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Tele2 response to OPTA consultation on market analysis

Market 11

Wholesale unbundled access (including shared access) to metallic loops and sub-loops for the purpose of providing broadband and voice services

Introduction

On 1 July 2005, OPTA published its draft decision for wholesale unbundled access (including shared access) to metallic loops and subloops for the purpose of providing broadband and voice services for consultation. This document serves as Tele2's official response to the consultation for market 11.

Tele2 supports OPTA's market definition (which is in line with the Commission's Recommendation), the proposed SMP designation of KPN on the relevant market as well as the remedies imposed. However, Tele2 has concerns in relation to the issues addressed below.

- **Appropriate cost accounting methodology to be FL-LRIC instead of EDC**

OPTA proposes to impose cost orientation on KPN by means of a Wholesale Price Cap ("WPC") system based on the Embedded Direct Costs ("EDC") method. With reference to the Commission's decisions regarding Portugal and Hungary, Tele2 is of the opinion that the appropriate cost accounting methodology should be FL-LRIC instead of EDC. For a more detailed description of Tele2's position regarding wholesale tariff regulation, please refer to the separate document containing Tele2's response to Annexes A-D on wholesale tariff regulation.

- **OPTA to provide certainty as regards regulation of associated facilities**

As regards associated facilities, OPTA states that it will investigate for each of the facilities individually whether a Comparative Efficiency Analysis ("CEA") can be applied. Tele2 is of the opinion that OPTA must provide certainty regarding the cost of associated facilities. For a more detailed description of Tele2's position regarding wholesale tariff regulation, please refer to the separate document containing Tele2's response to Annexes A-D on wholesale tariff regulation.

- **Pricing remedies are essential to promote competition**

The current situation makes it impossible for alternative providers to market a competitive retail offer on the basis of KPN's ULL offer. This is evidenced by the fact that an unbundled offer for ADSL only is more expensive than KPN's own offer for Belbudget in combination with ADSL.

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OPTA should regulate the broadband markets taking into account the investment ladder principle. This means that in order to promote competition and infrastructure investment, wholesale pricing should provide for sufficient incentives for parties to climb the investment ladder. It is a fact that in the countries where a cost model has been developed for network access, regulators have considerably reduced the monthly unbundling cost. That is the case in particular in Sweden where unbundling will cost approximately 8 EUR a month. According to a study commissioned in France by an alternative operator, the monthly cost of unbundling in that country is 7 EUR a month. The Dutch characteristics, e.g. population density, should, therefore, result in a monthly cost below that of France. In the opinion of Tele2 the need to establish a fair price for unbundling is worthy of OPTA's full attention since this will to a large extent also determine the price for WLR.

Tele2 takes the position that the costs relating to the "copper" should be separated from the PSTN and ADSL services and specified to the customer. The customer should therefore be able to choose from the following alternatives:

1. Telephony (PSTN) only, without a KPN subscription;
2. ADSL only, without a KPN subscription;
3. Both telephony (PSTN) and ADSL, without a KPN subscription.

- **Pricing remedies must be aimed at avoiding margin squeeze**

The ERG Broadband market competition report of 25 May 2005 emphasises that in order for the ladder of investment concept to work, proper migration processes must be in place and tariffs must give the right incentives. With reference to Cave as well as the Remedies Paper this report further emphasizes the importance of preventing margin squeeze in the broadband markets[1]:

Tele2 takes the view that a price squeeze test should also contain a retail-minus test

To check whether the retail offer is anti-competitive it is possible to calculate 'backwards' by using such a retail-minus check. By using the former monopolist's retail price and subtracting those costs that the former monopolist no longer has when an alternative operator manages parts of it, a measure of the actual costs (plus retail profit) for running the network is obtained. This estimate should be higher, as the profit of services on the legacy infrastructure is very high for most former monopolists, or at least equivalent to the result obtained from the LRIC model.

The composition of a retail-minus check can be visualised as follows:

[1]ERG (05) 23, p. 17.

