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

- ERG (08) 20rev1 -

Here: Position of the VATM (without trade/business secrets)

Berlin • Köln • Brüssel

Dear Sirs and Madams:

The Association of Providers of Telecommunications and Value-Added Services e.V. (VATM) applauds the initiative of the ERG launching a public consultation concerning the question of Geographic Aspects of Market Analysis.

We are pleased to have the opportunity and thank you for the possibility to provide the following input.

1. Starting Point:

The liberalization of the telecommunications markets in 1998 introduced a sector-specific regulation with the goal of reducing structural competitive deficits. In this context, the *ex-ante* regulation is a sharp tool that leads to significant infringements of the economic freedoms of any regulated enterprise. According to the regulatory law, no abuse of market power is necessary for imposing and enforcing obligations and restrictions. By contrast, general competition law

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assumes that functioning competition is the normal case and only interferes with its regime of abuse control after the facts show that there is specific evidence of anti-competitive behavior. The sector-specific market regulation is very flexible and strives to release the concerned market into the regime of general competition law once there is effective competition.

Before the backdrop of the development in the United Kingdom and in Austria and the current political discussion, the model of a partial deregulation of the wholesale broadband market is presented as a large success of the market liberalization; it is also argued that the long-term goal of the liberalization - the release of the markets from the *ex-ante* regulation - has come a significant step closer thanks to a geographic examination of the market. From the viewpoint of the competitors, the discussion concerning the advantages and disadvantages is politically motivated rather than shaped by facts. In this regard, a significant amount of relevant fact-based arguments that are crucial for the continuance of effective competition have been overlooked. The European Commission states, for instance, that the current EU legal framework already provides the possibility to determine geographic markets. The criteria that the national competition authorities are supposed to apply, however, must be robust, based on facts, and should be applied EU wide.[1]

As an introduction, a regionalization would be a novelty to the German telecommunications regulatory regime; its consequences for competition are currently very difficult to assess.

2. Situation in Germany

Given that the incumbent is under the obligation in Germany to provide its competitors with an IP bitstream product, this obligation should lead to lowering the market access threshold in the wholesale sector. But in spite of this offer, alternative providers will continue to be forced to make significant investments in order to build out their networks to the Central Offices. The development of the wholesale market for broadband access is significantly determined by advantages of scale and efficiency when it comes to exploring new network infrastructure. Wherever these effects are not achieved, competition is hampered by high market access barriers. In metropolitan areas or areas with high population density these advantages of scale can be more easily achieved and have already led to a market entry by cable network providers

[1] See the Press Release from EU-Commission under: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/232&format=HTML&aged=1&language=DE&guiLanguage=en.

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or alternative providers in many cases. In areas with a low population density, the incumbent usually remains the sole provider with its own infrastructure, whereby the market access barriers are significantly higher. The entry of further alternative providers into the competitive arena within the next few years is only realistic in areas where high advantages of scale can be achieved by connecting the networks with a Central Office or a Cable Node, which means predominantly in metropolitan and densely populated areas. Given the fact that in metropolitan and densely populated areas several alternative providers often already exist that compete with each other, as well as parallel infrastructures due to the established network providers, further access of additional market participants will only be possible to a limited extent. Moreover, there is a particular issue in Germany: unlike the two countries where national regulators have introduced concepts for the regionalization of regulation (United Kingdom and Austria), there is still no IP bitstream product in Germany that the competitors can use -- in spite of a regulatory order – because there is no offer by the incumbent. Lacking any experience with the new wholesale product, there is thus the real danger that the tedious process of introducing a new bitstream product will become obsolete; providers will once more be faced with the problem of an uncertain price structure due to the regionalization.

