



EUROPEAN COMMISSION

Brussels, 10/08/2012
C(2012) 5654

COMMISSION DECISION

of 10/08/2012

**pursuant to Article 7 (5) of Directive 2002/21/EC
(Withdrawal of notified draft measures)
Case CZ/2012/1322: Wholesale Broadband Access in the Czech Republic**

Only the Czech version is authentic.

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 as amended by Directive 2009/140/EC of 25 November 2009 and Regulation (EC) No 544/2009 of 18 June 2009 (the Framework Directive) and in particular Article 7 (5) thereof¹,

Having regard to the opening of the second phase of investigation pursuant to Article 7(4) of the Framework Directive on 11 June 2012,

Having regard to the additional information provided by the Czech national regulatory authority, Český telekomunikační úřad (ČTÚ),

Having regard to the notice posted on the Commission's website on 13 June 2012 inviting third parties to submit observations on the Commission's serious doubts letter (the Notice),

Having regard to the opinion issued by the Body of European Regulators for Electronic Communications (BEREC) on 10 July 2012.

Whereas:

¹ OJ L 108, 24.4.2002, p. 33.

I. PROCEDURE

- (1) On 11 May 2012, the Commission registered a notification² from the Czech national regulatory authority ČTÚ, concerning the Wholesale Broadband Access (WBA) market³ in the Czech Republic under case number CZ/2012/1322.
- (2) On 16 May 2012, a request for information⁴ (RFI) was sent to ČTÚ 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.
- (3) On 11 June 2012, the Commission, pursuant to Article 7(4) of the Framework Directive, informed ČTÚ that it has serious doubts as to the compatibility of the draft measures with EU law (the serious doubts letter) and that it considers that the proposed measure would create a barrier to the internal market. The Commission, pursuant to Article 7a(1) of the Framework Directive, also informed ČTÚ that it has serious doubts that ČTÚ's proposed remedies are compatible with EU law and that it considers that they would create a barrier to the internal market.⁵
- (4) On 13 June 2012, the Commission posted a notice on its website inviting third parties to submit observations on the Commission's serious doubts letter. On 25 June 2012, one interested party submitted observations to the Commission. The observations were carefully considered.
- (5) On 2 July 2012, the Commission sent an additional request for information to ČTÚ. ČTÚ's response was received on 5 July 2012.
- (6) On 10 July 2012, the Commission received the opinion of BEREC.

II. DESCRIPTION OF THE DRAFT MEASURES

II.1. Market definition

- (7) ČTÚ starts its analysis with a definition of the retail market, which it finds to comprise broadband access through xDSL, FTTx, cable and Wi-Fi⁶. It also finds that there is no separate retail market for broadband access provided through bundles.

² In accordance with 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.

³ Corresponding to Market 5 in Commission Recommendation 2007/879/EC 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 (Recommendation on Relevant Markets), OJ L 344, 28.12.2007, p. 65.

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

⁵ C(2012) 4074.

⁶ Defined as access via radio networks in non-licensed frequency bands. ČTÚ finds that although Wi-Fi access cannot be compared to other platforms in some qualitative characteristics, from the point of end users it is the second most widespread platform to gain internet access after xDSL and represents a substitute particularly for the most price-sensitive customers.

