Management summary fixed terminating access

Referring to draft market decision of 15 August 2008 (in Dutch)

1.1 Introduction

1. Under the terms of Chapter 6a of the Telecommunications Act [*Telecommunicatiewet*] the Commission of the Dutch Independent Post and Telecommunications Authority (referred to throughout as the "Commission") is required to analyse specific relevant markets in the electronic communications sector in order to determine whether there is effective competition in those markets or whether any market party holds significant market power (referred to throughout as SMP) in them based on a forward looking analysis covering the period until the end of 2011. The Commission may impose appropriate remedies on any market party which holds SMP.

2. This decision concerns the wholesale markets for call termination through separate public telephone networks which is provided on a fixed location. They are included in Market 3[1] in the new relevant market recommendation[2] (referred to throughout as the recommendation) issued by the European Commission (referred to throughout as the EU Commission).

1.2 Summary

3. Fixed terminating calls constitute a service which fixed telephone network providers provide to route a call to a number that is directly or indirectly connected to their network. Such a service is procured by other telephone service providers, many of whom also provide fixed terminating call services for calls to numbers which are connected to their network. As such, it is a service which providers procure from each other. In the case of geographical, 088, 084, 087, 112, 14xy and 116xyz numbers virtually no alternative (or substitute) is available. After all, where a user (caller) wishes to call a person or organisation on any such number, hardly any alternatives are available, if at all. Usually, the person concerned is quite simply inaccessible on any other number via a different network. Consequently, providers of fixed terminating call services to these numbers have a monopoly. Reference is therefore frequently made to a monopoly bottleneck for terminating calls (a termination bottleneck). This monopoly provides the relevant providers with an incentive and the opportunity to charge monopoly tariffs. This boosts their own earnings and simultaneously increases the costs of their competitors, who are required to procure terminating call services. The competitive position of these competitors is deteriorating as a result. As such, the providers have their bread buttered on both sides. Monopoly tariffs are predominantly determined by the value (the benefit) which callers obtain from the relevant calls.[3] This benefit is much greater than the cost of a fixed terminating call. As a result monopoly tariffs for fixed terminating calls are a good deal higher than the costs involved. As part of this decision the Commission has concluded that there is a real risk of excessively high tariffs being charged.

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[1] It was Market 9 in the previous recommendation.

[2] Recommendation of the European Commission concerning relevant markets (EU OJ 2007, L 344/65).

[3] It can also be said that monopoly tariffs are paid as a result of telephone call price elasticity. This is a different way of describing it but is similar in terms of its economic impact.

4. The monopoly on fixed terminating calls is exacerbated by the fact that any increase in fixed terminating call tariffs on the part of individual providers is virtually invisible to end users. There are two reasons for this. First of all, any increase in terminating call tariffs is not always passed on directly as part of the retail charges for calling other networks, especially where providers have tariff packages offering bundles of minutes (or unlimited calls) at a fixed rate.[4] Secondly, the inclusion of higher terminating call charges in retail tariffs is less transparent to end users. After all, they usually do not know which network they are calling and what retail charges they are paying. The latter is particularly true when making calls to smaller networks. As a result these smaller networks even have an incentive to opt for tariffs which exceed the generic monopoly equivalent. After all, end users are not aware that they are calling such a small network, let alone that they are familiar with the tariffs applicable in respect of it.

5. Although providers usually[5] procure fixed terminating call services from each other, the dominance analysis and research which underlies this reveals that the negative impact of any monopoly position amongst them is not negated by mutual buying power. Consequently, all of the providers hold SMP (significant market power) and may exploit their position in the absence of regulation by charging excessively high tariffs for terminating calls, thereby securing excessive profit from such calls.