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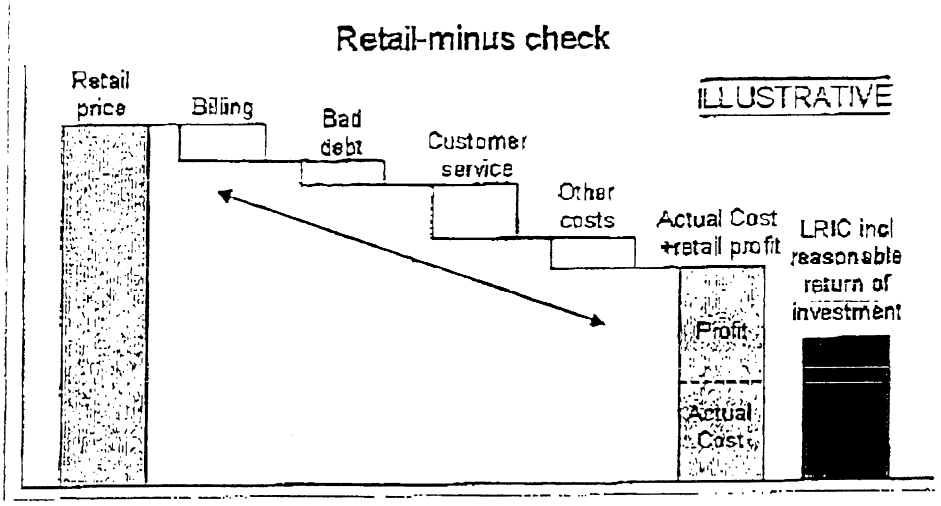

The retail minus check consists of the following steps:

1. Subtract all retail related costs that are incurred by the incumbent from the retail price.
2. Compare the retail minus based price (i.e. actual costs plus retail profit) with the wholesale price (preferably based on LRIC), which includes a reasonable return on investment. This ensures that the LRIC model in fact reflects costs and is efficient. If the wholesale price is higher than the retail-minus calculation, this implies that the price is anti-competitive and that the product cannot be introduced for that price.

More specifically, the "minus" must be in the order of -/- 30% to allow a reasonable margin.

- **Delivery to be closely monitored**

Experience in other jurisdictions shows that it is important to closely monitor implementation. For instance in Sweden, delivery is an issue since incumbent Telia on numerous occasions stopped delivering the service and only resumed on the specific order of the Swedish NRA. This has always happened when Telia needed a first mover advantage for some new service, disguised as technical or logistic problems. In order to avoid similar problems in the Netherlands, OPTA should take preventive measures such as imposing strict SLA's together with sufficiently deterrent penalties.

- **Local roll-out for PSTN voice should be made available**

In its draft decision, OPTA assumes that ULL enables alternative providers to offer in principle all services that KPN provides over the local loop including voice.[2]

[2] Paragraph 115 of the draft decision.

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However, in practice local roll-out for broadband does not enable PSTN voice services but only VoIP in combination with ADSL. Consequently, regulation of ULL is not sufficient, since 50% of the households in the Netherlands do not have ADSL and therefore gain no access to competing voice services. Moreover, these end users cannot be expected to implement facilities enabling PSTN voice services themselves.

Therefore, Tele2 is of the opinion that OPTA should regulate local roll-out also for the purpose of PSTN voice services.

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Tele2 response to OPTA consultation on market analysis

Market 12

Wholesale broadband access

Introduction

On 1 July 2005, OPTA published its draft decision regarding wholesale broadband access ("WBA") for consultation. This document serves as Tele2's official response to the consultation for market 12.

- **Market definition deviates by distinguishing low and high quality**

OPTA proposes to deviate from the Commission's Recommendation[1] by distinguishing between a market for low quality broadband services and a separate market for high quality broadband services. OPTA bases this distinction on the *"overboekingsfactor"*, i.e. the guaranteed bandwidth in relation to the bandwidth offered. On the basis of the published notifications, Tele2 is not aware of any other NRA having made this distinction in product market definition. It is important to reassess the proposed market definition since this has an impact on the SMP designation and remedies imposed as explained below.

- **KPN to be designated as SMP provider on low quality WBA market**

OPTA includes cable in the market for low quality broadband and, on this basis concludes that this market is competitive. Based on this market definition, OPTA concludes that KPN has a 30-40% market share. However, KPN is not designated as having has SMP in this relevant market, on the basis that regional cable operators offer a comparable wholesale service.

First, Tele2 notes that KPN's market share on the retail market is significantly higher than assumed by OPTA. Research[2] carried out by EIM and commissioned by OPTA includes a table setting out market shares of network providers via ADSL, showing that KPN has more than 75% market share. Tiscali/BabyXL comes second with 6,5%, Versatel has 2,5% and BBNed has 2,1%.

