

The Communications Framework Directive

Paper for Croatian Competition Agency

This paper summarises the new legal framework for the regulation of electronic communications services, discusses the role of market definition (and the eighteen markets designated as potentially susceptible to ex-ante regulation) and the designation of Significant Market Power (SMP) in these markets, and highlights recent experience of Member States in implementing the new Framework.

The Framework

The legal framework for the regulation of electronic communications services¹ in the European Union came into force in July 2003. The full framework consists of six Directives and a Decision, including the:

- 1) Framework Directive: outlining the general principles, objectives and procedures;
- 2) Authorisation Directive: replacing individual licences by general authorisations to provide communications services;
- 3) Access and Interconnection Directive: setting out rules for a multi-carrier marketplace, ensuring access to networks & services, interoperability, and so on;
- 4) Universal Service Directive: guaranteeing basic rights for consumers and minimum levels of availability and affordability;
- 5) e-Privacy or Data Protection: covering protection of privacy and personal data communicated over public networks;
- 6) Directive on Competition: consolidating previous liberalisation Directives; and the
- 7) Radio Spectrum Decision: setting the principles and coordination procedures essential for the development of a coherent EU radio spectrum policy.

The aim of the new framework was to prepare for a scaling back of regulation, with an increased reliance on general competition law. It places an emphasis on competition law principles in the process of delineating markets, in establishing which firms should be subject to regulatory obligations through the modeling of significant market power (SMP), and in the explicit requirement that markets should only be susceptible to ex-ante regulation if reliance on competition law is likely to be insufficient to address problems of ineffective competition.

The Commission considered that in addition to supporting the roll-back of regulation, a closer alignment of regulatory policy with the principles of competition law ensures that the regulatory regime would keep up with technological developments. When the previous framework was put in place, telecommunications was mainly a straightforward voice business conducted over a Public Switched Telephony Network (PSTN). However, the deployment of cable networks, the development of wireless technologies, and the general process of upgrading the PSTN has brought about new services such as broadband, data and video that can not only be bundled with voice services but

¹ 2002/21/EC of the European Parliament and of the Council.

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could also be delivered across a variety of platforms. The Commission noted that one of the core objectives of the new framework was to address any possible shortfall in the regulatory regime by bringing into its scope all e-communication networks and service.

Notwithstanding the overall de-regulatory move, ex-ante regulation was still considered essential for as long as former monopolists had significant market power, and thus for ensuring there was a level playing field for new entrants in the market. The Commission also wanted to ensure consistency of analysis and approach across Member States in assessing the competitive landscapes within these markets and when putting in place any necessary remedies.

The markets

Although electronic communications envelops a much wider range of services than pure telecommunications, the Commission agreed that the framework should not create undue regulatory burdens in new markets but instead should extend benefits of competition to them, and that NRAs should identify the boundaries of the markets where competitive blockages might exist and which may require regulation.

The Commission identified eighteen product and service markets where, in its view, competitive conditions were likely to be imperfect² and highlighted that only in exceptional cases could NRAs consider a market outside these. For the purposes of defining the precise boundaries (specific to a Member State) the Commission aligned the framework with the general concepts of competition law as applied to normally functioning markets. Market definition under such an approach relies on establishing the constraints, both from a demand and a supply perspective³, facing providers in a market were they to attempt to effect an increase in price (competition authorities have generally adopt a SNIPP test - a Small but Significant Non-transitory Increase in Price - to determine which products and services might fall within a market)⁴.

