Dear Mr Fonteijn,

SUBJECT: CASE NL/2005/0281: WHOLESALE BROADBAND ACCESS IN THE NETHERLANDS

Comments pursuant to Article 7(3) of Directive 2002/21/EC

I. PROCEDURE

On 4 November 2005, the Commission registered a notification from the Dutch national regulatory authority, Onafhankelijke Post en Telecommunicatie Autoriteit (“OPTA”) concerning the wholesale broadband access market in the Netherlands.

The national consultation² was launched on 1 July 2005 and lasted one month. The deadline for the Community consultation under Article 7 of the Framework Directive is 5 December 2005.

On 11 November 2005 the Commission services sent a request for information to OPTA and its response was received on 21 November 2005.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (“NRAs”) and the Commission may make comments on notified draft measures to the NRA concerned.

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² In accordance with Article 6 of the Framework Directive.
II. DESCRIPTION OF THE DRAFT MEASURES

The notified draft measures concern the wholesale broadband access (\textit{WBA}) market in the Netherlands. This market corresponds to market 12 in the Commission Recommendation on relevant markets susceptible to \textit{ex ante} regulation (“Recommendation”)\textsuperscript{3}.

II.1. Factual background

In the Netherlands, broadband penetration rates are one of the highest within the EU, with 52\% of Dutch households having broadband access.\textsuperscript{4} Approximately 40\% of these broadband connections are provided over cable networks. Taken together, the various cable networks in the Netherlands cover 90\% of all households, i.e. a larger coverage than in most other Member States. The remaining 60\% of broadband connections are provided over DSL infrastructure, covering 97\% of all households. The 60\% of broadband connections provided over DSL is split in around 45\% of broadband connections provided by KPN and 15\% of broadband connections provided by alternative, LLU-based DSL operators. Some LLU-based DSL operators, on the basis of access to the local loop regulated by OPTA\textsuperscript{5}, are individually able to provide WBA in an area covering, for the largest operator, around 30\% of the territory, covering 60\% to 70\% of the population. Nevertheless, the network of alternative, LLU-based DSL operators is for the time being limited essentially to the most densely populated Western part of the Netherlands.

II.2. Market definition

At the wholesale level, OPTA differentiates between the market for WBA with high overbooking ratio (1:20 and higher) (\textit{high quality WBA}) and the market for WBA with low overbooking ratio (lower than 1:20) (\textit{low quality WBA}).\textsuperscript{6} To justify this distinction, OPTA states that 1) the majority high quality WBA is mainly used for VPN services for which use low quality WBA is not a substitute\textsuperscript{7}; 2) only a few purchasers are prepared to pay the substantially (1.5 to 4 times) higher prices for high quality WBA; and 3) supply-substitution is limited as significant installation costs would have to be incurred by an operator providing only low quality WBA in order to be able to provide high quality WBA.

On the market for high quality WBA, OPTA finds that high quality WBA provided over DSL is a separate market from high quality WBA provided over cable on the grounds that it is technically not possible to provide high quality WBA over cable networks.

OPTA finds that low quality WBA provided over DSL and cable form part of the same market on the basis of the following: 1) Cable networks have been upgraded and now are technically capable of providing broadband access to app. 90\% of the households (as opposed


\textsuperscript{4} Among OECD countries, the growth of broadband penetration was the highest in the Netherlands and in Finland in the first half of 2005.

\textsuperscript{5} See notification and Commission’s comments in Case NL/2005/0280.

\textsuperscript{6} Overbooking is defined as the guaranteed bandwidth divided by the maximum bandwidth. If for example, a user has a 1024 kbit/s connection with an overbooking ratio of 1:4, this means that the user always has a minimum guaranteed speed of 256 kbit/s. Low quality WBA products make up more than 97\% of the sales of broadband access.

\textsuperscript{7} OPTA’s reply to the request for information.
to 97% for DSL); 2) Cable operators provide a form of WBA to independent third parties; 8) 3) A hypothetical monopolist of low quality WBA via DSL would not be able to increase its price to ISPs profitably. Such an increase would have to be passed on to the retail customers due to the low profit margins of ISPs and therefore would result in loss of market share at the retail level as a result of fierce retail competition. A loss of market share at the retail level would also lead to a loss of market share at the wholesale level (the theory of indirect pricing constraint).

