

Response to the public consultation

ERG Draft Common Position (CP) on Geographic Aspects of Market analysis

1. Introduction and executive summary:

While Fastweb understands that the possibility of geographical analysis of competition is foreseen in current framework directives, it believes that segmentation of the market and/or of remedies needs to be very carefully assessed by NRAs and only be envisaged in very specific circumstances when *irreversible effective* competition in the market can *unambiguously* be demonstrated and when adverse effects in adjacent markets (markets to which a monopolistic firm can leverage market power¹) can be excluded.

The primary objective of regulators, as also foreseen in the current regulatory framework when conducting a market analysis, is, and should remain, the *promotion of competition* as well as the *protection of consumer*. Therefore, it is of utmost importance, that before envisaging a differentiation of remedies based on geographic segmentation, *consumer gains from deregulation* (or lighter regulation) in certain areas must be *carefully weighted against consumer losses in other areas and/or markets* and the short/medium/long term effect on the level of competition on the market as a result of the modification of remedies.

In fact, geographic segmentation is a highly technical tool and, to date (see below), it has been used in very specific circumstances in certain markets (i.e. not for the access markets but for the “core” network markets). It should also be noted that if regulation is too prescriptive there is a substantial risk to end up with many fragmented national telecoms markets with difficulties enforcing the different remedies and different prices for competitive (urban?) and non competitive (rural?) areas.

In general, Fastweb believes that geographic segmentation should not be applied due to its too limited regulatory flexibility and the unstable boundaries which characterize telecommunications markets. Therefore, Fastweb believes that geographic segmentation of remedies should be evaluated only in exceptional circumstances as both the probability for regulatory errors and regulatory costs for both regulators and operators are high and the damages to competition may be irreversible.

So, as a preliminary general statement, Geographic Segmentation needs to carefully evaluated in terms of overall impact on the market and cost/benefit analysis.

A few fundamental questions need to be asked:

- If a certain geographic area is considered to be competitive, has regulation played a role in the development of competition? If the answer is yes, then NRAs should carefully consider if the removal of remedies could negatively impact the degree of competition reached and actually reverse the competitive dynamics? The assessment

¹ Rey, Seabright, Tirole: “The activities of a monopoly firm in adjacent competitive markets”, 2001

of the level of competition in a certain geographic area/market must necessarily be linked to an assessment or “*irreversibility*” of competition.

- In case of removal of wholesale remedies such as WBA/leased lines on the incumbent operator, is there a developed alternative offer of such services by other operators in the same area? For example, the presence of 3-4 operators in a ULL site does not by itself mean that there is the possibility by other operators to have access to wholesale services in that specific site because:
 - the ULL operators present in a single site may not have sufficient co-location resources to offer wholesale services (in many cases co-location space is limited so alternative operators may need to reserve it for their own retail customers)
 - even if some level of wholesale services were available by other operators in a specific area, would it be feasible for a retail operator to buy a “patchwork” of wholesale services by different providers in different areas. Is this practically feasible and what would the impact be in terms of increased transaction costs?
- Is the objective of regulation to define the maximum number of competitors in a specific area or should the objective of NRAs and regulation be the setting of conditions for fair competition and removal of entry barriers rather than the definition of the number of competitors allowed on the market?
 - For example, if remedies on the supply of WBA were to be removed on the basis of the presence of X number of ULL operators in a certain area (with X defined by the NRA), the practical consequence will be that the X+1 operator will not be able to enter the market for technical reasons (ie. limited resources for additional ULL operator on the same site) or economic reasons (the operator may not have the economies of scale to choose ULL as a wholesale solution from the beginning, so without the presence of other remedies such as WBA would be forced to choose not to enter the market at all. Whereas, in case of availability of WBA he may enter the market and then move to ULL after having reached some minimum economies of scale).
- Geographic segmentation of remedies creates a serious risk of cross-subsidies by the incumbent between competitive and non competitive areas and have, as an outcome, the reduction of competition in the “competitive areas”. Without ex-ante regulation which prevents discriminatory practices and cross-subsidies, the incumbent may have the incentive of adopting price/margin squeeze practices in competitive areas (which may be cross-subsidized by revenues from non competitive areas), thereby distorting competition and ultimately excluding existing competitors from the market. In this case, then there would be the paradox that the geographic segmentation of markets justified by the presence of competition would lead in the medium/long term to a reduction of competition in the same geographic market.
- Geographic segmentation in the presence of operators who have still not completed their network roll-out/coverage may have the adverse effect of discouraging further investments and therefore limiting the national scope of operators and weakening competition by encouraging the development only of metropolitan/regional players rather than allowing also the creation of nationwide competitors.
- Geographic segmentation may also exacerbate the digital divide since the incumbent may be discouraged from investing in regulated rural areas and concentrate investment and commercial efforts in metropolitan de-regulated areas, causing competitors to do the same with the final result to increase the digital divide.

Regulation typically enables competition in some markets. Such regulation typically produces results in terms of higher output and lower prices. Observing a higher

degree of competition in regulated industries does not necessarily mean that regulation should be removed, it could mean the contrary: that the approach so far adopted is the right way to cope with the specific market and to challenge incumbent's dominant position, and therefore calls for an even stronger regulatory approach.

