BEREC Opinion

Phase II investigation

pursuant to Article 7of Directive 2002/21/EC as amended by Directive 2009/140/EC

Case CZ/2012/1322:

Wholesale broadband access (Market 5) in the Czech Republic

Date: 10 July 2012

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1. Executive summary

On 11th of May 2012, the European Commission ("the Commission") registered a notification from the Czech national regulatory authority, Český telekomunikační úřad (hereinafter CTU), concerning the Wholesale Broadband Access (WBA) market in the Czech Republic. CTU proposes to include in the WBA market access through xDSL and FTTx platforms, as well as through cable and Wi-Fi. CTU does not find that cable and Wi-Fi exercise a direct constraint, but CTU includes them in the product market on the basis of indirect constraints they exercise. CTU proposes the division of the national territory into two relevant geographic sub-markets:

- Segment A, where at least 3 competing infrastructures are present (cable, xDSL and Wi-Fi or FTTx, xDSL and Wi-Fi) and where the market share of Telefónica does not exceed 40%; and
- Segment B, covering all other locations.

In segment A, CTU finds that no company has SMP and proposes the imposition of no remedies. In segment B, CTU finds that Telefónica has SMP and proposes the imposition of the following obligation on the xDSL network of the SMP operator:

- Transparency;
- Non-discrimination;
- Accounting separation; and
- Access.

The Commission expresses serious doubts in regard to the inclusion of cable and Wi-Fi in the relevant market. The Commission considers that CTU has not provided sufficient evidence to prove that such indirect constraints are sufficiently strong to warrant such a wide market definition. The Commission notes that CTU stated that Telefónica has no SMP in some areas precisely because it widens the market definition on the basis of indirect constraints.

The Commission expresses serious doubt about the geographic segmentation of the market and considers there is a lack of sufficient evidence supporting the division of geographic market into A and B segments. Whilst the Commission notes that the arguments made by CTU in favour of geographic segmentation of the territory might contribute to a retail market definition or a definition of appropriate remedies, the Commission doubts that these arguments are sufficient to identify two separate wholesale geographic markets.

Based on the Framework Directive, BEREC is issuing the current opinion on the serious doubts expressed by the Commission in accordance to Article 7(3). BEREC will issue separately another opinion on the serious doubts expressed by the Commission in accordance to Article 7(a).

Concerning the inclusion of cable and Wi-Fi in the market definition, BEREC agrees with CTU reasoning to include cable and Wi-Fi in the relevant market based on the indirect constraints they exert on Telefónica. BEREC considers CTU has provided sufficient evidence of the strength of these indirect constraints.

Concerning the serious doubts expressed by the Commission regarding the geographic segmentation, BEREC considers that CTU has provided sufficient evidence of a geographic differentiation of competitive conditions in the relevant product market defined above. As consequence, defining sub-national markets is appropriate.

2. Introduction

On 11th of May 2012, the European Commission ("the Commission") registered a notification from the Czech national regulatory authority, Český telekomunikační úřad (hereinafter CTU), concerning the Wholesale Broadband Access (WBA) market in the Czech Republic.

On May 16th 2012, the Commission sent a request for information (RFI) to CTU and a response was received on 21 May 2012. A supplementary RFI was sent on 25 May 2012 and a response was received on 31 May 2012.

The Commission initiated a phase II investigation, pursuant to Article 7 and pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC (Framework Directive), with a so called serious doubts letter on June 11th 2012. In accordance with the BEREC rules of procedure the Expert Working Group (EWG) was established on June 14th May 2012 with the mandate to prepare an independent BEREC opinion on the justification of the Commission's serious doubts on the case.

On 19th of June 2012 the initial meeting of the EWG took place in Paris. During this meeting, the EWG invited CTU to gather further information and clarification on the notification.

A draft opinion was finalized on the 4th of July 2012 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 10 July. This opinion is now issued by BEREC in accordance with Article 7(3) of the Framework Directive.

