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RESPONSE TO ERG/EC REMEDIES CONSULTATION

General comments

Telenor welcomes the opportunity to comment on the draft joint ERG/EC approach on appropriate remedies in the new regulatory framework document (the Document). Telenor's business portfolio includes being an incumbent operator in Norway and an entrant both fixed and mobile on a number of markets in the EU and accession countries.

Telenor expects the Document to play an important role for harmonised implementation of the new regulatory framework (the NRF) in the enlarged EU/EEA. Harmonisation is indispensable to create an internal market for the EUs electronic communications sector, thus creating a level playing field for operators active in several Member States across the single market. It is the responsibility of the ERG and the European Commission to ensure this.

Telenor furthermore expects the Document to ensure proportionate and targeted application of remedies, in those situations where ex ante regulation is deemed necessary. The principle of proportionality is an essential principle in Community legislation and has certain conditions attached to it, as reproduced by the ERG on page 20:

"Proportionality is one of the over-arching general principles of European law. It requires that the means to attain a given end should be no more than what is appropriate and necessary. To be compatible with the principle of proportionality, the action taken must pursue a legitimate aim, and the means employed to achieve the aim must be both necessary and the least burdensome, i.e. it must be the minimum necessary to achieve this aim."

Telenor appreciates the overview the Document gives of competition problems and its discussion on an approach to appropriate remedies. The application of appropriate remedies when there is a proven market failure is in the long-term interest of all operators.

Telenor would also like to recall the provisions in the NRF which declare that ex ante regulation should only be applied when competition law remedies are not sufficient. The mobile markets in the EU offer a good example in this respect. As stated by the ERG, the goal of the NRF is to limit

sector regulation to those markets where replication of infrastructure is infeasible or undesirable. In Europe over the past decade, one has indeed witnessed that mobile network infrastructure is feasibly replicable.

As we see it, the main challenge for the ERG is to provide solid guidance to NRAs, which has lack of experience in the application of competition law principles, on how to design appropriate, proportionate and also temporary remedies after having found a market failure.

We have some general concerns that we would like to address and we suggest the ERG/EC considers these issues further before the Document is finalized:

- **The proposed approach seems to be in conflict with the overall deregulatory intent of the New Regulatory Framework (NRF).** By following the proposed approach with the underlying presumption that SMP operators will always exercise market power, that multiple remedies are required in most cases and that there is almost no place for competition law in place of ex ante regulation, NRA's may contrary to the intention of the NRF move towards **regulatory micro-management** of the electronic communications sector.
 - The ex ante assumptions on incumbent's behaviour are hypothetical and do not assess how competition law (and its associated penalties) affects the incentives on players not to exercise market power in ways detrimental to market development. The approach to sector specific remedies must take due account of the disciplinary effect competition law has on firms' behavioural incentives in every situation that is being analysed.
 - The "behavioural approach" may be suited to ex post competition law treatment, but applied to an ex ante approach may fail to meet the principle of proportionality. An ex ante approach should be (more) confined to structural market defects and transitory measures, thus paving the way for effective competition (as opposed to behavioural remedies which are likely to prevail).
 - In most cases the Document dismisses the application of single remedies as inadequate. This is in part due to the approach taken to the lack of proper application of competition law referred to above of duplicating the competition law incentives with ex ante remedies. The Document argues that whether competition law is sufficient is answered at the stage of market definition. Such an approach is in Telenor's opinion flawed because **the process of defining a market does not necessarily expose the problems in the market, nor the appropriate solutions.** The outcome of this may be over intrusive interventions and failure to comply with the principle of minimum necessary regulation.
 - The relationship between the emerging markets concept and the curtailment of first mover advantages is problematic. The regulatory forbearance of emerging markets, which is an important principle of the NRF, may thus be lost.
- **The proposed approach describes many of the issues that need to be considered but unfortunately does not give much guidance on the decision making process to identify the adequate and proportionate remedy for the problem identified.** The Document fails to give adequate guidance for NRAs to assess problems in light of relevant prevailing market conditions because the approach remains rather theoretical with no real links to most real issues of the electronic communications market.

