

**European Regulators Group
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Vienna, August 11th 2008

Subject: ERG GM CP 2008

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

Dear Ladies and Gentlemen,

ISPA, the Austrian Association of Internet Service Providers, appreciates the invitation to comment the ERG draft Common Position on Geographic Aspects of Market Analysis.

1. General position to geographic analysis

From our point of view harmonization in regulatory measures is the main factor for success in building the base for a single European electronic communications market. We approve ERGs' efforts for more guidance for national regulators in order to achieve a solid level of legal certainty for the whole European electronic communications market. Especially the postulate that NRAs should ensure that a geographic differentiation does not lead to barriers for a further roll-out of infrastructure by alternative operators and that NRAs should thoroughly analyse the impacts of a withdrawal of specific regulations on competition on the market under consideration is a very important guideline when introducing geographic aspects in regulation.

A basic requirement to guarantee a roll-out of infrastructure is an efficient ladder of investment. It is important to keep the single steps of this ladder alive in order to achieve conquerable barriers to entry and support developing competition until the level of a sustainable and efficient competition for the whole market has been achieved. ISPA is completely consistent with the explicit message NRAs have to carefully consider possible effects on the market under the consideration as well as

adjacent markets and will only be able to withdraw (or decrease) regulation if competition is indeed effective and sustainable.

The main question defining the topic of geographic aspects of market analysis is which circumstances could justify the split of the national market into local geographical defined markets. In our opinion a separation in different local geographic markets can only be a solution for some special cases under specific circumstances. ERG is stating in its position that there is no need for geographic differentiated remedies. Either the differences between the single areas are that big that the separation in local geographic markets is justified or not. It has to be clear that in case of separated local geographic markets, these markets must have little mutual interference. Geographic differentiated remedies in absence of clear evidences for local geographic markets counter the sense of market definitions and would give NRAs the possibility to take arbitrary decisions when they impose remedies.

As mentioned before, ISPA supports proposals that lead to harmonization, legal certainty and promotion of competition. In our experience geographic differentiated remedies do not pursue these objectives.

2. Additional elements

ERG has noted some relevant points but in our opinion at least two further elements have to be kept in mind when introducing geographic aspects in regulation.

2.1. Adjacent markets

One important additional element we miss in the ERG draft Common Position are more intensive remarks to adjacent markets. It should be clear that the effects of measures (like deregulation in one market) on adjacent markets have to be analysed before. Especially the system of an efficient ladder of investment has to be kept alive across all markets. The markets have to be seen more or less connected together because most of the operators participate in more than one market with the consequence that measures taken in one market move the whole market system.

2.2. Element of size

The element the size of the national market was not taken into consideration. In a small country like Luxemburg, Belgium or Austria the whole market is much more conjunct and constraint than in big countries like UK, France or Germany, where often one state has the size of a small country.

Whereas the premises are quite similar in most of the European member states: one incumbent telecommunications network operator, which operates on an national scale with a network capable to supply all regions in the country, some (more or less local) cable network operators and some developing ULL, wholesale or resale operators; the size of the European member states are quite different.

In bigger countries the essential homogeneity of different areas, especially regarding a different level of competition in these areas, can be more easily argued than in smaller countries where the natural homogeneity and conjunction of the different areas in most cases makes no sense to split up different regional markets or handle remedies different in distinct areas. It should be taken into consideration that in smaller countries the difference between a higher developed urban area with more competition and a less developed rural area with less operators is as well present as in bigger countries. However in bigger countries the connection between the different areas is much less important than in smaller countries thus resulting from the higher number of urban areas with rural surroundings in bigger countries than in smaller countries where often just one really urban area can be identified. As in a small country the connection between the urban area and its rural surrounding plays a special role, this situation demands a particular treatment and attention by the NRA when geographic separation measures are planned.

3. Possible negative impacts of geographic deregulation

If an NRA considers geographic aspects of market analysis because areas of "local retail competition" are declared, the NRA must bear in mind that by separating an area into a segment where still regulation has to be applied and a segment which is deregulated the following affect might appear:

The SMPO is invited to use a predatory pricing strategy in the deregulated segments, subsidized by profits from segments where no "local retail competition" exists. If the SMPO succeeds with this strategy, competition is eliminated and it is not guaranteed whether competition can be reanimated by transferring regulation back to this segment.