2. Scope

While the possibility for geographical market definition is defined in the SMP Guidelines and the possibility to geographically differentiate remedies within a broader geographic market is outlined in the ERG "Remedies document", applications of a geographical segmentation were unobserved until recently. A segmented geographical market has yet only been defined in the UK (2007 WBA and 2008 leased lines (currently in consultation)). Geographically differentiated remedies have been applied in the UK (2003 leased lines) as well as in Austria (2008 WBA, 2006 leased lines) and France (2005 national fixed calls for residential customers), but with very different approaches and various degrees of differentiation of remedies. This limited sample does not allow the definition of general guidelines for the future and the difference of approach followed by NRAs in assessing each case increases the level of disharmonization between member states.

3. Target markets

We believe that it is useful to provide some initial considerations with regards to the markets which may be considered as possible candidates for geographical differentiation in order to be able to follow not only abstract but also practical reasoning.

3.1 Mobile markets:

In the mobile market coverage of all operators is generally national or very rapidly approaching national scale. Geographical segmentation of such markets can therefore be excluded following the preliminary analysis criteria outlined by the CP (page 10). This consideration nevertheless imposes a reflection due to the growing convergence between fixed and mobile communications services and level of vertical integration of the majority of incumbent operators.

3.2 Fixed markets:

In the fixed market geographical segmentation could in theory apply most prominently to key wholesale markets excluding ULL (essentially **Wholesale Broadband Access (WBA) and Leased Lines terminating segment (LL)**). The exclusion of ULL is due to the fact that in most European countries ULL is the primary remedy for allowing effective competition and the product on which all other wholesale remedies are based.

Other markets which are less likely candidates are transit services, trunk segments of leased lines and in general retail markets for access and voice communication services (both business and residential).

3.2.1 Wholesale Access Markets

Fastweb knows from extensive own experience that the replication of access infrastructure involves enormous fixed costs and is convinced that the access market cannot support more than 1-2 access operators. The market for wholesale (physical) network

infrastructure access at a fixed location should therefore not be considered a possible candidate for geographic segmentation.

Evidence on this view is supported by all recently published studies including those carried out by Analysys for OPTA, Comreg, and BIPT as well as studies conducted by the OECD and WIK. They strongly suggest that the economics for upgraded VDSL or FTTH networks will be even more affected by scale effects, and hence unlikely to be economically addressable by multiple network builders/operators. Thus, except in exceptional circumstances, we can rationally expect that there will continue to be variously one or two parallel networks for high speed broadband (cable + incumbent or incumbent + FTTH challenger) with little variation in the competitive intensity between regions.

WLL or Wimax do not appear to be a relevant competitive element in the broadband market for their too limited up/download speeds. There is currently no evidence that this scenario will not change in the foreseeable future. WLL/Wimax may offer some limited form of competition in a small sub-segment of the market which requires only very limited up/download speeds and quality of service, but cannot be considered a viable substitute or alternative to the fixed access network (either copper, cable or fiber).

Altnets generally compete on the territory with a mix of wholesale products according to the type of customer served, stage of development of infrastructure roll-out and economics. Removing wholesale products in part of the market will inevitably have a negative impact on the ability of operators to effectively compete. We believe that the removal of wholesale products should not take place following market segmentation but rather should be based on the evaluation that the product is no longer requested by the market.

For this reason, we believe that the statements on page 7 should be reviewed. In particular, we would also like to point out that the ERG Opinion on NGA confirmed that NGA may increase the scope for scale economies potentially leading to an enduring economic bottleneck.

3.2.2 Retail Markets

In the majority of Member States, retail markets tend in general to be more competitive than the wholesale markets, due to the fact that regulation has allowed other operators to enter the market and compete with the incumbent thanks to the availability of a wide range of wholesale service and ex-ante rules to guarantee access, non discrimination, cost orientation, etc. Nevertheless, the fact still remains that in many Member States, incumbent operators still retain a very high level of market share in basically all the markets, including the retail markets.

Retail markets tend in general to be considered national due to the fact that retail offers are usually nation-wide in scope, brand, advertising, pricing. The main alternative competitive operators also generally compete at a national level (with the exception of some form of operators with a city/regional focus or cable operators who have a local coverage). What may change is the type of wholesale service used by altnets to compete at national level, meaning that in some areas they may use ULL/proprietary infrastructure, in others WBA and in others CPS/WLR solutions. The mix between the different solutions is obviously not stable since in most cases altnets are still completing the network roll-out.

Fastweb believes that retail markets should remain national in scope, both because of the characteristics of these markets and homogeneity of demand patterns and because of the risks that may derive from a medication of remedies in specific areas, which can be summarized as follows:

- Risk of bundling between regulated/non regulated products on the retail market which NRAs would not be able to address in a timely manner without appropriate remedies. If price controls, non discrimination obligations, cost orientation and replicability tests were removed from some retail markets, what would prevent the incumbent operator from theoretically respecting “regulatory obligations” in regulated market but then completely bypassing them by offering uncompetitive bundles with other non regulated products.
- On-net discrimination: in the voice markets, if an operator has a significant market share with respect to the other operators, the risk deriving from possible deregulation may lead to on-net/off-net discrimination on calls which would give the incumbent operator an unfair and not replicable advantage compared to other operators. A similar phenomenon can be seen in the mobile market, in which in any case operators have a more distributed market share. In the fixed market, unfortunately in many cases, the incumbent is the only operator to have a market share above 50% and all other operators have market shares below 10% each. It is obvious that in this market situation, allowing the incumbent to take advantage of the “club effect” by being able to discriminate pricing between on-net and off-net traffic, would distort competition on the market and eliminate competitors.

