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Urząd Komunikacji Elektronicznej
(UKE)

18-20 Kasprzaka Street
01-211 Warsaw
Poland

For the attention of:
Ms. Magdalena Gaj
President

Fax: +48 22 53 49 253

Dear Ms Gaj,

Subject: Commission decision concerning Case PL/2012/1311: Wholesale broadband access market in Poland

Opening of Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC

I. PROCEDURE

On 26 March 2012, the Commission registered a notification by the Polish national regulatory authority, Prezes Urzędu Komunikacji Elektronicznej (UKE)¹, concerning the third review of the market for wholesale broadband access² in Poland.

The national consultations³ were held from 1 February until 2 March 2012. On 2 April

¹ Under Article 7 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

² Corresponding to market 5 in Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services OJ L 344, 28.12.2007, p. 65-69 (the Recommendation).

³ In accordance with Article 6 of the Framework Directive.

2012, a request for information (RFI)⁴ was sent to UKE, and a response was received on 5 April 2012.

Pursuant to Article 7a(1) of the Framework Directive, the Commission may notify the national regulatory authority (NRA) and the Body of European Regulators for Electronic Communications (BEREC) of its reasons that the draft measure would create a barrier to the internal market or its serious doubts as to its compatibility with EU law.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Previous notifications

The first review of the market for wholesale broadband access was notified to and assessed by the Commission in 2006⁵. UKE has defined a single national market for wholesale broadband access, designated Telekomunikacja Polska S.A. (TP) as an operator with significant market power (SMP) and imposed a full set of remedies. With regard to price regulation, TP was to implement a Forward Looking Long Run Incremental Cost ("FL LRIC") model and to set its access prices based on costs incurred. Until an independent auditor confirms the accuracy of the calculation, UKE intended to control TP's access prices on the basis of the retail minus methodology.

The Commission invited UKE to specify in its final measure the details of the access remedy including the products subject to a reference offer, to keep separate accounts, and to charge cost oriented prices.

The second review of this market was notified to and assessed by the Commission in 2011⁶. At that time UKE has defined a sub-national market consisting of almost the entire territory of Poland, except for 20 communes, which UKE considered to be competitive. Furthermore UKE has differentiated remedies in 3 groups of communes, depending on the competitive pressure faced by TP. The Commission commented on the exclusion of the allegedly competitive communes from the market definition, and requested UKE to base its forthcoming notification of the draft measure concerning those 20 communes on a thorough analysis of all relevant structural (in particular market shares and its evolution over time and entry barriers) as well as behavioural factors (in particular differences in prices, product/service functionalities and marketing strategies).

Furthermore, the Commission commented on the conditions for geographic variation of remedies, as well as on the proposed non imposition of a price control remedy in certain communes (so called "Group 2" communes, characterised by a weaker SMP position of TP).

II.2. The notified draft measure

II.2.1. Market definition

As in the second review of the market (2011) UKE considers that at the retail level the market for broadband access comprises the provision of broadband Internet access over copper, FTTx, coaxial cable, LAN Ethernet and leased lines. Wireless access (WiMax,

⁴ In accordance with Article 5(2) of the Framework Directive.

⁵ PL/2006/0472, SG-Greffe (2006) D/204907.

⁶ PL/2011/1184, SG-Greffe (2011) D/4675.

CDMA, FWA and satellite), Wireless Local Access Network (WLAN) and mobile networks (GSM/UMTS/LTE) are excluded from the relevant market because of their technical limitation, their restricted coverage of the Polish territory and their inability to offer a sustainable and guaranteed quality of service comparable to fixed networks-based infrastructures.

UKE proposes to include xDSL and FTTx based-access in the relevant market for wholesale broadband access. UKE excludes from the relevant market access through cable TV⁷, LAN Ethernet⁸, wireless and mobile networks (i.e. WiMax, GSM/UMTS/CDMA/LTE, WLAN, wireless radio access).

UKE considers that the geographical scope of the market is national.

