might not always be observable or available and that in such cases it might be helpful to consider retail prices. Indeed, given the importance that the regulatory framework ascribes to competition at retail level, even if there are no variations of wholesale prices, variations of retail prices should be taken into account for the analysis of wholesale markets⁴.

It is clear that having price differences at wholesale level is an indication of variation in competitive conditions, but sometimes the wholesale service is of such limited importance that it does not appear relevant from the point of view of pricing. That is the case, for instance, for wholesale BB access in the competitive areas, when there is a considerable degree of infrastructure competition and/or unbundling. In such areas, bitstream is almost non-existent, because operators do not use it. Indeed, prices may vary because the market is almost non-existent.

² Beyond a certain coverage threshold for CATV operators

³ According to CMT’s report about penetration of telecommunications services, July 2008

⁴ Reference Commission’s comments art. 7 case UK wholesale broadband access

Which areas should be aggregated?: We welcome the recognition that it is likely that some error in grouping may occur but the other alternative – a geographically uniform treatment- is likely to result in much greater errors.

In fact, the average treatment that is occurring today in many markets is resulting in a regulation that is based on average market conditions which does not always correspond to real market conditions. Whilst the reality of the markets shows important variations across and within certain geographic areas, all of these are treated similarly from a regulatory point of view.

Changes in geographic market boundaries over time

Changes due to the evolution of the access network:

Local geographic markets or differentiated remedies?

Telefonica generally agrees with the principle that markets vs. remedies should not be viewed as two alternative, equally applicable options. Geographic market definition is determined by the evidence from the analysis.

However, regarding geographic market definition, it should be pointed out that:

- While geographic markets have to be defined in line with the principles of the EU regulatory framework, the purpose of market definition is its applicability to ex-ante regulation. Losing sight of this reality and taking an excessively strict “competition law” approach that loses sight of its consequences for ex-ante regulation may be counterproductive.
- Most of the time, the geographic market definition is made on so-called “notional” markets, which are defined as “markets”, although its real purpose is to create a supply of a wholesale product to produce competition at a retail level.

Generally speaking, both options (geographic markets, variation in remedies) are valid and have their place, but definition of geographic markets should not be unduly obstructed by a narrow focus on competition on wholesale markets, exclusion of self-supply, or conditions for inclusion of self-supply unduly restrictive.

In this respect, self-supply is a key issue to include in the product market definition phase. For example, for the wholesale Broadband market, where either cable or LLU exists, they exert a competitive pressure in the wholesale broadband market.

Inderst and Valletti (2007)⁵ reach the same conclusions, saying that, when an alternative vertically-integrated operator exists, wholesale prices tend to be lower than those without vertically integrated competitors.

⁵ “Market analysis in the presence of indirect constraints and captive sales”. Journal of Competition law and economics, 1-29.

Although it is quoted as an example, the issue of a common pricing constraint gives the impression that it would be the “key” factor to decide between geographic markets vs. remedies. This issue should be further substantiated by the discussion undertaken by the ERG document in page 14.

Possible implications

The document places a good deal of emphasis on the study of the impact on competition of a geographic approach (remedies and markets). There is also a reference on the possible barriers to the roll-out of infrastructure by alternative operators in case of geographic markets.

Telefonica believes that if the market analysis is properly undertaken according to the principles of the EU regulatory framework, and taking into account the purpose of ex-ante regulation, this analysis of implications is given. In any case, the impact analysis should not play a greater role than an analysis of the implications of maintaining an average regulation. Maintaining an average regulation when there is evidence of competitive variations not only undermines the effectiveness of the regulatory framework itself and also risks severely distorting markets distortions and affect operators’ behaviour and investment decisions, to the disadvantage of end-users.

August 2008