6. Competition in the retail market could ensure that part of any excessive profit achieved on fixed terminating calls in the absence of regulation is at least partly eliminated in that market through reduced subscription fees and call charges. This is referred to as the waterbed effect. The Commission is of the opinion that the waterbed effect is not comprehensive (or full). Consequently, part of the higher terminating call tariffs is at any rate passed on to the relevant retail services and has the effect of boosting the average charge for a total package of retail services. Even if in an ideal situation the waterbed effect were to be comprehensive, with the result that any excess profit achieved on fixed terminating calls were to be lost on other services due to competition, high terminating call charges would continue to have an adverse impact. An initial adverse effect would take the form of a greater chance of differentiation between on and off-net tariffs. High terminating call charges could produce a persuasive incentive to differentiate between on-net and off-net tariffs. On-net calls are those made by subscribers to those on the same network and therefore remain within their own network. Off-net calls are those made by subscribers to those on other networks. As such, they leave the network and terminating call tariffs need to be paid for them. High terminating call charges – in excess of their actual cost – create an incentive to price these off-net calls higher than on-net ones. Such price differentiation is not conducive to welfare.

7. There is a second adverse effect in that even if in an extreme situation the waterbed effect was comprehensive and providers did not start to differentiate between tariffs for on-net and off-net calls, high terminating call charges could reduce welfare. In this case these high tariffs would continue to produce significant marginal expenditure, which could occasion uncertainty amongst providers in relation to the ultimate cost per customer. This would put a brake on the introduction of innovative tariff packages, such as unlimited and other call bundles. This could in turn reduce the overall demand for services and diminish the dynamic efficiency of the telephony markets.

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[4] This is currently the case with KPN's BelVrij packages.

[5] An exception may be found in the case of CPS and WLR providers who do not receive fixed terminating calls themselve but only procure this service.

8. In addition to this, high terminating call charges would have a disruptive effect in any situation on competitive relations between those providers whose incoming and outgoing calls do not offset each other. If terminating call charges were high, those providers who have a relatively large amount of outgoing calls would be disadvantaged and their competitive position would be weakened in relative terms. The latter applies to a large extent to CPS (carrier pre selection) and WLR (wholesale line rental) providers, who only have outgoing calls for their CPS subscribers. High terminating call charges have the effect of eroding these providers' margins.

9. The risk of excessively high tariffs is not confined to specific providers, such as the large or dominant parties in the underlying retail markets. All terminating call providers have an incentive and the opportunity to charge excessively high tariffs. As stated before, smaller providers have an even greater incentive and the opportunity to charge high tariffs. It is therefore appropriate that all fixed terminating call providers be regulated. It is also appropriate that they be regulated in symmetrical fashion and that the tariff ceiling be the same for all providers. Maintaining tariff ceilings for different providers (or groups of them) would make it possible for inefficient providers – or those paying a relatively large cost price – to remain in the market thanks to regulation. In this case the conditions governing production based on the lowest cost would not be optimal. This would result in diminished productive efficiency and hence reduced welfare.

10. The Commission will impose a remedy in the form of an identical tariff ceiling (symmetrical tariff regulation) on all fixed terminating call providers. The Commission deems such symmetry to be crucial. In addition, the same duty to grant access will apply to all providers at the regional network level. Apart from this, KPN (the incumbent operator) will also have a duty to provide access at the local network level. All providers will have a duty to ensure transparency and in KPN's case this will be supplemented with a duty to present a reference offer. Only KPN will have a duty to maintain separate administrative records.

11. Compared with the previous market analysis decision, two main changes have been made to the various obligations. First of all, the tariff ceiling will be the same for all providers (symmetrical). In the past there was a system as part of which KPN was subject to a slightly lower tariff ceiling than the other providers. The Commission is of the opinion that this asymmetry is no longer appropriate, especially in view of the increase in competition in the underlying retail markets, which no longer provides grounds for higher tariffs on the part of KPN's competitors. Secondly, a non-discrimination duty will no longer apply. Such an obligation would place unnecessary restrictions on terminating calls and would unnecessarily restrict competition in the underlying retail markets.