II.2.2. Finding of significant market power

UKE proposes to designate TP as the SMP operator in the relevant wholesale market. TP is the only supplier and holds a 100% market share⁹.

UKE's assessment is also based on the following additional criteria: (i) barriers to entry and expansion; (ii) economies of scale and scope; (iii) vertical integration; (iv) easy or privileged access to capital markets/financial resources; (v) absence of countervailing buyer power; and (vi) absence of potential competition¹⁰.

UKE concludes that TP has SMP in the entire territory of Poland, however the degree of TP's market power varies between two different groups of communes¹¹ (Group 1 and Group 2 communes). In the communes belonging to Group 1,¹² TP is constrained in its behaviour on the wholesale level due to indirect competitive pressure from cable TV and alternative operators at the retail level. In Group 2 communes TP retains a strong position on the wholesale market, and there is only a very limited pressure from competition at retail level.

In order to be qualified as a Group 1 commune the five following conditions have to be

⁷ As before UKE excludes cable TV networks from the product market at the wholesale level. UKE concludes that there are significant barriers to switching from wholesale bitstream to cable TV networks rendering such a switch uneconomical. UKE considers that although there is a theoretical possibility of access to cable networks at the wholesale level there are significant technical limitations and high costs for implementing such a solution. UKE states that there is lack of potential interest from alternative operators for such a wholesale offer, given that they have already invested into TP's Wholesale Broadband Access (WBA) offer.

⁸ UKE explains in particular that the adaptation of the existing transport layers of the Ethernet network to enable shared access would require a large investment, would be uneconomic given the significant costs incurred to reach the connection point, and cover a relatively small number of customers.

⁹ TP is the only entity providing WBA in Poland. Other infrastructure operators (e.g. LLU operators) at the moment do not grant WBA access to third parties but use their infrastructure to serve final customers through their retail arm.

¹⁰ There is only a very limited chance that TP's main competitors, i.e. Netia S.A. and Telefonía Dialog S.A. (since end of 2011 Telefonía Dialog belongs to Netia's capital group), will be able to enter the market for WBA on the basis of local loop unbundling.

¹¹ In its draft measure UKE has justified in further detail why it chose administrative areas (communes) and not the footprint of TP's network (MDF areas) as basis for its SMP assessment, making reference to availability and reliability of data as well as the ability to take into consideration particularly cable networks.

¹² Corresponding to 4 communal areas of 4 large cities in Poland (Wrocław, Torun, Lublin, Warszawa).

cumulatively met:

- 1) in the given municipal area, none of the operators has a share of 40 % or more in terms of the number of clients on the retail broadband access market;
- 2) in the given municipal area there are at least three operators who provide retail broadband Internet access;
- 3) at least 50 % of premises in the given municipal area have access to the infrastructure of at least three operators;
- 4) no more than 10 % of premises in the given municipal area has no access to the Internet;
- 5) the standard deviation of the share of the three largest operators is not larger than 10 percentage points.

II.2.3. Regulatory Remedies

UKE proposes to address the different competitive pressures in the two different groups by differentiating remedies within the national WBA market.

Group 1 (communes of Warsaw, Torun, Wroclaw, Lublin):

- obligation to provide access to the network; and
- non-discrimination.

Group 2 (communes in the remaining territory of Poland):

- obligation to provide access to the network;
- non discrimination;
- transparency (excluding FTTH);
- accounting separation (excluding FTTH);
- cost orientation based on forward looking long run incremental costs (FL LRIC), (excluding FTTH).

Under the non-discrimination and transparency obligations, TP will be required *inter alia* to provide copper based services at the same conditions (in terms of price, quantity, quality and available information) to alternative operators and to TP's retail division. TP shall furthermore prevent information sharing between the retail and the wholesale divisions of TP and implement a code of good practice directed to its employees in which the principles for ensuring non-discriminatory access to TP's network are established. TP will be obliged to use Key Performance Indicators (KPI)¹³ calculated separately for TP's retail arm and alternative operators.

With regard to Next Generation Access networks based on FTTH, UKE proposes to impose only access and non discrimination¹⁴ throughout the entire territory of Poland.