If regulation has achieved the intermediate goal of reduced retail prices existing competition would be the key to maintain sustainable low retail prices. Low prices without competition, which could appear by local separation, is not desirable. A following reanimation of competition would meet the obstacle of an higher entry barrier. This could occur as it is uncertain whether the necessary fixed costs investment are done, when there is no reasonable time to earn back the investments because of the low prices. Current competition induced by regulation is relying on low variable costs not considering high fixed costs (see e.g. mobile termination rates).

A new competitionless monopolistic structure with low prices is not desirable as there is no pressure for technical innovation and no incentive for sustainable low prices.

To sum up, introducing geographic aspects may lead to irreversible consequences. If there is a threat of irreversible negative effects by introducing geographical separation, these measures should not be introduced by NRAs.

4. Situation in Austria

4.1 Outline

For us it is important to highlight that geographic differentiation of remedies in a single national market has to respect the particularities of the whole market. As an example we want to explain the situation in Austria.

The electronic communications market in Austria is quite similar to the markets of the other European Member States. There is an incumbent with significant market power (SMP). This incumbent operates on a national scale and is the only operator that has network coverage (the former state-owned network) for the whole country.

The NRA defined in its last decision from 4th July 2008 regarding the wholesale market for “broadband access” the affected relevant geographic market on the national territory of Austria, but imposed regulatory remedies only partially (in the so called “area 2” – the rural areas). This market includes all operators that provide retail broadband access (Incumbent, LLU, wholesale broadband access, cable network providers, but no broadband by mobile devices).

On a national scale, the incumbent has a stable market share of approximately 47 % for the last years. The main competitor of the incumbent has a nationwide market share of about 30 %. No other operator has more than 5 % market share on a national scale. (This market includes DSL, cable and fixed wireless access products, eg WLL, w-lan).

4.2 Geographic Segmentation

NRA argued that the incumbent has significant market power in the relevant market but that (potential) competition problems only exist in a segment (“area 2”) of the defined market because in the other segment (“area 1”) the incumbent would be sufficient constraint by other operators.

Area 1 consists of all MDF – areas where the incumbent has a retail market share of less than 50 %, at least three major operators (including the incumbent) are active and at least 2.500 households are within the respective MDF – area. Area 2 covers the rest of the defined market. From an objective point of view area 1 sums up nearly all urban areas and area 2 the rural areas. In retail market shares the incumbent has a market share of about 75 % in area 2 in comparison to a market share of about 28 % in area 1. The only nationwide remedy (for area 1 and area 2) is accounting separation. All other remedies (access to broadband bitstream products, non discrimination obligation, access to “naked dsl” products, national and regional traffic handover, price control for regional traffic handover based on “retail minus” and publication of a reference offer) have been imposed solely for area 2, starting with 1.1.2009. The mentioned market shares refer to the shares on the retail market. On the wholesale market the market shares of the incumbent are almost 100% but these market shares were not taken into account of the calculation of the NRA. The NRA

just suggests that there will be enough possibilities for operators without own infrastructure to obtain wholesale offers either from the incumbent, which has no more obligation or from other “existing” providers, which often have not enough possibilities, no interest in competition or just offers for business use. In our experience and in all statements of the operators (except the incumbent) these suggested alternative possibilities do not exist and therefore will not take place.

4.3 Remarks

The introduction of geographical differentiated remedies encountered strong resistance and was met with criticism from all operators with the argument that there is no need for deregulation, as the market shares of the incumbent have been rather stable and no significant change in the competition conditions legitimates a (partial) deregulation. In fact the competition situation in Austria (stable market shares for the incumbent and sinking market shares for alternative operators) would support the opinion for stronger regulation than deregulation.

Following the arguments in ERG draft Common Position there are elements that support the local geographic markets because one or several alternative operators have significant but less than national coverage and they exert a significant competitive constraint only in the areas where they are present. In this context it has to be kept in mind that this significant competitive constraint developed because of the introduction of (national) regulation and the situation could rapidly change with (local) deregulation. There are other elements that object geographic separation like an almost national uniform price with no significant differences between the incumbent operator and alternative operators in Austria and no significant price difference between the incumbent operator and alternative operators where the latter are present. In fact the incumbent has the possibility to apply competition pressure on alternative operators by offering bundling products in special deals.