3. Negative Impacts of a Geographic Regulation

We believe that it would generally tend to make build-outs in rural areas more difficult. Given the price differentiations on the wholesale level and more lucrative purchase conditions within the municipalities, end user prices in urban areas could drop. This could be achieved on a primary level through the competitors, but on a secondary level the incumbent would follow suit so that the urban area as a whole would face a lower end customer price level. Given this competitive scenario, a uniform price scheme for end users and unified tariffs across the board would no longer be accomplished. With its lower tariffs, the incumbent could impose decreases in prices in urban areas with intense competition that are, <u>for strategic reasons, potentially much larger than the cost savings on the side of the competitors</u>. In total, this would broaden the strategic arsenal of the incumbents: in particular in areas of intense competition the incumbent could reduce its end customer prices far beyond the level of cost savings of the competitors. This would not only lead to significant revenue losses for the competitors, but also enable the incumbent to push them out of the market using strategic pricing. This would make it significantly more difficult to refinance infrastructure investments by the telecommunications providers as well as by the cable network operators. It would thwart infrastructure investments.

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Moreover, it is already foreseeable that the prices for Unbundled Local Loops in urban areas will also fall, whereas in rural areas they will increase. If the wholesale prices for bitstream and Unbundled Local Loops in areas with high population density drop, the incentive for alternative providers to invest in NGA-technologies will disappear. Hence, there is a real danger that only the incumbent will push for the introduction of these new technologies.

If the measures will be dropped, in particular the obligation to provide a Standard Offer, it will become much more difficult for smaller and medium-sized providers, in particular those from rural areas, to compete with the Germany-wide offers of the incumbent in the market. This means that competitors having contractual connections with a larger business customer who wants to link its locations throughout Germany will be prevented by the incumbent to fulfill the need and to provide this customer with a Germany-wide offer in the future. Given that the market-dominating enterprise will no longer be obliged to offer a wholesale product in areas with high population density, it can prevent effective competition in areas with lucrative business customers. In particular, the effect will be that providers serving the business customers in local areas as well as small providers will effectively be pushed out of the market. A further consequence of lifting the obligations to provide a Standard Offer could be that the incumbent will terminate existing contracts or will not renew them once they expire. Since the incumbent, being the provider of a bitstream offer, has knowledge of customer data and owns the existing infrastructure, the incumbent may simply take over the customers while providing the same terms that the competitors offer. Given that the same network connection could be used, there will be no additional costs for the migration, nor will there be waiting periods for the end customers.

While evaluating the above-mentioned arguments, we are very concerned that if the regulator ceases to treat all geographic areas in Germany on an equal footing, the already existing **inequalities between areas with a high population density and rural areas** will increase and, as a result, will run afoul with the goal of closing the digital divide. If the customer prices differ by geographic area (urban areas becoming cheaper, rural areas more expensive), such differentiation can only be supported with a geographic differentiation in the regulation of wholesale services. This differentiation will strengthen the trend that already today some remote areas are lagging behind economically and will widen the gap between urban and rural areas. The incumbent will need to comply with the regulatory obligations that will be imposed

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on serving rural areas and, at the same time, will lose any incentive for investments in new technologies. Instead, these investments will be channeled into areas with dense population that will no longer be regulated in the future; this will have dire consequences for the creation of any modern electronic infrastructure in the rural areas. The consequence is a digital divide between urban and rural areas that will be in conflict with the goals of the Telecommunications Act, namely to create a modern electronic infrastructure throughout the entire Federal territory.

An abandonment of the regulation for geographic reasons would also allow the incumbent to push all other enterprises out of the market using "dumping prices" in areas that will no longer be regulated. With these revenues the incumbent could cross-subsidize offers in regulated rural areas.

Finally, the significantly increased workload at the regulator should not be underestimated. A geographic segmentation would necessarily make the required market analyses much more complex. It would require more work, personnel and costs which contrasts sharply with the actually intended goal that the regionalization should reduce the regulation of the telecommunications sector.

4. Conclusion

Refraining from regulation in metropolitan and densely populated areas for the market of wholesale broadband access would **weaken competition.** The number of new market entrances of enterprises or new build-outs of certain areas by competitors would significantly diminish if a wholesale offer were no longer available. Sustainable competition on the level of the end customers can only be achieved by competition on the wholesale level or by consistent regulation of the incumbent of the wholesale level. Consequently, it is not sufficient to determine whether there is sustainable and self-supporting competition by merely focusing on the situation in the end user market. Rather, the situation on the retail level must be the decisive factor for the examination.

Sincerely,

Dr. Frederic Ufer
Legal Counsel

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