¹³ With regard to Group 2 areas (because of supplementary obligations of transparency) the KPIs should be published on the official website of TP on a quarterly basis. They should also be available for operators using TP's wholesale services. The publication of KPIs with regard to Group 1 areas is not mandated by UKE.

¹⁴ With regard to FTTH lines in the entire territory of Poland, as well as with regard to all infrastructures in Group 1 areas, UKE does not propose to impose on TP an obligation to publish (nor even to provide

Concerning the non imposition of cost orientation for access to FTTH networks UKE argues that until now TP has not constructed any FTTH lines, and therefore the main identified competition problem is lack of investments. According to UKE, full regulation of future (not yet existing) FTTH networks, and in particular cost orientation, would be contrary to the principles of adequacy and proportionality of the remedies to the identified competition problems. UKE considers that the remedies imposed on market player(s) should not create investment barriers and unnecessary burdens.

Moreover UKE considers that the currently implemented non-discrimination mechanisms, and in particular the TP-UKE Agreement¹⁵ and the transposition of the terms of the Agreement into the currently proposed draft measure will guarantee equivalent access not only to the copper, but also to the FTTH network in the near future. UKE considers that by means of the publication of KPIs and the margin squeeze test, UKE will be able to effectively monitor the development of prices for access to NGA networks on market 5.

III. ASSESSMENT

The Commission has examined the notification and the additional information provided by UKE and has the following comment:¹⁶

Finding of a national geographic wholesale broadband market while differentiating remedies within the relevant market

The Commission notes that UKE finds that the geographical scope of the relevant market is national and that TP has SMP in the entire territory of Poland. The Commission further notes that UKE finds that the degree of TP's market power varies between two different groups of communes and proposes to impose on TP differentiating remedies according to these groups of communes.

The Commission acknowledges that the regulatory framework does not preclude the imposition of different remedies in the same relevant market, in cases where differences in competitive conditions are observed but the evidence may not be such as to justify the definition of sub-national markets. Competitive conditions in the same geographic market may vary to a limited extent without necessarily requiring the definition of geographic submarkets since the definition of the geographic market does not require the conditions of competition between traders or providers of services to be perfectly homogeneous. It is sufficient that they are similar or sufficiently homogeneous, and accordingly, only those areas in which the conditions of competition are 'heterogeneous' may not be considered to constitute a uniform market.

As to the definition of a national geographic WBA market in Poland the Commission would however like to recall that at the time of the 2nd round

at request of alternative operators) the reports on KPIs.

¹⁵ Agreement between UKE and TP SA signed on 22 October 2009. The Agreement is a voluntary, non-binding set of TP SA's commitments on compliance with regulatory obligations. The Agreement also stipulated no reductions of TP SA wholesale prices for a period of 3 years (until 31 December 2012), leading to above-cost charges. The duration of the Agreement has been extended and it will expire on 31 March 2013.

¹⁶ In accordance with Article 7(3) of the Framework Directive.

notification of market 5 in Poland UKE considered the geographic scope of the market to be national with the exception of 20 communes in which UKE preliminarily identified a high degree of competition.

In this respect the Commission notes that UKE, to justify that the competitive conditions are homogenous and not lead to the definition of sub-national markets, demonstrates that there are no differences in the fees for wholesale broadband access, costs of the signal transmission, or the quality of wholesale broadband access. Furthermore, to explain the variations of competitive conditions, it assesses the number of operators, the market shares of individual operators in terms of the number of subscribers and the range and level of duplication of the infrastructure in the given commune. In this regard, the Commission would however like to invite UKE to strengthen its analysis of all relevant structural (in particular evolution of the market shares over time and entry barriers) and behavioural factors (in particular differences in prices, product/service functionalities and marketing strategies) to justify that existing variations of competitive conditions between the two groups of communes that have lead UKE to proposing differentiated remedies are not strong and stable enough to justify the definition of sub-national markets.