3. Background

The first review of the wholesale broadband access market was conducted in 2006 under case CZ/2006/0449. CTU defined a single national market for wholesale broadband access comprising access provided over xDSL and FTTx technologies. However CTU excluded Wi-Fi, cable and CDMA platforms from the WBA market insofar as these infrastructures did not offer access equivalent to bitstream access. CTU designated Telefónica as having significant market power and imposed on it obligations of access, transparency, non-discrimination and accounting separation. The Commission invited CTU to impose a price control mechanism to avoid a margin squeeze risk, as well as the obligation to provide access at connections at ATM level and/or DSLAM level.

The second review of the wholesale broadband access market was conducted in 2008 under case CZ/2008/0797. CTU defined a single national market for wholesale broadband access comprising access provided over xDSL technologies. CTU excluded FTTx, cable, Wi-Fi, FWA, CDMA and UMTS platforms from the WBA market. CTU designated Telefónica as having significant market power and maintained on it the same obligations as in the first review. The Commission questioned the exclusion of FTTx from the market. It also questioned CTU's broad definition of the retail market to include mobile and wireless products and invited CTU to follow-up closely the impact of retail competition on the relevant wholesale market and to check the SMP finding accordingly.

4. Lack of sufficient evidence supporting the inclusion of cable and Wi-Fi in the product market definition

a. Assessment of the methodology used by CTU

Concerns of the Commission

In its letter, the Commission expresses serious doubts pursuant to article 7 (4) of the Framework Directive as regards the markets definition and the SMP analysis. It stated a lack of sufficient evidence supporting the inclusion of cable and Wi-Fi in the product market definition.

CTU proceeds to consider whether competition at the retail level from vertically integrated undertakings may be such as to exert an indirect constraint on the market. CTU states that such indirect constraints are sufficient to include cable and Wi-Fi in the product market. The Commissions "*considers, however, that CTU has not provided sufficient evidence to prove that such indirect constraints are sufficiently strong to warrant such a wide market definition*".

The Commission notes that CTU stated that Telefónica has no SMP in some areas precisely because it widens the market definition on the basis of indirect constraints. Hence, the Commission notes that "*if the importance of indirect constraints is overstated, there is a risk of understating the SMP of the incumbent at the wholesale level by including self-supplied market-shares of vertically integrated operators who do not actually constrain the behavior of the incumbent on the wholesale market*".

BEREC's view

The question in this regard is whether CTU's decision of including cable and Wi-Fi in the product market definition based on the indirect constraints exerted on the wholesale market was correct or not.

The Commission has already expressed serious doubts in previous market definition and SMP analysis as regards the inclusion of indirect constraints in the relevant market assessment.

In the Explanatory Note (C(2007) 5406)[1], the Commission noted that "*the presence of cable (or other broadband-capable networks) in a given Member State may, however, exercise an*

[1] Explanatory Note to the 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 of

indirect constraint on the provider of DSL-based wholesale broadband access, through the substitutability between both products at retail level.". Then, the Commission added that "*such indirect pricing constraint, where it is found to exist, should be taken into account when assessing if the incumbent DSL operator has SMP on the relevant market*" and confirmed that statement in case UK/2010/1065[2] saying "*where pricing constraints from the retail market are found to exist, they should be taken into account at the stage of the SMP assessment. […] [The Commission] urges the British regulator not to include cable in the WLA market in its final measure*".

Yet, in case ES/2008/0805, the IRG Expert Group disagreed with the Commission's view that indirect constraints should as a principle rather be taken into account in the assessment of SMP than in the definition of the relevant market. It also considered that "*in principle indirect constraint can be taken into account in the market definition stage or the market power assessment stage. […] To the extent this is the case, it is for the NRA to determine which approach is more appropriate. Indeed, […] a number of NRAs have previously determined it appropriate to include indirect constraints in the market definition stage of the analysis rather than the market power assessment*".

Nevertheless, although the Commission commented or expressed serious doubts about the inclusion of broadband-capable networks in the market definition based on indirect pricing constraint instead of taking into account these indirect constraints in the context of the SMP analysis, the Commission noted in several cases[3] that the outcome of SMP assessment would not have been significantly different than the one proposed by the NRA.