The above-mentioned EIM report also shows that on the retail broadband market, KPN's market share is even higher and amounts to 51% when taking into account the combined market shares of all ISP's that are controlled by KPN (subsidiaries XS4ALL 10,2%, Planet Internet 19,2%, Het Net 14,4%). Other well-known providers have a much smaller market share (Wanadoo 12,6%, Tiscali 9,6% and Zon 9,6%).

[1] Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC.

[2] Table 11 of EIM Research '*Consumentenonderzoek afname van gebundelde communicatieproducten in Nederland*', (December 2004), p. 30.

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The above shows that KPN has a very strong position on the retail markets for (low quality) broadband. Moreover, OPTA itself remarks that if the current trend continues, KPN's market share is expected to increase to 60-65% of the broadband connections whereas cable operators will jointly represent the remaining 35-40%.

Alternative operators on the wholesale market potentially only cover 60% of the total end user market. This means that approximately 40% of the retail market is only serviced by KPN and cable operators who do not offer WBA. Moreover, in a number of geographic areas KPN remains the only provider.

It is likely that KPN will use its position to further increase market shares. Market shares of other DSL operators competing with KPN on the wholesale broadband market remain extremely low. Since KPN is dominant on both the wholesale broadband market, because KPN offers WBA to Planet XS4all, het Net etc, and on the retail market through its ISPs, it is necessary to regulate KPN's wholesale broadband offering. Moreover, in view of KPN's double dominance, Tele2 requests OPTA to also assess whether retail regulation is appropriate.

Consequently, OPTA's findings do not support OPTA's assumption that regional cable operators offer a comparable wholesale service. Moreover, in a number of geographic areas KPN remains the only provider. It is likely that KPN will use its position to further increase market shares.

For example, KPN differentiates its wholesale offer to Tele2 per geographic area. KPN currently charges considerably higher tariffs in those areas where no other parties are rolled out. These geographical issues are not addressed in OPTA's draft decision. Tele2 is of the opinion that OPTA should impose appropriate remedies to address such anti-competitive behaviour. KPN should provide a regulated and cost based wholesale offer for ADSL in those geographic areas where no other parties are rolled out.

- **Bitstream access and resale to be regulated in line with the ladder of investment**

Bitstream access is the first step on the ladder of investment, the next step is rollout. Tele2 stresses that in line with the ladder of investment principle, bitstream access should be regulated. Tele2 believes that the current market shares of KPN on both wholesale and retail levels show that KPN is indeed dominant on the broadband markets. Cable operators rolled out upgraded, interactive networks only in a limited number of geographic areas and the service levels of cable operators are insufficient. KPN has refused the provision of bitstream access, which is an important building block (*bouwsteen*) in the ladder of investment.

Tele2 is of the opinion that bitstream access should be regulated, because there are high barriers to entry and the incumbent's legacy network is well suited for providing the desired services, a situation that incumbents in Europe have already abused by capturing much of the ADSL markets and taking over the internet initiative from former dial-up ISP's. Competition at the service level on the legacy network would prevent abuse of a monopoly situation by KPN.

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The revised ERG common position on bitstream access[3] emphasises the importance of BSA:

> "Bitstream access is a wholesale product that consists of the provision of transmission capacity in such a way as to allow new entrants to offer their own, value-added services to their clients. Resale offers are not a substitute for bitstream access, because they do not allow new entrants to differentiate their services from those of the incumbent. In order to be able to differentiate their services (including VoIP) from those of the incumbent, new entrants must have access at a point where they can control certain technical characteristics of the service to the end user and/or make full use of their own network (or alternative network offerings) thus being in a position of altering the quality (e.g. the data rate or other features) supplied to the customer.

The ERG's conclusion is that:

> "Where the provision of bitstream access is essential to the development of competition in the WBA market, NRA's should mandate a bitstream access product according to national needs. The point in the network at which the WBA will need to be supplied will depend on the market analysis and in particular on the network typology and the state of broadband competition. When defining the appropriate point of access, NRA's should take the perspective of market parties."

Tele2 stresses that it should have the opportunity to offer its own broadband services (rather than the ADSL services of another provider) to end users. As evidenced by the Tiscali decision[4], OPTA attempted to facilitate the provision of wholesale broadband services but was confronted with the limitations of the old framework. OPTA now has the necessary tools to implement the broadband access regulation it considered necessary a year ago. In view of the fact that the competitive environment since has not changed, OPTA's approach should be consistent and regulate broadband access markets.

The decision not to regulate the low quality market is therefore not only contrary to the concept of the investment ladder that is supported by the ERG, but also inconsistent with OPTA's overall approach.