Bearing in mind the additional elements, mentioned above, the first element adjacent markets was not fully respected by NRA. The wholesale market for “Broadband access” is an important step in the ladder of invests, residing between ULL (Unbundling Local Loop) and resale. A reduction of this step would detain new operators to entry the market and would have negative implications for operators which primarily work on the ULL market as they need a competitive attractive nationwide wholesale product in order to be able to provide services nationwide. Especially operators that serve business customers with local different establishments (eg in area 1 and area 2) expect hard times and may nor be able to render their services in the future

The NRA introduced geographic separation with the argument of “sufficient retail competition” in area 1 but it did not consider the effects on adjacent markets which contribute to the “retail competition” of the nationwide market under their analysis. As the adjacent market for ULL has no geographic separation an interactive situation between the bitstream and the ULL market could occur. If the given reasons for the introduction of geographic separation do not longer exist because of an undesired

side effect regarding an adjacent market there is a remarkable probability that the interactivity of the situation could have an irreversible effect on the adjacent market.

The incumbent has no retail-minus obligation in area 1 in the wholesale broadband (bitstream) market though the incumbent has the opportunity to remove entrants of the adjacent (nationwide) unbundling market by offering predatory prices in the deregulated area. The function of retail minus is to control broadband retail prices vs broadband wholesale prices and to control broadband retail prices vs unbundling local loop and leased line prices. In area 1 the control of broadband retail prices vs broadband wholesale prices will fail because of deregulation with the consequence that alternative operators have to dodge to a general competition law or wait for a new analysis of the markets. The timeline until one of these approaches would lead to a result would take too long for most alternative operators to keep up their business.

Even during the non geographic wholesale (bitstream) obligations (M1/05) the SMPO did such pricing. In this case no margin squeeze on ISPs, but a margin squeeze on ULL operators occurred. The rent of the unbundling local loop had to be adapted in several cases ex post. Through the new geographic separation the situation has become even worse as no adaption will be necessary in a similar situation, when the SMPO offers different BB-access-retail offers.

Regarding the second additional element, the element of size, the Austrian electronic communications market is a rather small market in the European environment. Apart from the capital Vienna no other city hits the one million mark (Vienna has about 1.7 million inhabitants, the second biggest city Graz with 250.000 inhabitants) with the result, that most areas are not very densely populated. Therefore most new operators start their services in densely populated urban areas to roll out their business. As the country is rather small the number of urban areas is restricted. In these areas the existence of competition can be argued, but only under existing regulation. Deregulation would detain new operators to enter the whole market and will lead to a drop out of established operators. Size matters double in this case. On the one hand there are fewer areas to start business and on the other hand the existing urban and rural areas are very conjunct. To achieve enough scale to be an efficient provider, that can exist on a small market like Austria it is necessary to provide services in rural and urban areas.

5. Conclusion

Defining local geographic markets could theoretically make sense, if it is guaranteed that the deregulated areas are competitive and will stay competitive. It does correspond with European competition law but the NRAs are challenged to define clear benchmarks beforehand. On the other hand the introduction of geographic differentiated remedies seems to be more an interim vehicle leading to legal uncertainty for market players.

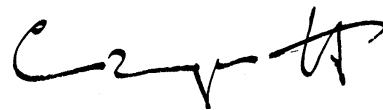
If market indications are strong enough a geographic differentiation on the level of market analysis may be appropriate and sufficient. However, such decision shall be based on a thorough analysis of the competitive environment. Therefore the factual rather than assumed or expected development of competition as well as the process of European harmonization have to be taken into account.

Best regards,

ISPA Internet Service Providers Austria



Roland Türke
President



Dr. Kurt Einzinger
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About ISPA: ISPA is the Austrian association of Internet Service Providers, representing approximately 200 ISPs. ISPA is a major voice of the Austrian Internet industry. Our goal is to shape the economic and legal framework supporting an optimal growth of the Internet and Internet services. We regard the use of the Internet as an important cultural skill and acknowledge the resulting socio-political responsibilities.