Beyond theoretical debates on the best approach, it seems reasonable to expect that the regulatory outcome of both methods (including indirect constraints only at the stage of SMP assessment or also at market definition stage) should be the same, especially if there are no strong direct constraints prevailing, such as in the present case. Depending on the market definition, including or not self-supply, the incumbent's market share will be mechanically lower or higher but in any case, the SMP assessment is not reduced to a simple consequence of the market share of the incumbent, even if some levels (e.g. 100%) constitute a strong presumption of SMP and of the need for remedies.

Regarding the present case, the retail market is composed of broadband accesses through:

- copper lines using xDSL technology,
- optical fibre networks (FTTx),
- cable TV networks (CATV),
- radio networks in non-licensed frequency bands using Wi-Fi technology.

Yet, on the wholesale market, Telefónica provides the only credible wholesale offer across the national territory in this market. CTU conducts an examination of substitutability of access

the European Parliament and of the Council on a common regulatory framework for electronic communications networks and service (C(2007) 5406), pp. 34-35

[2] SG-Greffe (2010) D/7658

[3] Case UK/2007/0733 (SG-Greffe (2008) D/200640), case FI/2009/0900 (SG-Greffe (2009) D/2294), case UK/2010/1064 (SG-Greffe (2010) D/7658)

through xDSL, FTTx, cable and Wi-Fi on the wholesale broadband access market and finds that neither cable (due to technical or economic constraints) nor Wi-Fi (due to a very fragmented infrastructure) exercise direct constraints on the wholesale market on xDSL and FTTx platforms.

As a consequence, CTU proceeds to consider whether competition at the retail level from vertically integrated undertakings may be such as to exert an indirect constraint on the market for wholesale access services and whether such indirect pricing constraints, where they are found to exist, should be taken into account. As mentioned before, these indirect constraints can be taken into account at different stage of the analysis (market definition or SMP assessment), although the Commission indicated its preference[4] for "*an approach where the elements relating to the SMP assessment are considered together in one analytical step and not split up such that some are found in the geographic market definition and some in the SMP assessment*".

BEREC believes it worth recalling at this point that market definition is a means to an end, the end of which is to assess whether end users are sufficiently protected by effective competition and whether or not ex ante regulation is required. It is therefore necessary for an NRA to identify all relevant products which provide a sufficient constraint on each other. When considering wholesale markets, this can be through direct constraints or indeed also indirect constraints from the retail level. Indeed, when conducting an analysis of wholesale markets under the regulatory framework the indirect constraints from the retail level may be stronger than any direct constraints, particularly if it is considered there would be no wholesale provision, in case of absence of a regulatory requirement.

BEREC also considers that in principle indirect constraints can be taken into account at the market definition stage or the market power assessment stage. However, it is important that, whichever approach is adopted by the NRA, the analytical model is correctly specified. To the extent that this is the case, the ultimate outcome of the analysis should be the same. However, it may be that to include indirect constraints in the market definition stage could be more straightforward and transparent than to do this in the assessment of market power. To the extent this is the case, it is for the NRA to determine which approach is more appropriate. Indeed, as noted above a number of NRAs have previously determined it appropriate to include indirect constraints in the market definition stage of the analysis rather than the market power assessment. When wholesale market definitions are based on indirect constraints, it is important not to overstate the strength of these constraints in the SMP analysis.

In the present case, BEREC has to assess the strength of these indirect constraints on Telefónica's wholesale offer. In this particular case, the Commission has based its concerns on a test stating that indirect constraints are sufficiently strong if:

[4] Case UK/2007/0733 (SG-Greffe (2008) D/200640), page 11.

(i) ISPs would be forced to pass a hypothetical wholesale price increase on to their consumers at the retail level based on the wholesale/retail price ratio;
(ii) There would be sufficient demand substitution at the retail level to retail services on indirect constraints such as to render the wholesale price increase unprofitable;
(iii) The customers of the ISPs would not switch to a significant extent to the retail arm of the integrated hypothetical monopolist, in particular if the latter does not raise its own retail prices.

For this reason BEREC will assess the application of this test by CTU in its notification.