Moreover, for high quality broadband, BSA is available but a resale offer is missing. In line with the ladder of investment principle, a resale offer should be available for high quality broadband.

- **Cost-orientation and accounting separation obligations to be imposed**

OPTA designated KPN as having SMP in the market for high quality broadband but did not propose to impose cost-orientation or accounting separation obligations on KPN. OPTA considers in its draft decision that also in view of the proposed pricing obligations on unbundled access there is no reason to impose cost orientation or accounting separation.

However, Tele2 considers pricing and cost accounting remedies necessary in view of the concept of the ladder of investment and in order to resolve problems of margin squeeze in both the high quality and low quality markets. Tele2 notes that the ERG in its Broadband market competition report dated 25 May 2005 strongly supports the

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[3] ERG revised common position on bitstream access. ERG (03) Rev2.

[4] CBb decision LJN AO8356 dated 16 April 2004.

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ladder of investment concept. According to the ERG, the NRA may actively support the upward move on the ladder of investment by dynamic pricing or sunset clauses. OPTA itself takes note in other decisions and policy notes of the need for tariff regulation to stimulate infrastructure investment with reference to Cave: "A policy of high access prices in this phase of their activity [sc. the starting phase for new entrants who intend to roll out infrastructure] may kill the entrant's business model stone dead"[5]. It would be inconsistent not to apply these principles also in respect of WBA.

- **Pricing remedies must be aimed at avoiding margin squeeze**

The ERG Broadband market competition report of 25 May 2005 emphasizes that in order for the ladder of investment concept to work, proper migration processes must be in place and tariffs must give the right incentives. With reference to Cave as well as the Remedies Paper this report further emphasises the importance of preventing margin squeeze in the broadband markets.[6]

Tele2 takes the view that a price squeeze test should also include a retail-minus test. To check whether the retail offer is anti-competitive, it is possible to calculate 'backwards' by using such a retail-minus check. By using the former monopolist's retail price and subtracting those costs that the former monopolist no longer has when an alternative operator manages parts of it, a measure of the actual costs (plus retail profit) for running the network is obtained. This estimate should be higher, as the profit margin of services on the legacy infrastructure is very high for most former monopolists, or at least equivalent to the result obtained from the LRIC model.

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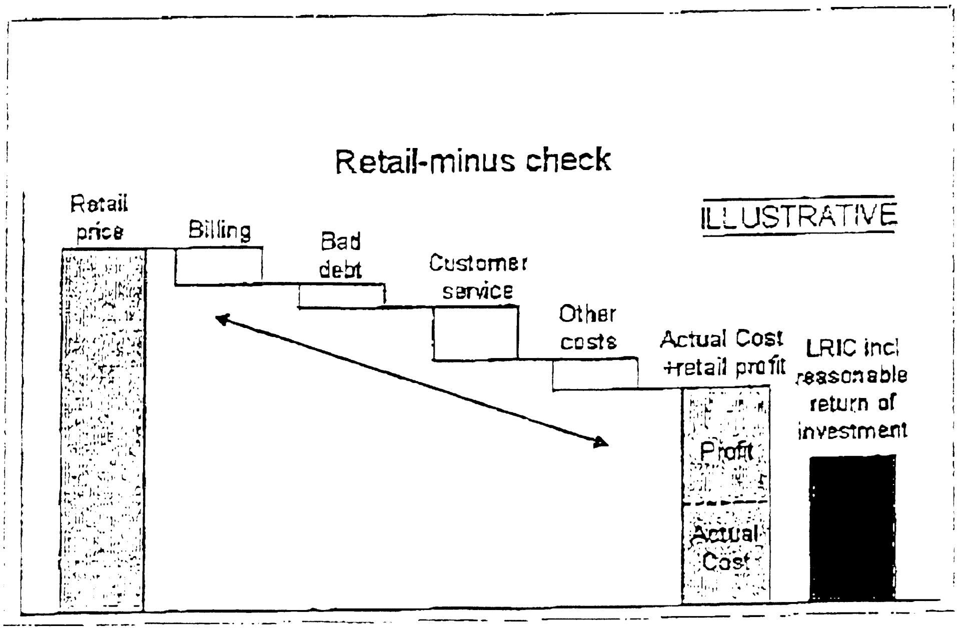

[5] Draft decision of OPTA regarding unbundled access, dated 1 July 2005, para. 414.

[6] ERG (05) 23, p. 17.

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