- In markets where infrastructure competition is the starting point and where the market is at least prospectively competitive the lack of clear guidance is especially noticeable.
 - Lack of guidance on **regulatory options assessment**. The Document does not go into details on its actual “mandate”, i.e. what may be considered a proportionate remedy. Solid guidance to NRAs on how to undertake a cost- benefit analysis of alternative remedies and on methods to conduct rigorous regulatory options assessment before the choice of remedies takes place is missing.
 - Lack of criteria for assessing the effect of remedies other than the rearrangement of market shares. For instance further cost/benefit analysis of the impact of the remedy and time limits on remedies imposed on SMP operators (in light of the investment ladder theory).
 - The questionable presumption that regulators (EC/ERG/NRA) will always aim to promote economic welfare and be able to judge the complex issues like defining market boundaries, SMP assessments, and the setting of remedies impartially and correctly, is not at all addressed in the Document.
- **The check-list approach in the Document gives a mechanistic and theoretical perspective that falls short of real-life market situations.** A theoretical economist needs to simplify to be able to make a consistent analysis. This is a major reason why theoretical work on competition on telecommunication often focuses on one (incumbent) infrastructure operator and how to facilitate competition with such a starting point. In the real world however this market setting is often not the case. There are often several players at the backbone level, in limited geographical markets the metallic loop meets competition from cable TV accesses and there are usually two or more mobile network operators. This is the case even in a small market like the Norwegian. In this perspective the ERG document seems too focused on a market context with just one incumbent, controlling an essential facility, and several newcomers trying to compete in the market. From the list of 4 market constellations (cases), it develops 27 competition problems to which the remedies should be applied. The approach ignores that:
 - One cannot assume a deterministic link between market constellations, behaviours and effects.
 - It induces very weak evidentiary requirements on NRAs – which merely have to identify the theoretical incentive to engage in one of the 27 generic competition problems as a trigger for imposing remedies.
 - It fails to address adequately the cost and benefits of the different remedies.
 - Specific time limits for remedies must be provided for (reviews, assessment, sunset clauses) in order to give adequate consideration also to dynamic effects (see argument below related to the concept of “ladder of investment”).

We come back to some of the general issues of concern when answering some of questions posed by the ERG.

Comments on the ERG Questions

Chapter 1: Generalization of Competition Problems

1. *Do you agree that the description of the competition problems provides the requisite level of detail? If not, please highlight areas where you would like more detail to be included in the final document.*

The Document should elaborate more on **the relationship between market failures and competition problems** as most of the competition problems are derived from the expected practice of SMP-operators of foreclosing markets or exploiting consumers.

When discussing **entry barriers** in this context it must be realized that most telecommunications markets can only support a limited number of viable infrastructure players. Economies of scale and scope and first mover advantages, which do not themselves constitute competition problems, must be fully understood, not analysed solely in the context of entry barriers/foreclosure.

The Document defines an **excessive price** as “one that exceeds the hypothetical competitive level (p 39). Telenor will question the suitability of the definition applied. According to European Case Law a price is excessive if it has no “reasonable relation to the economic value of the product” (United Brands). The definition applied in the Document is only correct if the standard is the theoretical model of competitive markets. This model, however, neglects markets dynamics. To foster innovation economic theory suggest that prices may be well above the theoretical level of perfectly competitive markets without being excessive.

By the same token the definition of **price discrimination** (two or more goods sold at prices which are different ratios to cost of production) is also not correct.

In sum the description gives an exceptionally high weighting to leveraging that is not reflected in the NRF.

If divergence from the theoretical optimal position of maximum welfare under competition is used as a criterion for intervention, it will always give NRA justification for intervention in the telecommunications market. However, this criterion for intervention is not the same as the competition law approach advocated by the NRF.

Concerning the problems related to **termination** (p. 40) the description is inadequate and it is further commented in Q12.

We recommend that chapter 1.5 is reconsidered as it may indeed lead to regulatory intervention beyond the minimum necessary and could imply disproportionate regulatory costs.

2. *Are there relevant examples of competition problems that are not covered by this framework? If you believe that there are, please provide details.*

No comment.

Chapter 2: Remedies Available

3. Do you agree with the description of remedies provided, in particular, does it provide the requisite level of detail?

No comment.