- (8) ČTÚ defines the wholesale product market as the market for bitstream access enabling broadband data transmission in both directions to an end user with a nominal download speed of at least 256 kbit/s and with access permanently available. ČTÚ proposes to include in the WBA market access through xDSL and FTTx platforms, as well as through cable and Wi-Fi, but not through mobile platforms such as CDMA and UMTS.
- (9) ČTÚ defines xDSL and FTTx as basic inputs for this market, and then conducts an analysis of the substitutability of other platforms that it finds to compete with xDSL and FTTx at the retail market level, i.e. cable and Wi-Fi.
- (10) For cable, ČTÚ finds that this infrastructure does not exercise a direct constraint on xDSL and FTTx because, although it is theoretically possible for cable operators to offer wholesale access to access seekers, technical and operational limitations and their economic impact do not make it feasible⁷. However, ČTÚ includes cable in the product market on the basis of the indirect constraints which ČTÚ, according to its own analysis, finds that cable exercises through competition on the retail market. ČTÚ in particular estimates that:
- A hypothetical wholesale price increase of 5 to 10% would have to be passed on by ISPs to retail customers by a magnitude of 3 to 7.5%, and a hypothetical monopolist would have a low likelihood of absorbing the wholesale price⁸;
 - There is sufficient demand substitution on the retail market as surveys indicate that a significant majority of both business and residential customers are price sensitive and would consider switching providers in the event of a price increase of about 7%⁹;
 - In the event of a retail price increase by alternative operators, retail customers would not switch to a significant extent to the retail arm of the integrated hypothetical monopolist because the latter would in all likelihood have to raise its own retail prices¹⁰. In any event, non-discrimination and separate accounting rules (and potentially competition rules) could prevent Telefónica

⁷ ČTÚ cites technical difficulties particularly with the DOCSIS 2.0 standards, although it notes that the main cable operator has also implemented DOCSIS 3.0. ČTÚ also highlights the relatively limited coverage of cable, estimated at about 35% of households.

⁸ On the basis of the observation of strong retail competition from alternative infrastructures and of Telefónica's reports of low profit margins of less than [...] % from its ADSL services in the years 2007-2009. ČTÚ also indicates, however, that Telefónica has higher percentages of margin between wholesale and retail prices, e.g. that the ratio between wholesale and retail prices ranged from 62% to 75% for selected services from May 2011.

⁹ ČTÚ conducted surveys in March 2011 which found that 76% of residential customers and 71% of business customers would consider switching to an alternative service in the event of price increase of about 7%. The results were similar if only ADSL users were considered. However, only 21% of residential customers and 4% of business customers would be willing to switch to a cheaper service offering a lower speed. The research was based on the most common xDSL service offered at the time, 8 Mbit/s. ČTÚ notes that since May 2011 Telefónica offers services of 2, 16 and 25 Mbit/s.

¹⁰ ČTÚ states that Telefónica's low margins make it unlikely that it would not transfer a wholesale price increase to its retail offer; further, that the bitstream customers of Telefónica represented only 3.6% of broadband access through xDSL, FTTx, cable or fibre at 31 December 2011 and that therefore they represent a limited potential customer base for Telefónica.

from keeping its retail prices stable following a wholesale price increase. ČTÚ does not conduct this analysis absent regulation as it believes that in that case there may be no wholesale offer.

- (11) ČTÚ also does not find that Wi-Fi exercises a direct constraint because of the impossibility of providing equivalent access and a wholesale offer, and because, although the platform offers coverage across the national territory, Wi-Fi providers are extremely fragmented¹¹. ČTÚ, however, includes Wi-Fi in the product market on the basis of the indirect constraints that Wi-Fi according to ČTÚ exercises, as a result of the same analysis adopted for cable.
- (12) As regards the geographical dimension of the market, ČTÚ 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.
- (13) ČTÚ proposes the segmentation of the geographic market on the basis of different barriers to entry¹², number of operators¹³, distribution of market shares¹⁴ and retail price differentials¹⁵.
- (14) ČTÚ has analysed the conditions of competition at the level of each municipality, considering it a territorial unit which is sufficiently large not to constitute an excessive administrative burden for the imposition of remedies and sufficiently small to present homogeneous conditions of competition. ČTÚ considered that a territorial segmentation on the basis of the exchanges of Telefónica would not be appropriate because of the small development of LLU and because of the significance of alternative infrastructure in the Czech context¹⁶.

¹¹ Over 1000 providers.