It is important to note, however, that market boundaries as well as competitive conditions within markets can change relatively rapidly, and the Commission has

² At the Retail level: 1. Access to the public telephone network at a fixed location for residential customers; 2. Access to the public telephone network at a fixed location for non-residential customers; 3. Publicly available local and/or national telephone services provided at a fixed location for residential customers; 4. Publicly available international telephone services provided at a fixed location for residential customers; 5. Publicly available local and/or national telephone services provided at a fixed location for non-residential customers; 6. Publicly available international telephone services provided at a fixed location for non-residential customers; 7. The minimum set of leased lines (which comprises the specified types of leased lines up to and including 2Mb/sec as referenced in Article 18 and Annex VII of the Universal Service Directive). Whilst at the wholesale level: 8. Call origination on the public telephone network provided at a fixed location; 9. Call termination on individual public telephone networks provided at a fixed location; 10. Transit services in the fixed public telephone network; 11. Wholesale unbundled access (including shared access) to metallic loops and sub-loops for the purpose of providing broadband and voice services; 12. Wholesale broadband access; 13. Wholesale terminating segments of leased lines; 14. Wholesale trunk segments of leased lines; 15. Access and call origination on public mobile telephone networks, referred to (separately) in Annex I(2) of the Framework; 16. Voice call termination on individual mobile networks; 17. The wholesale national market for international roaming on public mobile networks; 18. Broadcasting transmission services, to deliver broadcast content to end users. *Commission Recommendation of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services (2003/311/EC).*

³ Demand side substitution arises when customers switch to purchasing alternative products or services, and supply side substitution when firms currently providing other products would seek to supply the service.

⁴ Previous telecommunications regulation relied on pre-defined markets (and prescribed market share thresholds of 25%).

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already noted that it expects to revise its analysis for developing the list given developments in the past two years. The Commission also expects that the list should become shorter over time rather than longer. Second, country specific peculiarities around how technologies have developed may need to be considered. For example, there is an asymmetry between Member States where certain technologies have leap-frogged others (such as in a number of the new Eastern European States with fixed line services stalling at much lower levels than those across Western Europe and mobile services being adopted instead). Third, core interlinkages amongst the eighteen markets should be considered such as where services are bundled together or providers cross over the various markets.

Market assessments and SMP

The demarcation of market boundaries on the basis of competition law principles does not imply all eighteen markets require ex-ante regulation, only that they are susceptible to it. The framework notes that the markets that are susceptible to ex-ante regulation need to meet three additional tests before they can actually be regulated. These tests include proving:

- a presence of high and non-transitory barriers to entry,
- that the market does not naturally tend towards effective competition, and
- that the relative efficiency of competition law in regulating the market by itself is unclear.

The tests are similar to those applied under competition law when conducting a market assessment and when establishing dominance of the firm involved, or the existence of SMP. The Commission supplemented the framework with guidelines on assessing SMP. Such an assessment is based on a consideration not only of the share of the player in the market involved but also on whether or not there are countervailing factors that would prevent it from abusing its position in the market (in itself, even the highest of market shares is insufficient to confer dominance on a provider). Such countervailing factors might include say buyer power within the market or low barriers to entry meaning that the firm could not sustain increases in price without leading to entry in the market. The framework tasks NRAs with determining whether or not any operators in the relevant electronic communications markets might hold SMP giving them unfair advantages vis-à-vis new market entrants. The framework notes that where an NRA finds an operator with such SMP in one of the markets, it must propose appropriate measures to tackle the problem and where an NRA finds a market to be competitive, it should withdraw any existing regulations.

Applying the first test is straight forward as non-transitory barriers to entry are likely to be a feature of a number of the electronic communications markets most especially given the high technical know-how needed and the cost associated with the technology. NRAs would have to determine the scale of these costs and what impact they were likely to have on entry. Such entry may be from either existing players in other markets or from new players establishing themselves for the first time. To the extent that the entry costs for the former may be lower if they have already incurred a level of basic infrastructure, then the market entry costs could potentially also be lower.