Chapter 3: Principles to be applied by Regulators in choosing appropriate remedies

4. Are there any further principles, in addition to those set out in Ch. 3, that you wish to propose? If so, please justify them on the basis of the Directives.

The Document sets out five principles to be applied by NRAs for choosing appropriate remedies. One of these guiding principles is **reasoned opinion**. Under this heading, the Document states *that the proportionality principle requires that where there is a choice between a number of appropriate remedies (which ought to be the case in most cases according to the NRF), the least burdensome must be chosen*. And here it ends. We believe that there is a lack of guidance on the issues to be considered when analysing the least burdensome/proportionate remedy and on the actual decision making process to identify the appropriate remedy for the identified market problem. **We expect the ERG to elaborate further on this before the Document is finalised.**

We also expect the Document to give further guidance on a cost-benefit analysis of the intended remedies. **Regulatory costs** assessments must be taken into account.

5. Looking at the objectives in Article 8(2) of the Framework Directive, what are your views about how NRAs can balance short term and long-term objectives?

One of the objectives listed in art 8(2) is to promote competition by encouraging efficient investment in infrastructure and promoting innovation. To balance the short term and long-term objectives to ensure this, i.e. access to new entrants while preserving the investment incentives, it is necessary to confine the set of products to which access is mandated. Regulatory obligations on a very wide range of wholesale products will be highly damaging to investment; particularly if accompanied by ill-defined margin squeeze tests applied between a wide range of final and intermediate products. Justified margin squeeze tests should be performed only to a limited set of products, and in a clearly defined way. In the presence of innovation and technological uncertainty margin squeeze tests are likely to distort markets.

6. Do you think that there are any trade-offs between short-run service competition and long run infrastructure competition? If yes, please highlight potential areas and provide relevant examples. In this context, what are your views on the approach that NRAs should take in relation to (short term) business failures?

According to the Document, p. 58, when replication of the incumbents' infrastructure is feasible, remedies should assist in the transition towards a competitive market. In the other extreme case, where infrastructure replication is very unlikely, the NRA has to ensure that as much service competition as feasible is encouraged. Thus the assessment of the likelihood of infrastructure replication is critical when choosing remedies.

In the Document a set of guiding principles for NRAs in choosing remedies is described. The third principle is the likelihood of replication of the incumbents' infrastructure. In the guidelines, at page 62:

"It could be that, whilst there is no prospect of investment in the near future (and hence SMP exist), this situation is expected to change in the future".

Thus, NRAs has to assess the likelihood of infrastructure replication after (or in addition to) designating SMP. Accordingly if NRAs impose remedies to ensure service competition without explicitly assessing the likelihood of infrastructure competition, it will be a violation of the third principle.

At page 63 in the Document, a reference to the Access Directive is given (recital 19) where it is stressed that mandated access to promote short term service competition should not reduce incentives for competitors to invest in alternative facilities. There is evidently a trade-off between short run service competition and competitors investments. Accordingly, it is a demanding task to balance these factors. The Document recommends that entrants are given incentives to "climb up the investment ladder". It is, however, hard to see how NRAs can ensure that this climbing takes place without NRAs making long-term commitments with respect to remedies.

We can use the market for providing broadband access to residential customers as a stylistic example. Bitstream and LLU are alternative interfaces, where bitstream requires less investment from a newcomer as compared to LLU. Suppose a newcomer at the time of entering the market decides to use bitstream. One can then ask what factors can make the newcomer choose to climb up the investment ladder and convert its production such that it becomes based on LLU? There are basically three possibilities:

- Over time make bitstream relatively less attractive by increasing the price of this service
- Over time make LLU relatively more attractive by reducing the access price to this type of infrastructure
- Rely on scale economies, i.e. for some combinations of LLU and bistream prices it can be the case that newcomers up to a critical size prefer bitstream and newcomers above the critical size are better off by converting to LLU.

As we will see below, these three possibilities are highly interrelated. First of all, the price of LLU is typically given from a cost calculation (cost oriented price), it is accordingly hard to see how the NRA can manipulate this price without violating the principle of cost orientation.