Effects of deregulation

BEREC notes that the concerns of the Commission are related to the product and geographic market definition in the notification from CTU. As a result of the finding of effective competition on the wholesale broadband markets in segment A the existing regulatory obligations on these markets are withdrawn. In BEREC's view regulatory obligations should indeed be withdrawn as a consequence of a non-finding of SMP on a correctly defined relevant market.

Where an NRA is defining sub national markets and the analysis of these submarkets results in deregulation of certain geographic parts of the territory of the Member State, BEREC is of the opinion that NRAs should assess the possible consequences of withdrawing regulation in the light of the need for appropriate measures on neighboring markets. Such an assessment however should not act as a legal threshold that should be reached before a market can be deregulated.

In its assessment of the case BEREC has looked at the possible consequences of deregulation in segment A on the market situation in segment B. As Telefónica is currently regulated on a nationally delineated relevant market it has a national wholesale offer. A possible concern raised within BEREC is whether Telefónica would maintain its wholesale offer in segment A on a voluntary basis after deregulation.

In this context BEREC remarks in general that it is very difficult to predict the behavior of regulated companies in reaction to response to changes in the regulation. In the specific situation where Telefónica is facing strong indirect constraints from vertically integrated operators and to some extent a constraint from LLU operators, it can be expected that Telefónica will carefully examine whether the current wholesale offer should be maintained. A withdrawal of the wholesale offer in segment A areas might, in the presence of strong competition from cable and Wi-Fi operators, easily induce switching from xDSL to other broadband techniques, which would mean of loss of wholesale revenues that is not compensated by additional retail revenue. In such a scenario the withdrawal of the wholesale offer in a competitive market would not be profitable for Telefónica. With respect to this BEREC points at several wholesale broadband access markets in the EU (The Netherlands, Austria) where the withdrawal of access regulation on parts of market 5 did not lead to the withdrawal of the wholesale offers on the non-regulated segments.

b. Assessment of the indirect constraints – application of SSNIP test

Concerns of the Commission

CTU conducts an examination of the substitutability of access through xDSL, FTTx, cable and Wi-Fi on the wholesale broadband access market and finds that neither cable nor Wi-Fi exercises direct constraints on the wholesale market on xDSL and FTTx platforms. CTU concludes, on the basis of an analysis of the substitution at wholesale level, that both cable and Wi-Fi platforms do not exercise direct competitive constraints on xDSL and FTTx services.

CTU proceeds to consider whether competition at the retail level from vertically integrated undertakings may be such as to exert an indirect constraint on the market for wholesale access services and whether such indirect pricing constraints, where they are found to exist, should be taken into account. CTU states that such indirect constraints are sufficient to include cable and Wi-Fi in the wholesale product market.

The Commission considers, however, that CTU has not provided sufficient evidence to prove that such indirect constraints are sufficiently strong to warrant such a wide market definition. If the importance of indirect constraints is overstated, there is a risk of understating the SMP of the incumbent at the wholesale level by including in the analysis the self-supplied market-shares of vertically integrated operators who do not actually constrain the behavior of the incumbent on the wholesale market.

The Commission bases its findings on three points in particular.

Firstly, the Commission considers that CTU has not provided sufficient evidence that a price increase (SSNIP) at wholesale level would be passed on to consumers.

Secondly, the Commission considers that CTU has not provided sufficient evidence to conclude that cable and Wi-Fi are substitutes at the retail level, currently and on a forward looking basis.

In particular the Commission notes that the consumer surveys on reactions to a SSNIP test were conducted on the basis of the most common xDSL service offered in the Czech Republic, being 8 Mbit/s. Telefónica is now offering services with speeds of 2, 16 and 25 Mbit/s and customers may become increasingly accustomed to higher speeds. Since Wi-Fi services in the Czech Republic have on average compared to xDSL lower speeds, the Commission questions whether Wi-Fi services clearly constitute a substitute at retail level.

Furthermore, the Commission therefore considers that the substitutability analysis between Wi-Fi and other internet access technologies is not sufficiently supported by the data provided by CTU and that Wi-Fi does not constitute a substitute for other technologies, particularly if considered on a forward looking basis in view of the capability and growing importance of FTTx, VDSL and cable.