The Dutch competition authority (NMa) shares the conclusions of OPTA with respect to the market definition of low quality and high quality WBA.

II.3. Finding of significant market power (“SMP“)

Market for high quality WBA

On the market for high quality WBA, OPTA intends to designate KPN as having SMP.

In 2004 KPN had a market share (measured in terms of broadband connections including captive sales) of […] %, followed by BBned […] % Novaxess […] % and Versatel […] %. The market share of KPN has been growing in the past years and OPTA expects that in the absence of regulation on the market for high quality WBA KPN’s market share will increase.

OPTA claims that KPN has advantages compared to other undertakings as a result of its virtually nationwide infrastructure. In OPTA’s view, it is very important for an undertaking to have a high degree of coverage in this market, because this form of WBA is provided by means of data communication services to end-consumers and several establishments must be linked with each other.

The NMa shares the conclusions of OPTA with respect to the analysis of SMP on the market for high quality WBA.

Market for low quality WBA

On the market for low quality WBA, OPTA does not intend to designate any operator as having SMP.

On the market for low quality WBA, as defined by OPTA, KPN has a market share of 44%9 (measured in terms of broadband connections including captive sales)10. The largest cable operators UPC, Essent, and Casema held in 2004 market shares between […] and […]%. The LLU-based operators11 (BBNed, Versatel and Tiscali) held in 2004 market shares between […] and […]%. The market share of KPN has been growing in the past 4 years (from […] %

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8 For example, the cable operator Essent is providing WBA to the ISP Introweb (although limited to business customers), the cable operators Stichting CAI Harderwijk and Kabel Noord are providing WBA to the ISP Chello and the cable operator Cogas is providing WBA to the ISP @Home.

9 Captive sales account for […]% of the market. On the basis of merchant market sales, KPN’s market share would be […]% as it has only recently started offering low quality WBA. In that case BBned would have the largest market share with […] %. Cable operators would jointly have […]% and other DSL providers would have […]%.

10 LLU-based operators can provide WBA on the basis of regulated cost-based access to KPN’s unbundled local loop. See the results of OPTA’s analysis of the market for unbundled access to the local loop in the Netherlands and the Commission’s comments in case NL/2005/0280.
in the beginning of 2001) and, despite a small decrease of 1-2% in the past few months, OPTA expects a small increase for the coming regulatory period (up to 48% in 2008).\(^{12}\)

In OPTA’s view, competitive pressure from other operators indicate that there is no SMP on this market. OPTA notes that LLU-based operators, on the basis of access to the local loop regulated by OPTA, are able to provide WBA in an area currently covering, for the largest alternative operator, around 30% of the territory, covering 60% to 70% of the households (expected to increase further to 85% in 2006). The largest cable operator, UPC, is also increasing its coverage area by purchasing unbundled local loops of KPN outside its own coverage area and thereby relying on two wholesale inputs in parallel.\(^{13}\) OPTA also states that national coverage is not a requirement to be able to compete on the retail market, although OPTA recognises that there are some economies of scale on the market because of the high degree of fixed costs.

OPTA claims that it is due to competitive pressures in this market that KPN has recently started offering low quality WBA voluntarily, in the absence of any SMP-regulation on this market. LLU-based operators were also able to gain a market share of 15% together without there being any ex ante regulation on the WBA market.

OPTA also considers that it is of substantial importance that KPN – in spite of the absence of WBA regulation – does not have SMP on the market for which low quality WBA forms the main component, namely the retail market for broadband Internet access.\(^{14}\)

The NMa shares the conclusions of OPTA with respect to the analysis of SMP on the market for low quality WBA.

**II.4. Regulatory remedies**

In the market for low quality WBA, OPTA does not intend to impose any regulatory remedies on KPN.

OPTA intends to impose the following remedies on KPN in the market for high quality WBA:

a) **Access**: obligation to comply with reasonable access request

b) **Non-discrimination**: provision of broadband access on equal conditions and in equal circumstances and application of conditions equal to those that it applies to itself or associated companies.

c) **Reference offer**: publication of a reference offer with regard to high quality broadband access and update of this offer on a regular base.

OPTA claims that the access, transparency and non-discrimination obligations cancel out the potential competition restricting behaviour on the market for high quality WBA and therefore

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12 The alternative operators indicated in the framework of the national consultation that they expect KPN’s market share already to exceed 50% in Q1 of 2006.