4. Impact analysis

4.1 Effect on retail pricing

Geographically segmenting wholesale markets or remedies may lead to geographic de-averaging of prices which would tend to result in higher retail prices being charged in non competitive (probably rural) areas. This may conflict with NRA’s and national objectives to promote consumer welfare including fair access to services for those living in rural areas, also conflicting with the regulators combined objectives of competition and consumer welfare. The guidance should require NRAs to carefully weight the implications of any segmentation on consumer protection and universal service objectives.

4.2. Cross-subsidies and leverage of market power by SMP operators in other markets

Sub-national deregulation may lead to leverage of market power from non-competitive areas to competitive areas, thereby reducing retail prices in competitive areas and increasing them in non-competitive areas. This would lead to unfair cross-subsidies which may have the effect of allowing incumbent operators to adopt selective pricing /price or margin strategies in competitive areas which may ultimately cause competitors to exit the market. These strategies may be sustained by the incumbent due to the dominant position it has in other adjacent market. Therefore, there is a high risk that the modification/removal of remedies in a market which is deemed as competitive, may have the paradoxical effect in the medium/long term to make the market less competitive and restore SMP in that specific market.

4.3 Impact on competition

Regulators have to carefully consider the impact of deregulation on closely linked markets, in particular adjacent markets (other geographical or product/service markets covered by the service portfolio of the incumbent). In particular, effects from deregulation from the wholesale level on the retail level have to be considered.

While regulators seldom differentiate between the consumer and the business retail market, this difference must absolutely be taken into account at this stage. The ERG CP acknowledges the fundamental differences of these markets in the case of geographical differentiation. On page 15 the CP states: *“In particular an NRA may consider if the evidence suggests separate wholesale markets for ISPs providing multi-site connectivity services to business users from those providing services to residential users”*.

Business customers generally consume services at several fixed locations at once. Such locations are typically both urban and remote. Retail provision of business products would therefore necessarily be nationwide in scope. A geographic assessment of competitive variations would not be relevant in this case except if there was reason to believe that intense competitive conditions allowed nationwide provision by business service providers on the basis of voluntarily provided wholesale products suited to the business market or if all major business suppliers had extensive network coverage equivalent to those of the consumer providers being considered.

This consideration clearly raises questions regarding the respective wholesale markets. If wholesale markets are deregulated in a specific geographic area but retail markets are national in practice, this could lead to considerable distortions. In particular, *an operator providing services on own infrastructure in urban areas may not only face higher wholesale prices in other areas after sub-national deregulation, but may also have the risk of not being able to have access to any wholesale product in some areas if the obligation to provide specific wholesale services (such as WLR and/or WBA) were removed. In such a case deregulation would not only increase the overall altnet cost for provision of business services but also severely limit the ability for altnets to compete in the business market.* As most retail business markets are considered to be highly competitive for reasons of buyer power, such a (relative) raise in altnet costs may drive entrants out of the business market.

The importance of these considerations is recognized by the European Commission response to the UK WBA case (**UK/2007/0733**). The European Commission highlights: “the need for Ofcom to closely monitor the overall level of wholesale competition and the provision of wholesale broadband access services in the UK to ensure **that both business** and residential users are adequately protected by effective wholesale competition over the timeframe of its review.”

It must under any circumstance be avoided that altnet costs are raised through a change in regulation (or via deregulation). Altnets, in general and in particular in the business services markets, have to cope with significantly lower profit rates with respect to the incumbent operators. Deregulation in urban areas and the consequent greater flexibility by the incumbent to adopt anti-competitive practices which are now prevented in many cases via ex-ante regulation, could further limit altnets' profit margins and drive some of them out of the market. In any case, there would be a **considerable increase of the perceived**

regulatory risk in the market which may lead to substantive reduction in investment levels.