Thirdly, the Commission is concerned that the evidence does not suggest that customers of the access seekers would not switch to a significant extent to the retail arm of Telefónica, in particular if the latter does not raise its own retail prices.

Although according to the title of the paragraph the concerns on retail substitution also relate to the inclusion of cable on the retail market, the Commission has not provided arguments in its serious doubts letter why cable broadband products should not be considered substitutes in the retail market.

BEREC's view

Justification of doubts on the wholesale product market

BEREC considers that, on balance, CTU has correctly included cable and Wi-Fi in the definition of the relevant product market. The arguments on which BEREC has come to this conclusion are set out below.

<u>Pass through of wholesale price increase to retail level</u>

With regard to the concerns of the Commission on the extent to which wholesale price increases are passed through to the retail level, BEREC has the following observations. CTU has assumed in its market research that a price increase of 10% at the wholesale level will, given the wholesale to retail price ratio of 62% to 75%, translate in a retail price increase of around 7%. CTU thereby implicitly assumes a 100% pass trough of wholesale price increases into retail prices.

The Commission apparently bases its concerns on an assumption that margins at the retail level are sufficiently high to absorb of the wholesale price increase. The information on the profitability of Telefónica in the notification indicates from BEREC's point of view that these margins are not sufficiently high to absorb a wholesale price increase as suggested in a SSNIP test.

Standard economic theory suggests cost passed through rates of 100% for effective competition. Based on the information on profitability of Telefónica (and more specifically Telefónica low retail profit) and the observations on the pricing pressure on the Czech broadband market as a whole it seems reasonable to conclude that wholesale prices increases will be passed on to the retail level for a very significant part.

<u>Substitution at retail level between xDSL/FTTx and Wi-Fi services and cable services</u>

The information provided in the notification shows a high price sensibility of xDSL customers. The surveys show that 76% of residential customers and 71% of business customers would consider switching to an alternative service in the event of a price increase of about 7%. 21% of residential customers and 4% of business customers would be willing (as a first preferred option) to switch to a cheaper service offering a lower speed in reaction to a price increase. In addition, the surveys also show that for a large part of the xDSL users the connection technology is not an important factor in their choice of broadband service, in other words they are indifferent to the technology used to access the Internet. BEREC moderates slightly the conclusion of these surveys because they only deal with intention to change, while e.g. real availability of alternative technology where not taken into account in the surveys. Although, CTU demonstrates that costs for establishment of a new service are not regarded as significant, it would have been more robust to include the question relative to switching cost within the question about willingness to change in case of a price increase.

Cable services

As regards the inclusion of cable in the relevant retail market, BEREC notes that the Commission has not provided any substantive argument supporting its doubts. BEREC considers this a serious flaw in the motivation of the serious doubts letter.

On the substance of the question whether cable broadband services constitute a substitute for xDSL and FTTx, BEREC agrees with the conclusions drawn by CTU. BEREC considers that the evidence produced by CTU clearly shows that cable broadband constitutes a substitute for xDSL and FTTx services in the Czech Republic. Both xDSL and cable broadband services are comparable to each other and are generally used for the same purposes. The notification shows that on a Mbit/s basis cable services are even cheaper than xDSL services. While cable broadband services are on average provided at higher speeds than xDSL, there is considerable overlap with speeds of FTTx services. Also on a forward looking basis, where VDSL or FTTN services would become more prominent, cable broadband would be able to provide substitutes for these services. CTU provided evidence in the notification on market shares of operators in the 57 biggest cities with population over 20.000 in the Czech Republic. This information clearly shows that where cable operators are present they are able to attain very significant market shares. In a large part of the sample, cable operators have the highest market share.

Based on the above BEREC considers that where cable providers are active on the market, they provide a significant competitive constraint on xDSL and FTTx services and CTU has correctly included cable services in the relevant retail product market. The limited coverage of cable broadband on a national scale is dealt with in section 5.