13 In addition, several (six) ISPs combine cable based and DSL based low quality WBA, often within the same geographic area. For example, Quicknet offers broadband internet access via a cable based WBA from Multikabel and a DSL-based WBA offer from Tiscali within the same geographic area. Similarly, Introweb combines DSL-based access from KPN and Versatel with cable based access from Essent within the same geographic area.

14 KPN has a market share of […]% in the retail market, followed by UPC (13%) and various smaller operators.
does not consider necessary to impose price control regulation and/or accounting separation. The competition problem of excessive prices, for example, is in OPTA’s view sufficiently addressed by the non-discrimination obligation, which obliges KPN to apply the same conditions to third parties as it would apply to itself or associated companies.

III. ASSESSMENT

The Commission has examined the notification and the additional information provided by OPTA. The Commission does not contest OPTA’s proposal at this stage not to impose ex ante regulation to the low quality WBA market in the Netherlands. This conclusion is based on the particular features of the Dutch market, in particular the very large coverage of LLU (which seems to result in a situation where, behind the barriers to entry, the low quality WBA market tends towards an effectively competitive outcome even in the absence of ex ante regulation in this market) as well as the vast presence of cable operators on the retail market. However, the Commission has strong concerns about OPTA’s definition of the low quality WBA market and about its SMP assessment. To substantiate these concerns, the Commission has the following comments:

III.1. The inclusion of low quality WBA provided over cable networks in the definition of the relevant product market

In its notification, OPTA considers that the pricing constraint exercised by cable-based broadband services at the retail level has a sufficiently significant impact at the wholesale level to justify its inclusion in the WBA market.

OPTA’s approach to defining a wholesale market on the basis of the competitive conditions in the corresponding retail market is not in principle inconsistent with the methodology set out in the Recommendation and in the Commission’s Guidelines on market analysis and the assessment of SMP.15

However, for the definition of the relevant market, demand side substitution represents the most immediate and effective disciplinary force on the suppliers of a given product, in particular in relation to their pricing decisions. Basically, the exercise of market definition consists in identifying the effective alternative sources of supply for the customers of the undertakings involved.16 OPTA does not provide evidence of any direct demand side substitution, and states that to its knowledge there has been no switching at the wholesale level between neither DSL-operators and cable operators, nor between DSL-operators mutually. Such demand side substitution would rest on the assumption that operators currently buying DSL based wholesale bitstream products could readily switch to a bitstream product offered on an alternative technological platform, i.e. a cable network, in response to a price rise of the DSL based product. In practice, such switching could be restricted by considerable switching costs.17 Such

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15 Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165, 11.7.2002, p. 6. This was also confirmed by the Commission in its comments in case UK/2003/0032-34.
17 In order to migrate an existing customer base from DSL-based access to cable-based access, the ISP would probably have to subsidise the retail customer’s related costs such as the investment in new modems. In addition, costs would be incurred by providing technical assistance to retail customers for having them switch between technologies.
switching costs should have been assessed by OPTA prior to the inclusion of a cable based bitstream product into the relevant market.

Even if one were to ignore actual switching possibilities for existing wholesale customers and focus on substitutability between both products for new entrants (which have not committed to either DSL or cable infrastructure yet), there appear to be limits in the substitutability between both products. Cable-based WBA products in the Netherlands offer a much more limited coverage than the DSL-based WBA product of KPN or, for example, Versatel.\(^{18}\) This appears to restrict substitutability from the demand perspective (having to combine WBA products from different cable suppliers may not only increase transaction costs but also network and product integration costs). Despite having been available, according to OPTA, for several years, ISPs using third party access based on cable represent today only [...]% of the retail market.\(^{19}\)

Furthermore it must be noted that even if some degree of substitution between both products may exist for new entrants, this would not protect existing customers of KPN as KPN is in a position to price discriminate between new entrants and existing customers. KPN may very well price its WBA product competitively in order to attract new customers, while raising its price for existing customers once these customers, due to the high switching costs, have become tied to KPN.

Also from the supply-side, substitution is limited as a cable operator cannot readily switch to supplying DSL-based WBA and vice versa.