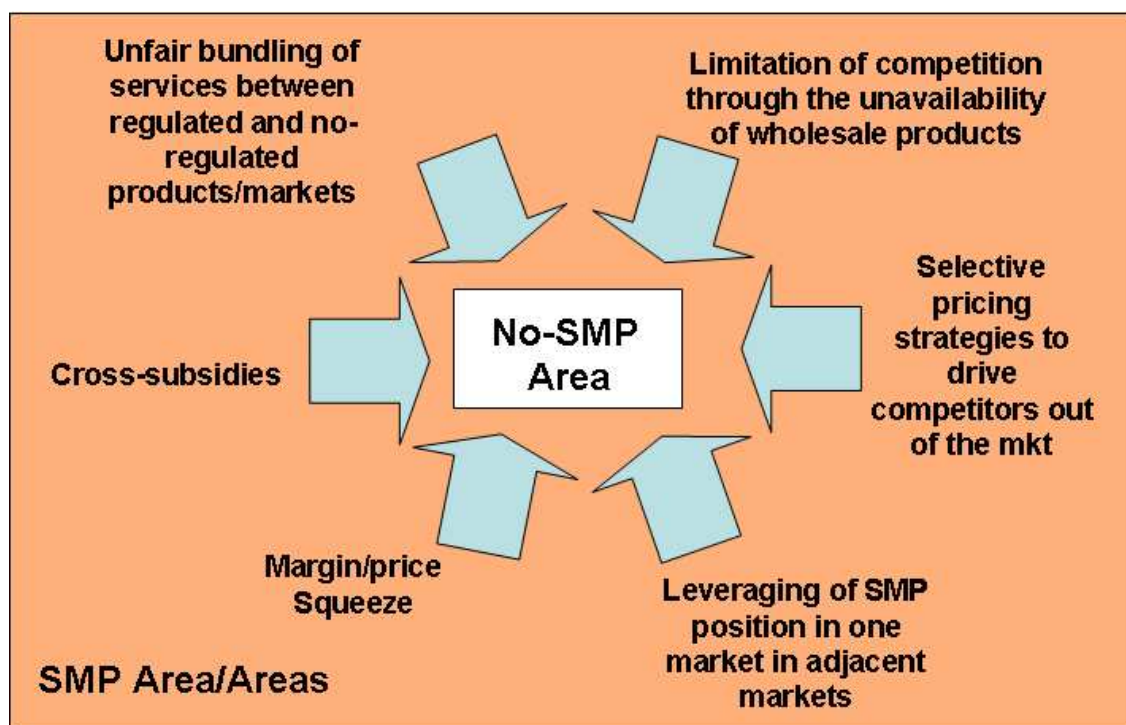


Figure 1: The risks of sub-national market segmentation and deregulation

Request 1: ERG should clearly state that NRAs should assess carefully the impact of deregulation on/from adjacent markets, including at least all other markets covered by the service portfolio of the incumbent/incumbents.

Request 2: ERG should clearly state that if NRAs identify significant adjacent market impacts and decide still to deregulate, measures must be taken in order to realign the regulatory risks for national altnet players. In particular, when removing deregulation in urban areas, NRA's must in compensation tighten price regulation in rural areas to prevent abuse and cross-subsidy.

5. Factors to be analysed by NRAs in evaluating the case for sub-national market segmentation and/or differentiation of remedies

Fastweb generally agrees with the criteria put forward to determine competitive conditions. As will be pointed out in detail, it believes however that such an analysis may turn out to superficial results and may also be subject to large and high-impact errors. Considering also the high costs of geographic segmentation (definition and remedies), segmentation should be confined to very exceptional circumstances (as outlined below) and that, if applied, a fully fledged SMP analysis of micro-units should be conducted in the market definition stage.

5.1 Is the level of competition reached irreversible?

If a certain geographic area is considered to be competitive, has regulation played a role in the development of competition? If the answer is yes, then NRAs should carefully consider if the removal of remedies could negatively impact the degree of competition reached and actually reverse the competitive dynamics. The assessment of the level of competition in a certain geographic area/market must necessarily be linked to an assessment or “**irreversibility**” of competition. By “**irreversibility**” we mean that the removal of regulatory constraints does not give room for the incumbent to increase or maintain its dominant position *in all* the relevant markets served by incumbent (now and in the period under review). In other words, deregulation is efficient when we expect that it has no impact on both competitors and incumbent strategies such as to weaken competition ex-post.

If competition has developed thanks to regulatory obligation in certain areas, it *could be that removing obligations could empower the incumbent to reduce competition where it existed*. If, on the other hand, competition has developed notwithstanding regulatory remedies, those remedies should be removed not because of competition but because they were ineffective and probably unnecessary from the beginning.

5.2 Have altnets reached target coverage of market?

Even though infrastructure competition has increased since market liberalisation 10 years ago, altnet coverage is in all European Countries far from the level of the incumbents coverage but growing at fast pace.

The markets we are concerned with are characterized by minimum efficient scale requirements, network effects, massive irreversible investments, reputational concerns. In these markets rational entry is not achieved at nationwide level with large scale from the beginning, but rather necessarily follows a ‘*splintering*’ strategy according to which small scale targeted entry is only the first step of a wider strategy of successive investments in neighbouring areas finalized at progressively reaching a nationwide dimension. Of course, splintering implies a sort of ‘*spatial ladder of investments*’ for which entry occurs generally first in metropolitan areas, according to the density distribution and/or type of customers and then it explodes in other areas, when the scale reached is such to cover common costs and to finance new investments. In this respect, dishomogeneity is only a short term picture of an ‘infant market’ rather than the structural and constant feature of a mature, competitive market.

Fastweb’s network for example is quickly growing and has covered about 50% of population (ULL and FTTH) after only 9 years, while the other 50% is covered via other wholesale services such as WLR and WBA (*bitstream*). It is therefore clear that the current situation is far from an initial situation with the incumbent defining a national competitive situation but in the next few years will be approaching a new equilibrium in which coverage of the incumbent and altnets (or at least the sum of altnets) should be more similar and covering again the whole national territory. Interfering with this process may lead to the elimination of competitive incentives and to a reversal of the current situation.

In practice NRAs have to ask themselves if it is their objective to define the maximum number of competitors in a specific area? For example, if remedies on the supply of WBA are removed on the basis of the presence of a number X of ULL operators in a certain area (with X defined by the NRA), the practical consequence will be that an additional operator may not be able to enter the retail market for various reasons (see 5.5 Infrastructure Versus Services market in affected markets). So without the presence of

other remedies such as WBA retail altnets would be forced to choose not to enter the market at all. Whereas, in case of availability of WBA they may enter the market and then move to ULL after having reached some minimum economies of scale.