Furthermore, following the examination of the notification and the additional information provided by UKE, the Commission considers that the notified draft measures fall under the Commission's powers of ensuring consistent application of remedies as set out in Article 7a of the Framework Directive, as the notified measures aim at imposing an obligation on an operator in conjunction with Articles 9 to 13 of the Access Directive.¹⁷

Draft measures imposing regulatory obligations on undertakings with SMP in Poland may have an influence, direct or indirect, actual or potential, on the ability of undertakings established in other Member States to offer electronic communication services. UKE's notification comprises measures that have a significant impact on operators or users in other Member States, inter alia measures which affect prices for users. Consequently, such draft measure may affect the patterns of trade between Member States¹⁸.

The Commission has serious doubts as to the compatibility with EU law of UKE's draft decision concerning the market for wholesale broadband access in Poland in its current form, in particular with the requirements referred to in Article 16(4) of the Framework Directive and Article 8(4) of the Access Directive in conjunction with Article 8 of the Framework Directive. Furthermore, the Commission considers, at this stage, that the draft measures may create barriers to the internal market.

The Commission expresses serious doubts in this regard for the following principal reasons:

Lack of sufficient evidence supporting the non imposition of cost orientation for FTTH infrastructure

Compliance with Article 8(4) of the Access Directive in conjunction with Article 8 of the Framework Directive and Article 16(4) of the Framework Directive

The Commission points out that remedies imposed under Article 16 of the

¹⁷ Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities, OJ L 108, 24.04.2002, p. 7, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37.

¹⁸ See Recital 38 of the Framework Directive.

Framework Directive in conjunction with Article 8(4) of the Access Directive should be based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the Framework Directive. In addition, Recital 20 of the Access Directive stipulates that the method of cost recovery should be appropriate in the particular circumstances, taking account of the need to promote efficiency and sustainable competition and maximise consumer benefits. Moreover, the Commission refers to Article 16(4) of the Framework Directive, which requires NRAs to impose on SMP undertakings appropriate regulatory obligations.

In this regard, the Commission points out that it may issue recommendations¹⁹ on the harmonised application of the Regulatory Framework in order to further the achievement of the objectives set out in Article 8 of the Framework Directive. This right arises, in particular, where the Commission finds that divergences in the implementation by the national regulatory authorities of their regulatory tasks under the Regulatory Framework may create a barrier to the internal market.

It is in this context that the Commission, in order to ensure a correct and coherent interpretation and application of the relevant provisions of the Regulatory Framework within the EU, adopted a Recommendation on regulated access to Next Generation Access Networks (the "NGA Recommendation")²⁰, setting out a consistent approach that the NRAs should follow regarding regulation of the markets for wholesale network infrastructure access (Market 4) and wholesale broadband access (Market 5).

For this purpose, the Commission recommended that NRAs should ensure that access remedies are maintained or amended where SMP is found on Market 5²¹. Further to that, NRAs should in principle impose cost orientation on wholesale broadband access products²², unless functional separation or other forms of separation have proved effectively to guarantee equivalence of access²³. Where NRAs consider that, in a given geographic area, there is effective access to the unbundled fibre loop of the SMP operator's network and such access is likely to result in effective competition on the downstream level NRAs may also consider removing the obligation of wholesale bitstream access in the area concerned²⁴.

While the Commission recognises that the NRAs have a certain margin of discretion, which allows them to take into account national circumstances, the Commission underlines that any alternative approach has to be duly justified, in order to show that it fully complies with the policy objectives and regulatory principles of the Regulatory Framework. In particular, such alternative approach would have to take into account characteristics of the specific markets to be regulated and be appropriate in light of the policy objectives and regulatory

¹⁹ In accordance with Article 19 of the Framework Directive.

²⁰ Commission Recommendation of 20 September 2010 on regulated access to Next Generation Access Networks (NGA), OJ L 251, 25.9.2010, p.35-46 (NGA Recommendation).

²¹ Recommend 31 of the NGA Recommendation.

²² Recommend 35 of the NGA Recommendation

²³ Recommend 36 of the NGA Recommendation.