Wi-Fi services

CTU has provided evidence from surveys that the intended and actual use of the connections is not significantly different between xDSL and Wi-Fi services (both groups downloading large data files, watching IPTV, listening to internet radio or playing on-line games as revealed by the marketing surveys). The notification shows that there is a significant overlap in terms of the speeds of services offered and consumed between xDSL and Wi-Fi services. On average Wi-Fi services are provided at lower speeds against lower prices. According to information provided by CTU this seems to be result of consumer demand preferring lower prices (with lower speeds) rather than result of any technological limitation of Wi-Fi technology. Furthermore, CTU has provided information that shows that Wi-Fi providers are investing in speed upgrades of their services to keep up with the other technologies. In this respect it is worth noting the Wi-Fi technology is scalable relatively easily, which provides Wi-Fi flexibility to adapt capacity in response to market demand.

In BEREC's view, price and quality differences are in themselves not enough to conclude that products are not substitutes. What matters is whether customer preferences are so strong that in case of a price increase customers would not switch to a significant extent, making the price increase profitable. Based on the information in the notification, this seems not the case on the Czech broadband market. The evidence indicates that the relevant product market is wider than xDSL and FTTx and that Wi-Fi is a substitute in both areas where cable is present and where cable is not present. .

On the bases of the above BEREC considers that CTU has provided sufficient evidence to substantiate its conclusion that Wi-Fi services are substitutes at retail level and are part of the relevant retail market.

<u>Switch to the retail arm of Telefónica in reaction to a price increase</u>

In BEREC's view the application of this criterion is suitable in case the indirect constraints are assessed in the context of the SMP analysis, since it presupposes the presence of both vertically and non-vertically integrated operators on the relevant markets. The application in the context of a SSNIP test which supposes a non- vertically integrated hypothetical monopolist of wholesale services is therefore problematic. However, BEREC will give its opinion on the application of the criterion below.

The Commission bases its conclusions regarding this issue mainly on the assumption that Telefónica would be able to absorb a wholesale price increase, which is dealt with earlier in this BEREC opinion. Based on its finding regarding the possibilities to absorb the wholesale price increase, BEREC considers this an unlikely scenario.

Conclusion on the inclusion of cable and Wi-Fi in the relevant product market

In the light of the above, BEREC considers that CTU has provided sufficient evidence to base its conclusion that a SSNIP of wholesale broadband services would be passed on for a very significant part into retail price increases. Such retail price increases in themselves would induce switching to other technologies rendering the wholesale price increase unprofitable.

Therefore, BEREC considers that the inclusion of cable and Wi-Fi services in the relevant wholesale market based on the strength of indirect constraints is justified in this case.

BEREC notes that this conclusion does not necessarily imply that the indirect constraints are sufficiently strong to prevent CTU from finding SMP on the whole or parts of the territory of the Czech Republic. That finding is dependent on the exact definition of the relevant geographic market, which is dealt with in the next section, and the specific demand and supply conditions on the relevant market which is part of the SMP analysis.

5. Lack of sufficient evidence supporting the division of the geographic market into A and B segments

Concerns of the Commission

The Commission raises serious doubts as regards the compatibility of CTU's proposed geographic market definition with EU law, more precisely with the requirements laid down in Article 15(3) and Article 16(4) of the Framework Directive justified in light of the objectives laid down in Article 8 of the Framework directive.

In line with its discussion in relation to the product market, the Commission considers that CTU has not provided sufficient evidence of the indirect constraints exercised by the retail offers of cable and Wi-Fi operators on the WBA market, and that such constraints affect the conditions of competition in the Czech territory to the extent that two separate geographic markets can be found. Whilst the Commission notes that the arguments made by CTU in favour of geographic segmentation of the territory might contribute to a retail market definition or a definition of appropriate remedies, the Commission doubts that these arguments are sufficient to identify two separate wholesale geographic markets.

BEREC's view

The question in this part is whether CTU's decision of defining two relevant geographic submarkets was correct or not. That means that it has to be checked whether competitive conditions in the Czech Republic are geographically differentiated to such an extent that defining sub-national markets is appropriate

As in the question of indirect constraints above, BEREC believes it worth recalling at this point that market definition is a means to an end, the end of which is to assess whether end users are sufficiently protected by effective competition and whether or not ex ante regulations are required.