5.3 Is the market really 100% contendible or are there limitations to competition?

Another issue which should be carefully analysed is if the current competitive conditions allow for **contendibility of 100% of the market**. NRAs may be tempted to assume for example that the presence of 4-5 ULL competitors in a specific area may be a proxy for assuming that the market is fully competitive.

But this may not be the case. In fact, in cases where there are limitations in co-location spaces in some ULL sites (which actually has a higher degree of probability of happening in competitive metropolitan areas which may be considered as candidates for geographic segmentation), the possibility of alternative operators to compete with the incumbent is limited. For example, in case of limitations of co-location space in an MDF site covering 20,000 lines so that there is only available space for 4 operators each with a 2,000 lines capacity, it means that the maximum contendible market will be limited to 8,000 lines (or 40% of the market).

So in this case, even though in theory the market could be seen as competitive due to the presence of 5 operators (incumbent + 4 altnets via ULL), it is clear that in practice it is not so. Deregulating this market removing alternative wholesale remedies such as WLR or WBA would be a mistake.

5.4 Are there ongoing changes in the market which may affect the competitive landscape?

5.4.1. The evolution vs NGN networks

Another issue to carefully consider and address is that the current competitive framework is based on existing remedies and available wholesale services offered by the current infrastructure of the incumbent operator (so mainly via ULL, WBA and WLR services which utilize the copper lines of the incumbent).

The current debate on the development of NGNs may change this landscape since several incumbents have announced that they are planning changes to their current architecture which may seriously affect current sites for ULL.

If an MDF site is removed or VDSL/FTTH technologies deployed by the incumbent in an area that has been considered competitive (due to the presence of ULL operators) with the consequence for example that there is no obligation by the incumbent to offer WBA services, then we would have the paradox that the incumbent would have even more incentives to wipe out competition by removing the MDF site for ULL, since in that case no other means would be available for operators to compete.

Competition is taking place among operators which have different technological profiles. Technology matters: for example in the case of Fastweb. In the same local areas Fastweb may offer FTTH or ADSL services through wholesale access from incumbent. It could be that developing FTTH could be easier and faster in some urban areas than in other, due to timing and costs of civil infrastructure. The possibility for Fastweb to offer ADSL services while developing its own optic fibre network is one crucial way to challenge incumbent's dominant position by attracting customers earlier. Here access to incumbent network is an

‘accelerating device’ towards full competition. And the speed of the process depends on the existence of regulatory remedies on incumbents in those areas.

This issue is taken into consideration in the CP document but we believe that NRAs should take particular care in evaluating the opportunity of geographical segmentation in this particular phase of transition versus new network infrastructure and technologies which will have an impact on the competitive landscape both on retail and on wholesale markets.

5.4.2. The effect of fixed-mobile convergence

Another aspect that affects the debate on the need for geographical market segmentation and that needs to be seriously considered regards the impact on the definition of markets and competitive conditions due to platform convergence (with particular emphasis on fixed-mobile convergence). The assumption that this convergence will only take place in the long term is not correct.

Fastweb is convinced that platform convergence between fixed and mobile services is a **current** phenomenon shaping competition and is affecting the definition of markets since it forces inevitably local competition to become nationwide.

Thus fixed-mobile convergence has a countervailing effect on geographical market segmentation and dishomogeneity.

Request 3: ERG should clearly state that NRAs have to demonstrate the irreversibility of competition before proceeding with deregulation and the contendibility of 100% of the markets by altnets.

Request 4: ERG should also advise NRAs to avoid implementation of geographical differentiation of markets/remedies in cases of uncertainties over the evolution of competition due to implementation of NGA and convergence phenomena which may have a significant impact on competitive landscape both in retail and wholesale markets.

6. Criteria for the definition of geographical segmentation

As already stated above, Fastweb believes that there is a high risk of deregulating non competitive areas. The proposed SMP analysis of the small initial units chosen in the detailed analysis is arbitrary and *does not ensure homogeneity of competitive conditions*. As the CP as well as European Commission (on the UK WBA case) recognize, **the mere number of operators is an insufficient proxy for the homogeneity of competitive conditions**. Even though the CP provides a more advanced approach by cumulating the number of operators with market shares and factors indicating scale economies (such as households covered) or uniformity of prices, such factors may risk to be arbitrary and lead to errors of judgement.

Competition cannot be assessed by any single one of these variables. Taking into account all variables proposed certainly improves the result but it *is still far away from a complete and well proven SMP analysis*. Clearly *there is a high risk of error margins due to a superficial and only theoretical analysis of competitive conditions*.

Secondly, it has to be asked *how the “competition thresholds” are chosen*. When an NRA chooses an operator threshold of X, it implicitly assumes that X operators present (for example in a LE) warrant effective competition (even if in combination with other factors such as the number of households etc).

Fastweb believes that defining X is a particularly difficult task. Competitive conditions vary widely regionally because of many factors including the number of operators, households, market shares and price uniformity, but including a long list of other factors as well.

Another consideration is that such a decision by an NRA would implicitly define the structure of competition in a specific market, thereby deciding a priori that in a market there is only space for X number of operators. This would prevent other operators to expand in that geographical area, thereby increasing entry barriers and creating an oligopoly.

