

## Access to networks through competition law: the case of KPN - Reggefiber

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## TELECOMMUNICATIONS

# Access to networks through competition law: the case of KPN – Reggefiber

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This article showcases a unique cooperation between a competition authority and a sector-specific regulator to remedy the potentially negative effects of a merger on competition.

In this article we present the case of a unique cooperation between a competition authority and a sector-specific regulator, leading to an access regime for a new optical fibre network. The case, in which the Dutch incumbent telecommunications company KPN sets up a joint-venture with a new entrant in optical fibre called Reggefiber, is special for another reason: the remedies imposed are far-reaching and specific. Finally, the case is of interest because it provides a framework under which private investments in a new network can be combined with an open structure, guaranteeing reasonable access conditions for third parties.

## Legal setting

For this case two legal settings are relevant: competition law and sector-specific regulation, *in casu* telecom regulation. These legal frameworks, though both meant to improve the functioning of markets, differ in a number of respects. Competition law is generally focused on (i) a violation of competition law by means of a cartel in which two or more competitors collude at the expense of customers; (ii) an abuse of a dominant position in which a dominant firm for example excludes other companies; and (iii) merger control. In the case of merger control, companies are under a legal obligation to notify the relevant competition authority of a planned merger or acquisition (above a certain threshold in terms of yearly turnover). The merger can only proceed after the competition authority has approved it. If the competition authority sees potential competition problems with the proposed merger, the companies involved may offer remedies to alleviate these concerns. Competition law applies to all sectors of an economy.

Sector-specific regulation is generally focused on setting up a regime for access to a specific network, including regulated tariffs or awarding licenses to market participants. Sector-specific regulation as the name implies is limited to a specific sector. Most sector-specific regulation is focused on access to networks like the electricity grid,

gas pipelines and the fixed telephony network. The case presented here is a merger control case under competition law, where an access regime imposed as a remedy is identical to the one laid down in a market regulation decision of the telecom regulator.

## Institutional setting

Generally, EU Member States have different institutions to implement competition law and sector-specific regulation. Thus, each Member State has a competition authority, with the European Commission taking on the role as EU competition authority. Separately, each Member State has a regulator for the telecom sector. In some countries, sector-specific regulators have been combined into one institution, such as the German *Bundesnetzagentur*. In the Netherlands, however, the energy regulator is part of the competition authority NMa. The Dutch telecom regulator OPTA is a separate institution. In the case described below, two different authorities, the competition authority NMa and the telecom regulator OPTA, were involved.

## The case: KPN – Reggefiber

The KPN – Reggefiber case deals with the roll-out of optical fibre networks in the Netherlands. KPN, as the Dutch telecom incumbent, owns the national copper network, which has existed from the beginning of the 1900s and is currently subject to access regulation by OPTA. Both KPN and third parties use this network to offer retail services to consumers, including fixed telephony and broadband internet services. Over the last years, KPN has been under increasing competitive pressure in the Netherlands from cable companies who jointly have national coverage. Their network is used to offer cable television, broadband internet services and fixed telephony to consumers.

Since the copper network faces technical limitations, it is expected to be phased out at some point in the future to be replaced by an optical fibre network that is technically capable of high-speed data transmission. In the meantime,

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cable companies have invested in their coaxial networks to allow for more high-speed data transmission. Since the cable companies cover different regions of the country, they do not compete with each other and can therefore (for the purpose of this article) be seen as ‘one competitor’ for KPN and Reggefiber with respect to television, broadband and fixed telephony. There are no access obligations on the cable networks.

Reggefiber is a new entrant in the Dutch telecom market. It was set up by a construction company in order to start building optical fibre networks. Until 2008, Reggefiber had rolled out a few local optical fibre networks, but take-up had been slow.

KPN and Reggefiber wanted to establish a joint-venture in order for KPN to leverage its customer base and marketing expertise, whereas Reggefiber would bring in its technical expertise in rolling out optical fibre networks. A joint-venture of the type KPN and Reggefiber wanted to undertake is subject to merger control by the NMa. The planned transaction was notified to the NMa in July 2008, and approved with remedies in December of the same year.

The NMa’s main concern with the creation of the joint-venture was that a potential competitor of KPN, Reggefiber, would be taken out of the market, thereby decreasing competition in the Dutch telecom market.

### The joint-venture’s effect on the market

In their notification of the merger to the NMa, KPN and Reggefiber stated as their goal to provide almost all Dutch households access to a fibre network (Fibre-to-the-Home or FttH) in the coming years. It was widely expected that this initiative would significantly change the competitive possibilities of the Dutch telecommunications market.

In figure 1 the altered structure of the telecommunications market after the creation of the joint-venture is shown. After the merger, the three networks – fibre, copper and coaxial – would exist simultaneously, whereby KPN would have control of both the optical fibre and the copper network. When,

sometime in the future, the new higher-capacity fibre network would replace the current copper network, the number of firms in the market would be reduced from three to two. The NMa found, after careful examination of the potential effects on competition, that the shift in ownership of the optical fibre network from Reggefiber to KPN could lead to decreased competition in two ways: less competition between the copper and the optical fibre network and a reduced incentive to provide access to the network to downstream service providers.

### Effects on competition and regulation

Considering these two effects, the second effect would have the largest impact on competition. It should be recalled that, at the time of the notification of the joint-venture, the copper network was subject to access regulation by OPTA because of KPN’s dominant position on certain telecommunications markets. The optical fibre network, on the other hand, was not subject to regulation because Reggefiber had a negligible market share at that time, although it could potentially gain a very large market share. By creating the joint-venture, KPN might have had the possibility to escape existing access regulation and transfer its dominant position from the copper network onto the yet unregulated optical fibre network.