Thus, if the regulator wants to rely on scale economies when providing incentives to climb up the ladder, the available tool is to adjust the bitstream price exactly to the level (or to the narrow interval) where there exists a critical size where firms are better off by switching. It is highly questionable whether an NRA has sufficient information to predict the right level of the bitstream price in order to achieve this outcome.

The NRA can of course adjust the bitstream price over time as new information is gathered so that one indeed arrives at a price that provides incentives for climbing up the ladder. The NRA is then in a position of carrying out micromanagement of relative profitability of the competing broadband providers. Thus if the NRA at a given time decides to adjust the price of bitstream upwards, the small firms relying on this product will be relatively worse off and might in extreme cases go bankrupt. If the NRA decides to adjust the price of bitstream down (e.g. because one finds that the price structure provides incentives for over investment), then some firms that already have converted to LLU (climbed the ladder and invested) will regret their decision and they will lose competitiveness as compared to firms that still rely on bitstream. Thus it might be hard for the regulator to change relative prices sufficiently to tilt the balance between the different access solutions since such a tilting would be harmful for some firms. The firms being harmed may argue that their chosen strategy for market entry was contingent on expectations of future access prices and that the NRA should not be allowed to reduce the value of their investments.

One might argue that the implication of the arguments above is that the NRAs should be cautious and stress that the balance between different access prices will change over time, but that the direction of the changes is unknown. I.e. say to newcomers, prior to entry, that the NRA in no way is guaranteeing that access prices will remain unchanged. This would however harm competition, since it would increase the risk of entering the market and thus a smaller number of newcomers will enter the market. **Note that this effect stems from the fact that the NRA is not willing to commit to a certain policy of access prices over time.**

One possible way of overcoming the problems described above **is to commit to an access price path over a certain time period such that the pricing, over time, provides stronger incentives to climb up the ladder.** Then the risk for newcomers is reduced since it can include future access prices in its business plan. At the same time the NRA has made certain that there over time, will be incentives to climb up the investment ladder. This way of overcoming the problem is described in the Document, at page 65 we read:

“NRAs may have to signal in their reviews that they view some remedies as bridging a gap so that new entrants can easier make incremental investment but that market players cannot base their long-term business models on the basis of these remedies alone. Thus, the NRA has the ability to change the incentive properties of the regulatory framework over time but must do so in a predictable and transparent manner so that business decisions can be planned accordingly.”

It is very hard to see how NRAs can provide **incentives for climbing up the ladder without making commitments with respect to future regulation prior to market entry by newcomers.**

7. Do you agree with the proposed treatment of emerging markets? If not, please provide details.

The Document refers to the Framework Directive recital 27 that states that the market leader should not be subjected to inappropriate obligations. Early intervention should only be considered in *exceptional circumstances* (p. 69) and NRAs will therefore have to ensure that they can fully justify any form of early, ex ante intervention in an emerging market (p 70). The Document is at this general level in line with the Framework and Access Directives focus on the need to ensure investment and innovation as well as to avoid regulation of emerging markets. On the other hand

the Document states that:

"if it is the incumbent that is investing to be able to provide new services over what are non-replicable legacy network elements, then the NRA may need to consider how to grant access to new entrants to these on equivalent terms. (p. 71)"

This seems to be based on the assumption that there is no need for investments in legacy infrastructure to provide the new services, and it may reduce the incumbents incentives to invest and develop the infrastructure to enable new services.

It is, however, indisputable that most new products/services/markets are inevitably related to or dependent on existing products/network elements. However, if this means that there will be neither any forbearance from regulation nor any clear limits of what are the elements included in "legacy infrastructure" the concept of emerging market will be undermined.

Emerging markets must be distinct in terms of the services currently offered to consumers. These kinds of services will frequently be what we can call "converged services" and need input from different markets e.g. communication and content or communication and software. These complementary inputs must all be present to establish the new service. The NRF covers electronic communication networks and services and some associated services, but clearly do not cover complementary input such as content and some software services. We will emphasise the need to analyse this state of competition and cooperation before imposing remedies in emerging markets. The incumbents market power based on control over network facilities can be reduced by for instance content owners inputs in a market for online content distribution in 3G.