Possibly aware of these limitations as regards direct substitutability, OPTA bases its finding of a single wholesale market for DSL and cable based bitstream products on an assumed indirect pricing constraint derived from substitutability between cable and DSL at the retail level. The Commission considers that such an indirect competitive constraint should not have been taken into account at the stage of the definition of the relevant market. Moreover, for the theory of indirect pricing constraint to be applied at all, it would have to be shown that i) ISPs do not absorb such a price rise at the wholesale level but were forced to raise prices at the retail level,\(^{20}\) that ii) even in case ISPs pass on the price increase, all or most of the customers of the ISPs forced to raise prices would switch to retail cable operators and not, for example, to the retail arm of the WBA provider, in particular if the latter does not raise its own retail prices. This has not been demonstrated by OPTA. Account should, for example, have been taken of demand elasticity in order to substantiate the claim of an indirect pricing constraint coming from demand side substitution at the retail level. In this respect it is also noteworthy that KPN applies distinct tariffs for its WBA product in so-called A-zones.

\(^{18}\) KPN’s network is nation-wide and covers 97% of households. Versatel’s DSL network covers [...] % of the territory and [...] % of the households. UPC owns the largest cable network covering [...]% of the territory and [...]% of the households. UPC is not providing third party access to its cable network. Mutikabel seems to be the largest cable operator offering third party access; Mutikabel’s network covers [...]% of the territory and [...]% of households (see page 55-56 of the notification).

\(^{19}\) For comparison: ISPs using third party access to bbned’s WBA product based on DSL represent [...]% and ISPs using KPN’s WBA product that came available earlier this year currently represent [...]%

\(^{20}\) In fact, it seems that in the past ISPs, providing retail broadband internet access on the basis of the agency model of KPN, did not include KPN price increases in the retail price [ACT comments in national consultation]. Furthermore, OPTA indicates in its reply to the request for information that the gross margins of ISPs range between [...] and [...]%.
and B-zones,\textsuperscript{21} despite cable operators being present in both zones and retail prices being uniform throughout the country.

For the reasons indicated above, the Commission has strong concerns as to whether low quality WBA provided over cable and DSL form part of the same market.\textsuperscript{22}

\textbf{III.2. The finding of no SMP on the market as defined by OPTA}

Even if one were to accept OPTA’s broad market definition, including cable-based WBA in the relevant market, the Commission has strong concerns about OPTA’s finding that KPN would not hold SMP. On such a broadly defined market, KPN’s market share would be 44\%. KPN’s market share has increased strongly over the past four years (coming from 3\% in January 2001). Even if KPN’s share of both DSL and cable based broadband connections seems to have decreased by […] percentage points in the past five months, OPTA expects that KPN’s market share will grow to 48\% in 2008; according to the alternative operators, KPN’s market share would exceed 50\% in Q1 2006. The market share of KPN’s largest competitor (UPC) is substantially lower, around 13\%.\textsuperscript{23}

Additional elements seem to point in the direction of KPN having SMP. OPTA recognizes for example that KPN controls infrastructure which cannot easily be duplicated. Alternative operators are investing in alternative infrastructure, but KPN is the only operator which has ensured national coverage. Competing DSL operators have today maximally […]\% of the investment in place to ensure national coverage ([…]), even though this investment enables them to cover 60-70\% of Dutch households. Competing cable operators have maximally […]\% of the investment in place to ensure national coverage (UPC) and cover maximally […]\% of Dutch households.

OPTA also recognizes that KPN has advantages of scale and scope, linked to the high level of fixed costs and the broad product portfolio of KPN enabling it to distribute fixed costs over various retail products. OPTA indicates that these advantages of scale and scope may reduce over time (especially taking into account that the wholesale input – access to the local loop – is provided to alternative operators at cost-oriented prices), but in view of the fact that KPN’s retail market share is expected to increase on the retail Internet access market and remains very high on certain neighbouring markets (such as retail calls) it is uncertain that these advantages will disappear over the period of the review.

OPTA furthermore recognises that the barriers to enter the WBA market are high, but indicates that this has not impeded alternative operators to become active on this market and gain substantial market share (15\% combined on the market including cable; 25\% combined on DSL-based WBA only). The Commission points out that KPN’s market position has to be assessed against the position of each of its competitors taken individually; moreover, the presence of alternative operators on the market does not exclude that barriers to entry are high.