With regards to the issue of aggregation of units/areas to create reasonable boundaries for a specific geographic market, the following factors should be taken into account:

- the single units which define an area should be continuous and make up a clearly identifiable and logical area with clear boundaries which in some degree would need to be independent from the network architecture of operators (since the architecture may evolve over time)
- the area would need to make economic sense as a business decision by operators to invest and achieve a sustainable business plan from an economic point of view.

Fastweb understands that authorities may be unable to conduct a fully fledged SMP analysis on all initial geographical units. As a consequence of that however, we believe that it would be second best not to conduct a limited and arbitrary analysis of these markets but, in this case, it would be preferable to avoid the definition of segmented markets and/or geographically differentiated remedies.

While it would be more correct to assess the competitive conditions in the period under review, it is very difficult to forecast such conditions, especially in a dynamic and innovative industry such as telecommunications. The CP proposes in particular to send questionnaires to operators asking them about their infrastructure investment plan. We believe that the principle of legal certainty can be maintained only if assessment by NRA is based on current rather than on future conditions of a specific market since in this case the degree of discretionality and/or level of arbitrariness by the NRA would be very high and subject to hypothesis which may not turn out to be respected, causing in that case irreversible damage to the market and competition.

What should in any case be assessed in a future perspective is the risk that the current competitive conditions may change based on ongoing known trends and technological developments. In this respect, the impact of fixed-mobile convergence and the evolution vs NGN networks would necessarily have to be taken into account.

Effective competition in the affected markets relies on the assumption of entry of a consistent number of operators in a competitive area through ULL or proprietary infrastructure via cable and/or FTTH networks and a consequent introduction and availability of WBA/LL wholesale services by these operators. The ERG CP assumes that any other retail operator who wishes to enter the market would then be in the position to choose any of the present “infrastructured” operators for provision of WBA/LL.

Such an approach may be misleading and not take into account the actual constraints of the wholesale market both on the supply side and on the demand side. On the supply side, NRAs should carefully assess and evaluate the possibility of altnets to offer an adequate level of wholesale services to that of the incumbent in terms of resources, service portfolio and geographical coverage. On the demand side, NRAs should consider if an operator who wishes to enter a market on a metropolitan, regional or national level would be in a position to buy a “patchwork” of wholesale services by different operators.

Regulators have to evaluate the service and not the infrastructure market; they should evaluate effective and not potential competition (as assumed by the “barriers of entry”). In case of removal of remedies such as WBA/leased lines on the incumbent operator for example: are there developed reasonably priced and flexible voluntary alternative wholesale offers of such services by other “infrastructured operators” in the same area?

For example, the presence of 3-4 operators in a ULL site does not by itself mean that there is the possibility by other operators to have access to wholesale services in that specific site because Operators present in a local exchange may not be able technically (ie. limited co-location space), economically (scale would not justify the introduction of wholesale operations) and in terms of organization to offer wholesale services. In particular, the ULL operators present in a single site may not have the organization or resources required to offer wholesale services since they require a dedicated organization in terms of staff, billing systems, support systems, operational systems, procedures, etc. In many countries, few if any alternative operators have this ability since their main focus is on retail customers.

In addition alternative operators may not be able to offer such wholesale services based on several reasons:

- For example, it has to be considered that a retail operator cannot negotiate WBA agreements local exchange per local exchange for **organizational and technical difficulties which would lead to very high transaction costs**. The more agreements exist and the more dispersed the availability of an alternative WBA service, the higher are the costs for connection, interoperability, management and supervision. There are therefore significant transaction costs, which also increase with the amount of transactions.
- Especially in cases where an unbundler has a sub-national footprint which does not cover the whole sub-national area because certain local exchanges have not been unbundled for various reasons (such as lack of co-location space, absence of necessary scale economies, etc.) a *“fall back” nationwide WBA and LL non-discriminatory offering may be crucial to ensure continuity, continuous coverage and stability of retail operations. On the other hand, since in most cases operators are still expanding their network from a regional to a national basis, it is likely that the first step of the increase of network coverage will be via “light” wholesale services such as WLR*

and/or WBA in order to gain some critical mass to move to other solutions such as ULL or proprietary infrastructure. In the absence of some wholesale remedies in some areas such as WLR/WBA, these operators would be severely restricted in expanding their coverage and competition would be weakened.

For the homogeneity of economic conditions test, this would imply to not consider the first criterion (entry barriers), and for the second and third criterion (number of operators and markets shares) to consider only operators offering wholesale services to third operators.

Furthermore, the CP should provide more detailed guidance on how to evaluate practically the opportunity of geographical segmentation.

For example:

- What are the criteria in terms of thresholds to be reached in order for NRAs to proceed with the more in-depth analysis needed to evaluate the possibility of sub-national segmentation?
- What are the conditions in terms of number of competitors/market shares/availability of alternative wholesale services/limitations of leveraging by incumbents of SMP position in adjacent markets/restraints to cross-subsidies from SMP operators in adjacent markets, etc. that ensure fair and sustainable competition in a specific area/market segment in order to be considered a viable candidate for segmentation and differentiation of remedies?
- How much should remedies be differentiated and what criteria should be used?

We believe that a very strong and simple criterion should be provided by ERG in order for NRAs to decide if a further in-depth analysis should be pursued, due to the difficulty and time which needs to be dedicated to this in-depth analysis.