The analysis of the geographic market must define an area in which the undertakings concerned are involved in the supply and demand of products and services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.[5]

In the assessment of the justification of the serious doubts of the Commission BEREC will make use of the relevant guidance documents produced by the Commission and BEREC's predecessor ERG.[6] In its Common Position on Geographic Aspects of Market Analysis ERG came to the conclusion that where the available evidence suggests that the scope of the relevant market is local and this is justified on the basis of there being insufficient homogeneity of competitive conditions, then market power will be assessed in each of the

[5] 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 165/6, 11.7.2002 ("SMP-Guidelines").

[6] ERG Common Position on Geographic Aspects of Market Analysis (definition and remedies), ERG (08) 20 final CP Geog Aspects 081016

separate markets. However, this is not to say that competitive conditions need to be completely homogeneous throughout the whole of the geographic market, only that the competitive conditions are sufficiently homogeneous. This implies that there can be some variation in competitive conditions within a geographic market. This is consistent with the Commission's guidance on this point. An important condition for the definition of sub national markets is that the differences in the conditions of competition between geographic areas are sufficiently stable or sustainable.[7] If these differences are not sufficiently stable it may be appropriate to differentiate remedies geographically within a nationally defined geographic market.

Assessment of the analysis by CTU

Choice of the appropriate geographic unit

The ERG common position identifies two main options for the choice of the geographic unit on which the analysis can be based:

(i) units based on political or administrative boundaries such as postcodes, political districts or communities; and

(ii) units based on the network structure of the incumbent operator (or possibly alternative operators with sufficient coverage) such as local exchange areas.

CTU has chosen the first option being the level of communities within the Czech Republic.

Based on the observation that the differences on geographic conditions seem mainly caused by the presence of alternative networks and to a lesser extent based on LLU, BEREC considers the choice of the community as the appropriate geographic unit is justified in this case.

Assessing the homogeneity of competitive conditions

In its Common Position, ERG considered that the most important criteria for the analysis of the homogeneity of competitive conditions are those which are also of importance in an SMP analysis:

(a) barriers to entry

(b) number of suppliers

(c) distribution of market shares

(d) pricing and price differences

[7] See case UK/2007/733 (Wholesale broadband access in the UK, Letter SG-Greffe (2008) D/200640 from Februari 2, 2008.

(a) Barriers to entry

In its draft decision CTU has shown that barriers to entry are caused by economies of scale and the sunk costs made by investments into backbone and access networks. The level of the barriers to entry is dependent on the size of the potential demand in a certain community. CTU notes that while CATV and FTTx networks are mainly built in larger municipalities with a larger demand (> 5000 inhabitants), Wi-Fi networks are present in almost 74% of the total level of communities covering around 95% of the population.

In BEREC's view the analysis provided by CTU shows that a smaller potential demand and the presence of economies of scale, in particular in CATV and FTTx networks, create barriers inhibiting entry in smaller municipalities. These barriers are less relevant for investment in Wi-Fi networks as they operate on a significantly smaller minimum efficient scale. The above stated has been demonstrated also by higher broadband penetration rate increasing with increasing size of the municipality.

(b) Number of suppliers

In its draft decision CTU uses the number of technologies present in a certain community instead of the number of suppliers. In BEREC's view this seems justified given the character of the retail market in the Czech Republic where competition between different technical platforms is present. Indeed, two large providers of internet access on the bases of xDSL and CATV technology compete with a very high number of relatively small Wi-Fi operators and FTTx operators. Therefore a comparison on the basis of the number of suppliers per community may not be sufficiently informative on the conditions of competition in these communities. The number of technologies present may reflect these conditions better. In addition BEREC notes that CTU has shown in its draft decision that a correlation exists between the number of technologies and the number of suppliers in a given community.