The NMa found that the joint-venture could have both the ability and the incentive to foreclose access to the optical fibre network to downstream providers, in order to strengthen KPN’s own position on the downstream retail markets, benefiting both KPN and the joint-venture. This could lead to less downstream competition at the retail level, resulting in higher prices and lower-quality services offered to consumers.

The incentive to foreclose can be estimated by calculating the so-called critical diversion ratio. With the input of KPN’s price and cost data on various up- and downstream markets and KPN’s market shares, the NMa has determined under what circumstances foreclosure would be profitable for the joint-venture. The number of consumers that need to switch to KPN

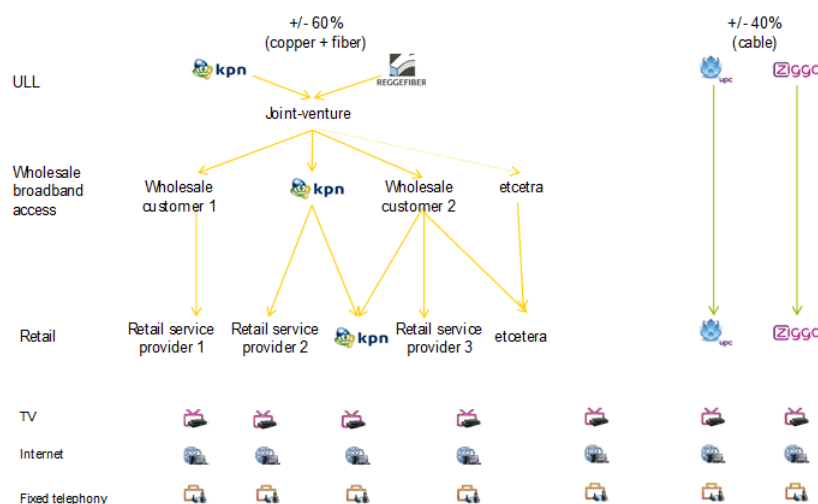


Figure 1 | Market structure after the creation of the joint-venture.

from alternative downstream providers, rather than to alternative infrastructures, to make foreclosure profitable, is called the critical diversion ratio. This ratio revealed that the joint-venture was likely to have an incentive to foreclose downstream competitors, which could lead to a significant impediment of competition on the downstream markets.

### Existing and new regulation: access to Unbundled Local Loop

In order to avoid the abovementioned possible competition problems from occurring, KPN and Reggefiber proposed very specific and detailed remedies to gain clearance for the merger by the NMa. The conditions imposed on the joint-venture are similar to the existing regulation of the copper network. Access regulation is designed to ensure that downstream customers, such as wholesalers, can get access to the unbundled local loop of the optical fibre network. This is essentially the last mile of fibre from an access point to the subscriber's home, the most expensive part of the network to duplicate. Upon gaining access, customers of the joint-venture can then provide wholesale and retail services on the fibre network. To ensure access and downstream competition, the conditions include the following core elements:

- Obligation to keep the joint-venture separate from its parent companies;
- Obligation to provide information about the roll-out planning to (potential) customers;
- Obligation to grant access to third parties on specific terms;
- Obligation to treat all parties in a non-discriminatory way;
- Obligation of transparency (including reference offer);
- Price cap and minimum quality level; and an
- Enforcement procedure.

The fact that, to some degree, the newly created joint-venture operates independently from KPN and the fact that most investments in the FttH network had yet to be made, provided some advantages in the determination of a reasonable price cap. In similar cases it is often difficult to calculate the true costs of providing access to the network because the network usually already exists. In this case most of the network had yet to be rolled out and the business model of the joint-venture for the deployment of the FttH network was available to the NMa and OPTA, which made it easier to assess the costs associated with its roll-out. These calculations were then used, together with an assessment of the average cost of the (financial) capital and a correction for the risk of investment, to determine the price cap.

Overall, the conditions guarantee that downstream rivals of KPN and Reggefiber can gain access to the network for a reasonable price, in such a way that competition on the retail markets can be stimulated. This will benefit end-consumers through lower prices, higher quality and a wide selection of services.

### Cooperation NMa – OPTA

The NMa has co-operated closely with OPTA regarding the design of the conditions since the latter – as a sector-specific regulator – has a lot of detailed knowledge and experience in designing and enforcing access regulation of the copper network. The co-operation resulted in two simultaneous decisions: one decision by OPTA to regulate the copper and optical fibre networks and one decision by the NMa, clearing the merger under virtually identical conditions. Since the new access regime is, where possible, identical to the copper access regime, the parties involved and its customers are accustomed to the regulatory framework, which should make the regulation more effective.

OPTA has also a special role in the enforcement of the conditions. In principle it is not a task of a competition authority, nor does it have the necessary resources to engage in detailed regulation and monitoring of access conditions. But because the regulatory framework of OPTA and the conditions imposed by the NMa are in large parts identical, the NMa could make OPTA the first stop for market participants in case of a violation of the commitments by KPN or Reggefiber. In this way the NMa was able to impose an extensive access regime through proper cooperation with OPTA.

### Court case

The NMa's decision in the case of KPN – Reggefiber is currently under appeal at a specialised Dutch court. Both downstream customers of the joint-venture, such as BBned and Tele2, and competitors that own the Dutch cable networks have appealed the decision. However they have not challenged the fact that the NMa imposed access remedies to remediate possible competition problems as such.

### Conclusion

The KPN – Reggefiber case shows that it is possible to design an access regime under which private companies are willing to invest in new infrastructure and accept access by third parties. It furthermore demonstrates that under specific circumstances, such as the existence of a sector-specific regulator, an access regime can be used to remedy the negative effects of a merger on competition. Finally, it shows that competition law and sector-specific regulation can be used to reinforce each other and to foster competition in a network sector. ★