This threshold criteria should be simple, objective, easy to measure so we believe that market share of operators in a specific area can be a suitable candidate. The main criterion is obviously the absence of operators with SMP both on the retail and on the wholesale markets.

Such considerations are obviously very general. The thresholds should be adjusted through a thorough analysis of the market.

Most importantly it is important that the geographical unit used to measure market share be significant, with defined limits, recognizable by operators, consumers and authorities and coherent with the units used in other markets.

For example, defining a sub-market per local exchange should be avoided for several reasons:

- Geographical area covered by each local exchange difficult to define
- Geographical area covered by each local exchange may change over time due to changes in network architecture of the incumbent which may therefore change boundaries and competitive conditions.
- In case not all local exchanges in a certain geographic area (ie. a metropolitan area) respond to the requisites for segmentation, the availability of differentiated remedies in the same metropolitan area would be impossible to monitor and manage and cause significant problems for operators operating in that area.

When applying this example to WBA for example, it is clear that limited co-location space has to be taken into account. At this point the threshold might have to be set further below 25%.

Request 5: ERG should clearly state that both geographical differentiation of markets and remedies should be confined to exceptional circumstances as the process of market aggregation is subject to extensive errors, largely arbitrary and not in line with SMP Guidelines.

Request 6: ERG should clearly state that NRAs in order to reduce regulation errors should provide a trial period (2-3 years) during which an eventual deregulated area should be closely monitored and powers for rapid intervention should be reserved.

Request 7: ERG should clearly state that NRAs in order to limit the risk of regulation errors should focus on current and not future competitive conditions on the market, taking into account current technological trends and phenomena which may jeopardize current competitive situation.

Request 8: ERG should clearly state that competition has to be assessed at wholesale service and not at a “structural” infrastructure level.

Request 9: ERG should clearly state that effective wholesale service competition and not “potential theoretical” competition based on the presence of ULL operators and/or operators with alternative infrastructure in some areas has to be assessed.

Request 10: ERG should state that NRAs should only proceed with the evaluation of sub-national segmentation in cases in which no operator has more than 25% market share.

Request 11: ERG should draft a more detailed Common Position on geographic segmentation of markets and remedies which gives detailed guidance on:

- how the indicated thresholds (for competitive homogeneity and aggregation of geographical units) can be defined***
- how in practice NRAs should decide on whether to use geographic segmentation of market or of remedies once they have indications for geographical non homogeneity of economic conditions. In particular, how in detail can a threshold be constructed to decide if such conditions are sufficiently different to warrant geographical segmentation of markets or not.***

7. Timing of deregulation, regulatory uncertainty and inefficient anticipated changes in regulation

Regulation typically enables competition in some markets. Such regulation typically produces results in terms of higher output and lower prices. Observing a higher degree of competition in regulated industries does not necessarily mean that regulation should be removed, it could mean the contrary: that the approach so far adopted is the right way to cope with the specific market and to challenge incumbent's dominant position, and therefore calls for an even stronger regulatory approach.

When it can be anticipated that regulation will be quickly removed after it is introduced (even if only on sub-national scale), that means that in the future, when other regulation is again introduced its quick removal may be anticipated and the regulation less effective. This is particularly true for non-infrastructured providers when proceeding to local deregulation of wholesale services. When in the future a reseller would have to write a business case she would have to take into account that after an estimated and eventually short period regulation will be removed. Even if this would be only relevant in certain geographic area, these areas are typically urban and represent a high incidence on costs. Local deregulation therefore increases regulatory uncertainty, reduces retail entry and finally reduces investment for fears of cross-subsidization.

In conclusion, regulatory obligations should not be removed exactly when they are producing efficient results in the market.

8. Geographic segmentation of markets versus segmentation of remedies

The CP (page 18) states:

“Within a national market it could be the case that there exist geographic variations in competitive conditions, but that the conditions of competition do ***not vary so much that it undermines the finding of a national market i.e. the conditions of competition differ but are nonetheless sufficiently homogeneous to define a national market***”

The usage of geographical segmentation of market or remedies is therefore defined by *the degree of homogeneity* of competitive competition. The definition of a threshold between the two is however not clear and could give rise to arbitrary decisions by NRAs. Unfortunately, this issue has not been addressed by the ERG CP.

Even though conceptually the segmentation of the market and segmentation of remedies should not be seen as substitutes, there is however the risk that in practice NRAs may decide to use one or the other at their convenience.

Therefore, clear guidelines should be issued in order to precisely define the background for the 2 different approaches: differentiated remedies or geographic segmentation.

In fact, Fastweb believes that differentiated remedies should consist in a different degree of application of a specific remedy. Conversely, the application of different remedies or even the deregulation of an entire local areas means that the competitive conditions are not homogenous and, as a result, geographic segmentation should be required.

In other words, one should not allow that differentiated remedies are used by NRAs to completely deregulate a market as a substitute of market segmentation (which may be more difficult to justify by the NRA).

We would like to point out that the European Commission in comments pursuant to Article 7(3) of Directive 2002/21/EC to the case AT/20085/0757 (WBA) states on page 9²:

² Original text in German: „Die geographische Differenzierung von Abhilfemaßnahmen kann in Situationen angemessen sein, in denen beispielsweise die Grenzen zwischen den Gebieten mit verschiedenem Wettbewerbsdruck variieren und sich im Zeitablauf mit Wahrscheinlichkeit verändern, oder dort, wo

"Geographic differentiation of remedies can be inappropriate when the frontier between competitive and non-competitive areas varies and is likely to change over time. Or, when significant differences in competitive conditions are observed, but not enough evidence for the definition of sub-national markets is available. Furthermore, a geographical differentiation of remedies can be inappropriate where the removal of remedies can have an adverse effect on consumers and on competition in general."