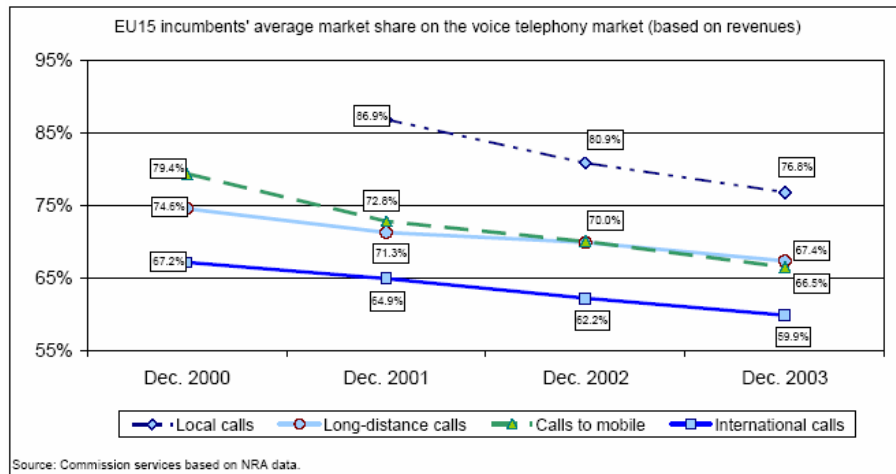
The second test involves a forward looking assessment of whether or not the market tends towards effective competition. It is apparent that there are some activities

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involved in the provision of e-communication services that are characterised by significant economies of scale (or scope), meaning that the infrastructure parts of the markets are unlikely to ever become competitive i.e. exhibiting characteristics of a natural monopoly. In particular, this has proved to be the case for the fixed line "access" market, more commonly known as the "local loop". Despite liberalisation of telecommunications market across Europe, incumbent providers have not seen a significant erosion of market shares, as seen in the figure below which sets out the EU-15 average incumbent market shares in the voice telephony market.



The European Commission's 10th implementation report also noted that incumbent shares of the market across the new Member States remains extremely high, notably in the local call segment with shares over 90% in many of the cases.

Unbundling of the local loops has, on the other hand, been more successful. The 10th implementation report also noted that:

"A noteworthy trend has been the increase of 110% in unbundled local loops (fully unbundled and shared lines) from 1.8 m in July 2003 to more than 3.8 m in the EU 15 in July 2004. Two factors underlie these results: decisive regulatory action, in particular in terms of pricing, has yielded positive results, and in certain countries, new entrants are beginning to increase their investment in infrastructure."

The third and final test involves considering the effectiveness of competition law in dealing with any of the previously identified competition concerns. As such, the Commission views the framework, in part at least, as a temporary phenomenon required to make the transition from the formerly monopolistic telecommunications industry to a fully functioning market system regulated by competition law. This test looks at whether or not there are other features of the market that mean competition law could be sufficient to regulate the market on the basis of its ex-post case-by-case assessments (one particular example here is that of the existence of significant buyer power in the market). The test also considers the relative effectiveness of competition law *vis-à-vis regulatory policy* in regulating the market i.e. assessing the possible future conduct of firms with SMP that might need to be contained by an authority, followed by an assessment of whether competition law or regulatory policy (e.g. with detailed licence conditions or putting in place industry level codes of conduct) would be more appropriate.

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It is also worth noting that regulators are subject to statutory duties and objectives over and beyond those of a competition authority - competition law is premised on the need ex-post to protect markets from abuse of a dominant position or concerted practices that could significantly harm the competitive process. Competition authorities are not generally charged with pro-actively seeking to promote competition or to impose structural remedies within markets where they feel competition has not become sufficiently established. Moreover, the role of competition authorities is to protect the "competitive process", as opposed to specific players or the status quo within a market. Regulators of the classic utilities, on the other hand, are charged with pro-actively promoting competition in markets where the legacy of state-run monopolies has left imperfect competitive conditions. In practice, regulators should work to the aim of bringing about effective competition and then to leave general competition law to regulate the market.