For the reasons indicated above, the Commission has strong concerns as to whether KPN does not have SMP in the market for low quality WBA.

\textsuperscript{21} For 512/256 and 1024/512 Mit bitstream the price differential exceeds […]\%.

\textsuperscript{22} In case of a “DSL-only” market definition, KPN’s share would be 75\%.

\textsuperscript{23} UPC’s market share has decreased substantially over the past four years and continues to decrease.
III.3. The non-imposition of ex ante regulation in the market for low quality WBA

With regard to the particular features of the Dutch market (i.e. high broadband penetration; high penetration of cable infrastructure; high penetration of alternative, LLU-based DSL operators in the absence of regulation of low quality WBA\(^{24}\); competitive retail broadband market) taken cumulatively, the Commission does not contest OPTA’s proposal at this stage not to impose ex ante regulation to the low quality WBA market in the Netherlands. On the basis of the information provided by OPTA, it would seem that behind the high barriers to entry, the market for wholesale DSL-based bitstream access *tends* towards an effectively competitive outcome (within the meaning of the three criteria test set out in the Recommendation)\(^{25}\), even in the absence of regulation on the low quality WBA market. In particular, the fact that LLU is already in place in the Netherlands with coverage up to 70% of the population, which is expected to increase to 85% in 2006, enables alternative operators to provide a wholesale DSL-based bitstream product in competition with KPN. In addition, the competition between cable operators and DSL-based operators on the retail internet access market further reduces the need for ex ante regulation of the low quality WBA market in the specific case of the Netherlands.

Nevertheless, since the above assessment is based on a likely market tendency over the period of the review, the Commission asks OPTA to carefully monitor market developments, to re-conduct a market analysis and to notify its results within one year from the date of this letter. In monitoring market developments, OPTA should closely examine whether KPN is not leveraging its market power on the low quality WBA market into downstream markets where it is present as well (in particular into the retail internet access market and the retail calls markets), for example by refusing to supply low quality WBA in response to a reasonable request, by supplying low quality WBA on discriminatory terms (for example, by making the provision of low quality WBA conditional upon an undertaking on the part of purchasers not to invest in LLU) or by raising the price of low quality WBA. OPTA should also monitor whether KPN is not engaging in anti-competitive behaviour such as predatory pricing or price squeeze in order to protect its position on the low-quality WBA market, in particular in those areas where LLU is in place.

OPTA should also consider imposing accounting separation on KPN on the basis of finding SMP in the market for local loop unbundling that would also cover the provision of low quality WBA in order to facilitate the above monitoring and the application of competition law.\(^{26\,27}\)

III.4. The non-imposition of accounting separation in the market for high quality WBA

\(^{24}\) For example, on the basis of merchant sales, BBNed would have the largest market share in the low quality WBA market with 82%.

\(^{25}\) Recital 9 to 16 of the Recommendation.

\(^{26}\) Pursuant to Recital 5 of Commission Recommendation 2005/698/EC of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications, “when an obligation for accounting separation is imposed on a notified operator with SMP on one or more markets, the imposition of accounting separation may cover markets where the operator does not have SMP, e.g. to ensure the coherence of data.”

\(^{27}\) See the Commission’s comment in case NL/2005/0280.
The Commission invites OPTA to impose the obligation of accounting separation on KPN in the market for high quality WBA in order to be able to monitor KPN’s compliance with the non-discrimination obligation. Such remedy should ensure that KPN makes transparent its wholesale prices and its internal transfer prices for high quality WBA.

Pursuant to Article 7(5) of the Framework Directive, OPTA must take the utmost account of comments of other NRAs and the Commission and may adopt the resulting draft measure and, where it does so, shall communicate it to the Commission.

The above assessment reflects the Commission’s position on this particular notification, and is without prejudice to any position it may take vis-à-vis other notified draft measures.

Pursuant to Point 12 of Recommendation 2003/561/EC28 the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission29 within three working days following receipt whether you consider, in accordance with Community and national rules on business confidentiality, that this document contains confidential information which you wish to have deleted prior to such publication. You should give reasons for any such request.

Yours sincerely,

For the Commission,
Neelie Kroes
Member of the Commission

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29 Your request should be sent either by email: INFSO-COMP-ARTICLE7@cec.eu.int or by fax:+32.2.298.87.82.