(c) Distribution of market shares

In the notification, CTU has provided information showing that in municipalities where more technologies are present, the market shares of Telefónica are lower. Furthermore CTU has provided information on the market shares of different operators in the municipalities with a population of 20.000 inhabitants or more (57 municipalities).[8] This information shows that in the municipalities where CATV operators and FTTx operators are active, these operators have significant market shares. In a significant number of communities of segment A shown in Table 25, the cable operators have the highest market share.

The comparison of average market share of Telefónica between segment A and segment B shows that significant differences in market shares exist between the two segments.

[8] Table 25 of the notification concerns the 57 biggest cities in segment A (over 20 000 inhabitants). Although, segment A has about 250 cities, table 25 provides information for the most significant cities of the segment A.

The same applies also for market shares of CATV operators where the difference in market shares between two segments is even bigger (relatively high presence of CATV operators on segment A and only minor presence on segment B).

In addition to this, BEREC also notes that although Wi-Fi services seem fragmented at a national scale they can have significant presence at the level of municipality.

Therefore in BEREC's view CTU has demonstrated that significant differences in market shares of the relevant operators and technologies exist between the communities in segments A and B.

(d) Pricing and price differences

The draft decision of CTU notes that cable providers generally have lower prices than Telefónica for comparable services.

It also shows that Wi-Fi prices in communities where only two technologies are present (being xDSL and Wi-Fi) are significantly higher than communities where four technologies are present.

With regard to the pricing policy of Telefónica, CTU shows that although list prices are the same within the whole territory of the Czech Republic, Telefónica applies special acquisition offers in specific areas. These offers are applied almost exclusively in areas where next to xDSL networks and Wi-Fi networks also CATV and FTTX networks are present (there are some exceptions on the presence of FTTx but no on CATV).

In BEREC's view CTU has demonstrated that significant pricing differences exist between communities due to the presence of alternative technologies. The fact that Telefónica applies regional acquisition offers also underlines that Telefónica is facing stronger competition in communities where more technologies are available. The fact that the market share of Telefónica in these areas is significantly lower may also be the result of not applying differentiated pricing to the full extent.

Sustainability of market boundaries

The notification contains the following information on the sustainability of market boundaries.

Although fragmented, Wi-Fi networks already have an almost national coverage and are being upgraded. CTU has stated that no further geographical roll out of cable networks is expected. In areas where cable networks are present the operators undertake investments in upgrading the existing networks to enable supply of additional services and higher speed services.

Telefónica is not investing in extensions of the copper network with new copper lines. Investments are made in application of new technologies such as VDSL.

On the basis of this information, BEREC considers that the market boundaries are rather stable.

Conclusion on the division of the geographic market into A and B segments

Based on an assessment of the above mentioned criteria BEREC comes to the conclusion that CTU has provided sufficient evidence showing that significant differences in competitive conditions exist in the wholesale broadband access markets in the Czech Republic. These differences can be mainly attributed to the presence of CATV and to a lesser extent FTTx networks in the communities contained in segment A. In addition to this BEREC also notes that although Wi-Fi services seem fragmented at a national scale they can have significant presence at the level of municipality.

BEREC notes that CTU has proposed a classification according to the following criteria: communities where at least 3 technologies are available and where the market share of Telefónica does not exceed 40% belong to segment A. This market share reflects a careful approach in the assessment of SMP and is justified in the light of BEREC's earlier remarks on the inclusion of Wi-Fi and Cable in the relevant market based on wholesale constraints.

6. Conclusion

On the basis of the review of the available documents and other information supplied by CTU, BEREC draws the following conclusions as regards the justification of the serious doubts.

Concerning the inclusion of cable and Wi-Fi in the market definition, BEREC agrees with CTU reasoning to include cable and Wi-Fi in the relevant market based on the indirect constraints they exert on Telefónica. BEREC considers that CTU has provided sufficient evidence of the strength of these indirect constraints. However, BEREC wants to highlight that these conclusions regarding Wi-Fi are the result of the specific position of Wi-Fi within the Czech market.

Concerning the serious doubts expressed by the Commission regarding the geographic segmentation, BEREC considers that CTU has provided sufficient evidence of a geographic differentiation of competitive conditions in the relevant product market defined above. As consequence, defining sub-national markets is appropriate.