¹² Primarily the size of demand in more populated areas, which affects the importance of economies of scale and sunk costs. In its response to the RFI, ČTÚ also states that most areas with less accessible terrain (e.g. mountainous areas) are located in segment B.

¹³ According to ČTÚ the number of operators depends on the population density but also the potential for growth, i.e. penetration.

¹⁴ ČTÚ notes that some changes to market shares can be expected during the next review period, particularly as Telefónica will continue to invest in FTTx networks and will continue to acquire small Wi-Fi providers.

¹⁵ Whilst Telefónica does not differentiate its wholesale prices between regions, it has differentiated regional offers at the retail level (offering lower prices for the first 12 months of a subscription) which are present mostly in municipalities with higher levels of competition. Further, the retail prices charged by Wi-Fi providers are lower in areas that have more competing infrastructures. Together with the lower prices offered by cable operators, this results in lower average prices in segment A.

¹⁶ In a response to the RFI, ČTÚ indicated that at the end of 2011, LLU providers represented 1.9% of Market 5 (as defined), whereas xDSL in total represented 37.4%, FTTx 9.1%, Wi-Fi 32.6% and cable 20.9%.

II.2. Finding of significant market power

- (15) In segment A, ČTÚ finds that no company has SMP. By definition, in these areas Telefónica's market share is 40% or less of the product market as defined by ČTÚ. ČTÚ states that cable operator UPC Česká republika, s.r.o. (UPC) has a 27.7% share. ČTÚ states that all other operators, including T-Mobile Czech Republic a.s. (T-Mobile), have less than 3% of the market as defined. There are about 880 other operators (primarily offering services on cable, FTTx and Wi-Fi platforms) out of which eight have market shares above 1%.
- (16) ČTÚ finds no undertaking as having SMP on several bases such as lower barriers to entry, range of offered products and services, economies of scale, vertical integration, development of a sales and distribution network, prices charged and profitability, although ČTÚ also finds that the overall size and national coverage of Telefónica is unique and gives it a competitive advantage.
- (17) In segment B, ČTÚ finds that Telefónica has SMP. It has a market share of 53.3% according to ČTÚ's market definition and the second largest competitor has less than 2%. Telefónica's SMP is confirmed by ČTÚ's analysis on several other bases such as its overall size, barriers to entry, economies of scale and vertical integration.
- (18) In a response to the RFI, ČTÚ stated that at 31 December 2011 the nation-wide market share of Telefónica on the WBA services market including self-supply provided through copper only was 94.8%, and LLU operators represented the remaining 5.2%. ČTÚ also stated that Telefónica's share of the WBA FTTx market was 4.5% (constituted entirely by self-supply, given the absence of a wholesale offer on an FTTx platform in Market 5¹⁷).

II.3. The notified regulatory remedies

- (19) ČTÚ proposes not to impose remedies in segment A.
- (20) In segment B ČTÚ proposes the imposition of the following obligations on the xDSL network of the SMP operator:
- Transparency¹⁸;
 - Non-discrimination;
 - Accounting separation; and
 - Access.
- (21) ČTÚ indicated in a response to an RFI, dated 31 May 2012, that the access obligation would apply to the xDSL and FTTN networks of the SMP operator, but not to the FTTH networks. ČTÚ explained that the SMP operator's FTTH network is very limited and that its investment focus is FTTN. The non-discrimination obligation would, according to ČTÚ, be applicable and ensure third-party access to the FTTH (or

¹⁷ Although, according to ČTÚ, FTTx wholesale offers exist in Market 6.

¹⁸ Including the publication of a reference offer and of key performance indicators.

FTTB) network should Telefónica choose to offer any retail services based on FTTH. In a further response to an RFI during the Phase II investigation, dated 5 July 2012, ČTÚ indicated that the general obligation would rather apply to all FTTx services, including FTTH, but that they expected Telefónica to concentrate rather on FTTCab.