Telenor disagrees with the treatment of the concepts of "emerging markets" and "first mover advantages" and the attitude that these concepts primarily represent another opportunity for the SMP-operator to foreclose markets. The suggestion that first mover advantages are equivalent to SMP must be rejected. The proposed approach will not give players an incentive to take the risk to invest to explore new opportunities. If innovation is an objective to be pursued, the Document should make clear that investments in new technology or services should not be subject to ex ante regulation. As a minimum it must be stated that the benchmark regulatory option of "no regulatory remedy at all" needs to figure much more prominently in the cost-benefit analysis of remedies. The NRA should be able to demonstrate that an active regulatory remedy will deliver a long run increase in economic welfare, relative to the benchmark of no regulation in emerging markets.

One should also acknowledge that there is already a lot of wholesale regulation for the provision of existing services, which can be more than enough to ensure a level playing field.

8. Are there any special considerations which should be taken into account in designing appropriate and proportionate remedies for the markets in accession countries?

The principle of proportionality is a core principle for application of remedies under the NRF and is meant to reflect national differences/particularities also in the enlarged EU. NRAs have a legal obligation to impose proportionate remedy(ies) on SMP operators after having analysed the competition situation in the relevant markets. Therefore the definition and analysis of the national markets is where characteristics of accession countries can be reflected.

However, we would like to encourage the Commission and the ERG to assist NRAs in accession countries to ensure correct and timely implementation of the NRF (including the provisions of the old framework, given that this is a prerequisite for a proper implementation of the NRF).

Chapter 4: Matching problems and remedies

9. Do you agree with the description of problems and related remedies? If not please provide an alternative analysis.

We are sometimes left with the impression that the ERG does not follow its own principles of regulation (chapter 3) when it allocates remedies to competition problems (chapter 4).

The first principle is that **remedies should be related to the problem identified**. However, the problem may only be identified after a thorough market analysis, while the Document offers a prescription of potential competition problems and prescribes multiple remedies.

The second is that remedies should **protect consumers where replication is not considered feasible**. Telenor welcomes this suggestion.

The third principle is to **support feasible infrastructure investment**. The investment ladder theory is attractive, but to arrive at the stated effects, i.e. investment in infrastructure where feasible, the model must be accompanied by rigorous conditions, see above.

Given its too vague description in the Document, we are therefore sceptical as to the way the investment ladder theory will be implemented in practice, unless strict conditions and sunset clauses to gradually roll back the relevant regulatory obligations are put in place. Entrants should also be obliged to provide plans to show that they actually do intend to invest as their market shares grow.

We would also like to see a clarification to the somewhat confusing statement on page 64, where the ERG says that:

"Where NRAs make the assessment that replication is feasible, they will have to ensure that they promote this at the same time as supporting competition in services. (underlining is ours)."

This is confusing and contradictory given that the ERG in other places state that the ultimate goal must be that (new) entrants roll out their own infrastructure (p 62).

It is also interesting to note another statement of the ERG on page 62:

"In a dynamic innovation driven market with the constant potential for disruptive technologies emerging, it is often impossible to predict with any degree of confidence the likely direction the market may take."

We do not think this rimes with the main conclusions of the Document, namely the prescription of multiple remedies to match a number of predefined potential competition problems.

The fourth principle is **reasoned opinions**. As noted above, we think that the paragraph on reasoned opinions needs further elaboration by way of a regulatory options assessment to precede the imposition of remedies.

The fifth principle is **incentive compatible remedies**. This principle presupposes that the regulated firm believes the imposed remedy is appropriate, which is not a given unless the NRA has conducted a comprehensive cost-benefit analysis of available remedies. Incentive compatible remedies are regulation structured in a way that makes voluntary compliance outweigh the benefits of evasion. However, the discussion in the Document is really about penalties that NRAs should use to enforce compliance. As such this is a new idea that warrants further justification and discussion.

10. Do you agree that the document offers sufficient guidance concerning the approach on remedies to be taken by NRAs? If not, please highlight those areas where you would wish to see more guidance provided.