Implementation by Member States of the Directives

NRAs must follow the Article 7 procedure of the Regulatory Framework, in which a draft regulatory measure of one country which affects trade between Member States need to be submitted for consultation to the Commission and to NRAs of other Member States. The Commission ultimately has power to veto a notified measure if it has serious concerns as to its compatibility with Community law. Under these procedures, the Commission has now received over 100 notifications from Member States. The majority of these have remained unchallenged by the Commission with a few exceptions discussed further below.

In terms of market definition, notifications received so far cover all but one of the markets (the wholesale national market for international roaming on public mobile networks – market 17). NRAs have not generally deviated from the eighteen markets defined by the Commission, which has yet to challenge a notification purely on market definition. Only two of the markets have been subject to different approaches: the wholesale broadband access market (market 12) and the market for broadcasting transmission services (market 18). In the case of wholesale broadband access, four NRAs (UK, Finland, Sweden and Ireland) included broadband access via cable within the market⁵. It was generally considered that there was an indirect pricing constraint exercised by cable-based services at the retail level which suggested that the market should be extended to include cable. In the case of broadcasting transmission services, three NRAs (Austria, Finland and Ireland)⁶ notified the market with all three choosing to split the market by platform. In all of the cases the NRAs considered that cable transmission did not require ex-ante regulation, principally due to must-carry obligations and the limited negotiating power of cable operators. However, the Austrian and Finnish NRAs also excluded services via satellite from their market definition, principally because the providers were not covered by their jurisdictions. Separately, a number of NRAs sought clarification on the treatment of termination of voice calls on 3G networks. On this, the Commission was of the view that it was not necessarily a newly emerging market but one that should be considered as part of the market for voice call termination on individual mobile networks.

⁵ Cf. cases UK/2003/00032-34, FI/2002004/0062, SE/2004/0083, IE/2004/93.

⁶ Cf. cases AT/2003/0081, IE/2004/0042 and FI/2004/0076.



Looking at the assessment of SMP, the Commission has so far used its veto on four occasions - twice against measures proposed by the Finnish regulator, FICORA, once against the Austrian regulator, TTK, and against the German regulator, RegTP⁷. The first veto related to the markets for publicly available international telephone services provided at a fixed location for residential and non-residential customers in Finland. The Commission believed that there was insufficient evidence to back FICORA's view that there were no SMP operators in either of the markets. In particular, FICORA failed to provide full market share information or data related to price levels in the market or to any other factors that might have been relevant for the assessment of market power (e.g. profitability and cost structures). In the second Finnish veto decision, the Commission did not agree with FICORA's view that the mobile operator with the highest market share had SMP in the market for access and call origination on public mobile telephone networks. Again, the Commission felt there was insufficient evidence to support FICORA's findings. In the third veto decision, the Commission challenged the proposal of TTK which sought to cease regulating wholesale transit services in the fixed public telephone network in Austria. The approach adopted by TTK in this case was to extend the market definition to include operators which no longer demand transit services, resulting in the subsequent market share analysis yielding a much lower share for Telekom Austria (TA). In this case, the Commission noted that there was little evidence to suggest that operators could promptly shift to self-provision and that without extending the market TA's market share was closer to 90%. The Commission did, however, accept that operators which no longer demand transit services could present potential competition, but considered that this was more relevant for the subsequent SMP assessment rather than for market definition purposes.

Finally, in the case against RegTP, the Commission objected to the regulator's finding of an absence of SMP of alternative network operators (ANOs) in the market for call termination on individual public telephone networks provided at a fixed location in Germany. In this case RegTP argued that, despite the 100% market share of the 53 ANOs on their individual networks, their behaviour was constrained by the buyer power of Deutsche Telekom AG (DTAG). The Commission considered that any buyer power of DTAG would be lost insofar as their call termination rates are currently regulated and that it could not realistically stop purchasing termination services thus being deprived of any buyer power it might have had.

Tasneem Azad, DotEcon Ltd.

March 2006.

⁷ Cf. cases DE/2005/0144, AT/2004/0090, FI/2004/0082, FI/2003/0024 and FI/2003/0027.