²⁴ Recommend 37 of the NGA Recommendation.

principles enshrined in Article 8 of the Framework Directive.

The Commission notes that UKE does not propose cost orientation for FTTH bitstream access. In this respect, UKE underlines the initial stage of development of fibre-based products in Poland and a need to promote investments, which, in its view, justify a differentiated regulatory approach.

In its draft measure, UKE acknowledges that the NGA Recommendation calls for cost oriented access to FTTH, however, UKE argues that the imposition of cost orientation would not be proportionate and appropriate. UKE's justification rests on two main arguments.

First, UKE has not observed any competition problem with regard to access to the FTTH network of the SMP operator (as there are no such networks built by TP yet). UKE argues that the main problem relates to the lack of investment into such an FTTH network, which should be incentivised by light-touch regulation.

Second, the proposed measures (including also the existing Agreement between TP and UKE) are, in UKE's view, sufficient to guarantee equivalence of access, and that therefore the exception foreseen in Recommend 36 of the NGA Recommendation can be invoked.

With regard to incentivising investments, the Commission points out that the regulatory framework does not foresee "regulatory holidays" (i.e. forbearance of regulation) as a means to foster investments in network infrastructure where the investing operator was found to have SMP. At the same time, Article 13(1) of the Access Directive states that "[...] to encourage investments by the operator, including in next generation networks, national regulatory authorities shall take into account the investment made by the operator and allow him a reasonable rate of return on adequate capital employed, taking into account any risks specific to a particular new investment network project." Therefore the principle of cost orientation does not exclude incentivising the incumbent operator for potentially risky investments in future NGA networks. The Commission has, also in its NGA Recommendation, indicated mechanisms, which aim at providing incentives to invest, while maintaining the principle of cost oriented access (such as for example allowing for an appropriate risk premium while setting the cost oriented price).

With regard to UKE's second argument that equivalence of access is secured absent cost orientation, the Commission has serious doubts as to whether the proposed regulation is sufficient to ensure equivalence of access for all operators to fibre based bitstream products offered by TP.

In this respect, the Commission notes that the Agreement between TP and UKE is not of a binding character and can only be considered as TP's voluntary commitments. Moreover, the Agreement itself is limited in time and expires already in March 2013, which is significantly before the end of the current market review period of 3 years.

While the Agreement appears to have improved TP's compliance with imposed obligations, the Commission has reason to believe that the Agreement has not delivered full non discriminatory access to TP's network. In the view of the Commission the "freezing" of charges²⁵ (above their cost oriented levels) for all

²⁵ See footnote 15.

wholesale access products, for example, could have a discriminatory effect on new entrants.

Moreover, the Commission underlines that the lack of an appropriate cost model setting truly cost-oriented fibre access prices implies that access seekers (as well as access providers) will not be in a position to reliably assess potential investment costs and subsequent revenue streams associated with NGA roll-out. As a result, instead of promoting the roll out of new networks, UKE's approach may hamper investment in next generation technology by alternative operators during the period of this market review.

In view of the above, the draft measure does not appear to be compatible with EU law, in particular with the policy objectives and regulatory principles as set out in Article 8(4) of the Access Directive in conjunction with Articles 8 and 16(4) of the Framework Directive.

Insufficient mechanisms to monitor a non-discrimination obligation with regard to FTTH lines

Compliance with Article 8(5)(d) of the Framework Directive in conjunction with Article 10(2) of the Access Directive and Article 16(4) of the Framework Directive

The Commission points out that according to Article 8(5)(d) of the Framework Directive the NRAs have to promote "*efficient investment and innovation in new and enhanced infrastructures, including by ensuring that any access obligation takes appropriate account of the risk incurred by the investing undertakings and by permitting various cooperative arrangements between investors and parties seeking access to diversify the risk of investment, whilst ensuring that competition in the market and the principle of non discrimination are preserved*". Article 10(2) of the Access Directive requires non-discrimination obligations to ensure that SMP operators apply equivalent conditions in equivalent circumstances to other undertakings providing equivalent services.