From Telenors point of view three of the principles for imposing remedies seem to be somewhat forgotten in chapter 4 of the Document:

- Ex ante remedies should only be applied when ex post competition law do not address the competition problem
- The NRA must, when imposing a remedy, demonstrate that it addresses the problem
- The least burdensome remedy should be selected

In chapter 4, each of the 27 generic competition problems are dealt with by one or several ex ante remedies. It seems however that a lot of the problems described could be solved by ex post remedies, or the SMP operator has no incentives to use its SMP because competition law forbids it. If this is the case, ex ante remedies should not be used either because there is no problem (competition law eliminates the SMP operator's incentives to use its market power) or if the problem is still there, ex post control will deal with it. The Document may thus turn into guidance on how to impose unnecessary remedies as opposed to the principle of proportionality.

Telenor would suggest that **the effect of competition law is integrated in the analysis of the each of the 27 generic competition problems**. All operators are aware that competition law forbids for example predatory pricing, and this has an impact on their incentives to follow such a strategy. Even though the question of the impact of competition law should be answered in the market analysis it seems impossible to impose remedies without a rethinking of the market analysis of the market in question.

11. Does the document provide sufficient guidance on which particular cost accounting methodology would be appropriate for those competition problems for which NRAs may consider price regulation? If not, please highlight those areas where you would wish to see more guidance provided.

The Document gives no guidance on which cost accounting methodology the NRAs should choose when calculating and setting the wholesale price, but recommend one of four developed

methodologies (p. 81). At the same time the Document is rather biased in describing the four possible methodologies. It states for example that Ramsey pricing, a method the Document states is well developed and hence a possible choice, can be regarded as practically unfeasible. To calculate costs is a very complicated matter, and it is not possible to give a clear guidance on which method to choose in a few pages. Therefore the Document should either give an unbiased description of pro and contra of the different methods or no description at all.

12. Is sufficient guidance provided in relation to mobile call termination in chapter 4. If not, please outline what issues would require further elaboration. Please express your views on the principles that should guide NRAs in dealing with new entrants and/or smaller players in mobile termination markets.

Asymmetrical termination obligations will by itself lead to a competition problem. The approach to the “price control” remedy for termination, paving the way for asymmetric obligations, indicates that the perspectives on the termination market under the NRF and the Recommendation have not been fully understood.

13. Does the document provide sufficient guidance with the text boxes on bitstream, re-selling access lines and international roaming in Ch. 4?

As noted above, we have the impression that the ERG is “jumping to conclusions” without providing the required supporting evidence to its claims. Ex ante regulation under the NRF should be based on competition law principles, which is not a mechanistic exercise and requires high evidentiary standards. For example one is surprised to see that the ERG states on page 84, despite the preceding 5 principles described for imposing remedies that:

“as long as market power at the wholesale level exist, however, the setting of a cost oriented access price appears to be the only possibility to open the retail market to competitors and eliminate the incumbent's excess profits”. (underlining is ours).

Another example where we would call for more solid underpinnings behind arguments are the effects of bitstream access: On page 64, the ERG claims that

“there is general agreement that the existence of a bitstream product in broadband is an important bridging remedy that should enable the new entrants to compete vigorously until they are in a position to roll-out more of their own infrastructure (which must be the ultimate goal).”

As regards wholesale line rental, there is even less evidence that this access will provide incentives for the new entrant to climb the investment ladder.

We would also call upon the ERG to provide more solid arguments before dismissing certain remedies as inadequate.

14. Do you agree that the principles developed also apply in cases of joint dominance? Do you have observations regarding specific remedies that may be appropriate in situations of joint dominance?

No comment.

15. Do you think that the discussion in Chapter 4 will assist NRAs in achieving a consistent application of the framework? In particular, is it sufficient to focus on harmonisation of outcomes or should there also be harmonisation of regulatory approaches?

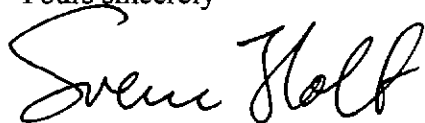
The Document does not address how to approach markets where there are differences in the level (and prospects) of competition in different regions of Europe.

Other comments

16. Please provide a concise description of any other issues that you believe the document should address or a critique of any other aspects of the document that you consider relevant. In doing so please refer to actual or potential problems encountered in electronic communications markets, as well as to relevant case law and other precedents.

No comment.

Yours sincerely



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