Fastweb agree with the above, provided that the lack of homogeneity of competitive condition is not so strong to require geographic segmentation. As the markets under consideration display certainly the characteristic of a frontier between competitive and non competitive areas that is likely to change over time, the definition of sub-national markets should in general not be considered by NRAs.

The same argument should be applied in perspective. Since changes in regulatory market definition maintain the features of a structural or irreversible change, in order to reduce the risk of regulatory fallacies, it may be desirable to introduce first changes in remedies, when needed, and eventually to proceed in the future, only after having observed and tested market competition, to modify market definition.

Having such a **hierarchy of regulatory instruments**, and provided that the background for the application of the 2 models is clear, allows for the introduction of a sufficient degree of flexibility so as to promptly restore regulatory remedies should market test reveals that competition dynamics is still in its infancy in the markets analyzed.

Request 12: ERG should clearly state that NRAs should evaluate the introduction of sub-national markets only after a prior significant experience with geographically segmented remedies in the market and always retain the power to intervene and modify approach..

9. Other issues to be considered

9.1. Maintenance of accounting separation requirements

Geographical segmentation of markets could lead to full deregulation of sub-national markets. As one of the main concerns of local deregulation is cross-subsidization, Fastweb believes nationwide (and split per region) accounting separation and transparency remedies should in any case be retained. The legal framework does seems to be compatible with such a choice, as the Commission has provided guidance in the Explanatory Note of the Recommendation on Relevant Markets Susceptible to Ex-Ante Regulation, confirming that these conditions **may be applied cross-markets. A nationwide finding of SMP is therefore not required to monitor conditions across a segmented country.**

signifikante Unterschiede in den Wettbewerbsbedingungen beobachtet werden, jedoch die Evidenz für die Definition von geographischen Submärkten nicht ausreichend ist. Des Weiteren kann eine Differenzierung von Abhilfemaßnahmen dort angemessen sein, wo eine verfrühte Aufhebung der *ex ante*- Regulierung eine schädliche Auswirkung für Verbraucher und den Wettbewerbsprozess haben kann.“

Request 13: ERG should clearly state that nationwide transparency and accounting separation remedies have to be retained in the case of deregulation of sub-national markets under all circumstances in order to control and prevent cross-subsidization problems.

9.2 Need for a Cost/Benefit analysis

As a geographically segmented approach will not only increase regulation errors but will also markedly increase the cost of regulation a thorough cost/benefit analysis of the segmented approaches has to be conducted.

Request 14: We therefore invite ERG to clearly state that NRAs wanting to introduce geographically segmented regulation must produce a detailed cost/benefit analysis including:

- i) estimated additional regulatory costs (for the NRA as well as for operators)***
- ii) estimated consumer benefit (including prospective development of prices and quantities). When estimating the consumer benefit NRAs must indicate what weight they attribute to the consumers of each of the identified areas. After deregulation the level of competition has to be monitored in each submarket/area where remedies are differentiated.***

Request 15: ERG should clearly state that NRAs should only introduce sub-market segmentation if it displays a clear net benefit of in terms of competition and consumer welfare.

9.3. Process to remove regulation in a sub-national markets

Fastweb would like to point out that under no circumstance regulation should be removed without a thorough SMP analysis demonstrating unambiguously a market of irreversible effective service competition. The draft Common Positions seems to not include this requirement as at the stage of preliminary/detailed geographic market definition sub-national markets can be excluded from regulation with an abbreviated “SMP within market definition” procedure.

Request 16: ERG should clearly state that NRAs must under all circumstances conduct a fully fledged SMP analysis if they want to remove regulation in sub-national areas.

10. Implications for the EU Telecoms Review

10.1 Universal Service Objectives:

The guidance to NRAs on geographic segmentation should be accompanied by guidance to legislators for the current revision of the framework. In particular:

In case of progressive removal of retail regulation, wholesale regulation becomes increasingly more important. Wholesale price averaging, non discrimination in the provision of wholesale products may be crucial in ensuring the universal service objective of affordability across the national territory. Such importance could be indicated under article 9 of the Citizens Rights Directive.

Request 17: ERG should state that legislators should recognise the importance of wholesale price averaging in the promotion of affordability across the national territory (article 9).

10.2 Risk of cross-subsidization practices:

Geographic segmentation significantly increases the scope for leveraging of market power through cross-subsidization. Fastweb believes NRAs should be more flexible to contrast such situations. Today NRAs have to demonstrate Market Power both in the source as well as the target market in order to intervene.

The target market, however, could be competitive and demonstration of market power impossible. In order for NRAs to address the issue, the framework directive (article 14) should be amended to allow cross market remedies. This would allow regulators to intervene in cases of leveraging of market power between competitive and non competitive regions after an eventual geographic deregulation.

Request 18: ERG should suggest that Article 14(3)

“Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking.”

should be substituted by:

“When an undertaking has significant market power on a specific market, it can leverage its market power held in the market into a second closely related and to constitute and strengthen its market power on the second market.”