UKE argues that non discrimination achieved by the Agreement will be ensured even after the Agreement's expiration (March 2013), by means of transposition of the provisions of the Agreement into regulatory decisions and Reference Interconnection Offer(s).

The Commission has serious doubts as to the extent to which the achievements brought about by the Agreement will be ensured by means of the notified draft decision.

In this respect the Commission notes that crucial elements of the Agreement are not transposed into the notified draft decision²⁶.

In particular, the Commission notes that the draft decision provides for only a very general obligation to use and apply Key Performance Indicators (KPIs), which are yet to be defined by TP, whereas the implementation of the Agreement resulted in a detailed list of very specific KPIs. The mechanism to monitor KPIs was constructed by UKE itself with respect to copper based services and is built

²⁶ UKE argues that those obligations can not be imposed on TP as it would amount to functional separation. The Commission notes however that the Agreement itself was falling short of functional separation of TP.

on two pillars: (i) the detailed non-discrimination remedy and (ii) transparency obligations under which access seekers would be in a position to monitor and detect any discriminatory practices of TP (using the requirement to publish KPIs and the relevant analysis of these indicators). The notified draft decision, however, does not provide anymore for the transposition of the provisions of the Agreement concerning the audits of TP's compliance with its obligations. Further, the Commission notes that TP will not be obliged to publish, or provide at the request of alternative operators, the results of KPI measurements for FTTH in the entire territory of Poland. TP will also not be obliged to provide any information on the prices and conditions of access to its FTTH network. This will considerably limit the ability of third parties to monitor and establish potential discrimination with regard to the provision of wholesale services.

On top of that the Commission notes that the non imposition of accounting separation with regard to FTTH networks will seriously limit UKE's ability to conduct a margin squeeze test between TP wholesale and retail offers. UKE will not possess any reliable (audited) information with regard to TP's wholesale and retail costs.

In view of the above, the draft measure therefore does not appear to be compatible with EU law, in particular with the policy objectives and regulatory principles concerning the promotion of efficient investments whilst preserving the principles of competition and non-discrimination as set out in Article 8 and 16(4) of the Framework Directive, read in conjunction with Article 10(2) of the Access Directive.

Creation of barriers to the internal market

The Commission believes, at this stage, that UKE's draft decision would create a barrier to the development of the internal market. The pricing of wholesale broadband access as well as the incomplete enforcement of the non-discrimination obligation (in particular of its monitoring aspect) are important factors for actual or potential competing operators from other Member States who intend to provide services in Poland.

Despite UKE's efforts to impose a non-discrimination obligation which mimics a functional separation scheme, the Commission is of the view that the incomplete implementation of the relevant provisions from the Agreement lead to a situation in which it may be difficult to detect non-price related discriminatory practices whereas the level of access rates would be freely set by the incumbent operator.

Further to that, without cost-oriented access to TP's future FTTH infrastructure, TP will be able to limit the expansion of alternative providers of high-quality broadband access at the retail level by pricing access to such necessary input prohibitively high. This would impact on the ability of alternative operators to offer to their retail (business) customers pan-European connectivity and other cross-border services.

In the light of the above, the Commission considers, at this stage, that the notified regulatory measure would create a barrier within the single market.

The above assessment reflects the Commission's preliminary position on these particular notifications, and is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

The Commission points out that, in accordance with Article 7a of the Framework Directive, the draft measure regarding the market for wholesale broadband access in Poland shall not be adopted for a further three months.

Pursuant to Recital 17 of Recommendation 2008/850/EC²⁷, the Commission will publish this document on its website, together with a notice inviting third parties to submit observations on this serious doubts letter within ten working days. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission²⁸ within three working days following receipt whether you consider that, in accordance with European Union and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication. You should give reasons for such request.

Yours sincerely,
For the Commission
Kristalina GEORGIEVA
Member of the Commission

²⁷ Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC, OJ L 301, 12.11.2008, p. 23.

²⁸ Your request should be sent either by email: INFSO-COMP-ARTICLE7@ec.europa.eu or by fax: +32.2.298.87.82.