- (22) ČTÚ proposes not to impose a price control remedy or cost orientation obligation on the SMP operator. In its response to the RFI, ČTÚ stated that it did not identify excessive pricing as a problem in this market and that therefore such obligations would not be proportionate.

III. THE COMMISSION'S SERIOUS DOUBTS

- (23) On 11 June 2012, the Commission, pursuant to Article 7(4) of the Framework Directive, informed ČTÚ that it has serious doubts as to the compatibility of the draft measures and particularly the proposed market definition with EU law and that it considered that the proposed measure would create a barrier to the internal market.
- (24) The Commission, pursuant to Article 7a(1) of the Framework Directive, also informed ČTÚ that it has serious doubts that ČTÚ's proposed remedies are compatible with EU law and that it considers that they would create a barrier to the internal market. However, the present Decision does not refer to the serious doubts raised by the Commission pursuant to Article 7a of the Framework Directive, which are the subject of a separate and parallel procedure as foreseen by the Framework Directive.

IV. OBSERVATIONS SUBMITTED BY THIRD PARTIES

- (25) On 13 June 2012, the Commission posted a notice on its website inviting third parties to submit observations on the Commission's serious doubts letter.
- (26) On 25 June 2012, one interested party submitted observations to the Commission. The observations were carefully considered. The party in question expressed their support of the Commission's serious doubts regarding the market definition. The party expressed concerns about the proposed deregulation of Segment A, which according to the submission, effectively leads to deregulation of more than 250 municipalities, half of which have a population of less than 5,000. The party states that in the absence of regulation, there will be no appropriate wholesale offers on the market and that it is not economically feasible for alternative operators to use LLU in order to serve all small or isolated municipalities.
- (27) Furthermore, the party expressed particular concerns that, absent regulation, alternative operators would have difficulties serving multi-site business customers and pointed out that the business segment is much more reluctant to use cable or Wi-Fi-based services than consumers are. Should the product market be delineated as proposed by ČTÚ, the party advocates segmentation between consumer and business services.
- (28) Regarding the geographical market definition, the party is concerned that the approach of "counting technologies" leads to an unreliable assessment of the competitive situation since it e.g. does not consider the real coverage of the technologies within the respective municipalities. The party further states that it does not believe that ČTÚ

conducted the SSNIP test correctly, and that the NRA relies too heavily on a consumer market survey, which was what led to the inclusion of Wi-Fi and cable in the relevant market based on indirect constraints.

V. BEREC OPINION

- (29) On 10 July 2012, the Commission received BEREC's Opinion on the Commission's serious doubts letter.
- (30) In its opinion, BEREC states that in its view market definition is a means to an end, namely to assess whether end users are sufficiently protected by effective competition and whether or not *ex ante* regulation is required, and that it is therefore necessary for an NRA to identify all relevant products which provide a sufficient constraint on each other. BEREC believes that when considering the boundaries of wholesale markets, this can be done through direct constraints or indirect constraints from the retail level. BEREC also indicates that it should be up to the NRA to decide whether indirect constraints should be analysed at the stage of determining the market definition, or rather at the market power assessment stage.
- (31) BEREC's opinion considers the possible consequences of deregulation of parts of the Czech market and whether the SMP operator would maintain its wholesale offer in the deregulated areas on a voluntary basis after deregulation. BEREC remarks that it is difficult to predict the behaviour of regulated companies. In its view, the withdrawal of the wholesale offer would not be profitable for the SMP operator, because, in the presence of what BEREC views as strong competition from cable and Wi-Fi operators, it might easily induce switching from xDSL to other broadband infrastructures, which would mean a loss of broadband revenue which is not compensated by additional retail revenue.
- (32) BEREC considers that on balance and having made an assessment of the test adopted by ČTÚ for such inclusion, ČTÚ has correctly included cable and Wi-Fi in the definition of the relevant product market based on the strength of indirect constraints. BEREC considers that based on the information on the profitability of the SMP operator (and more specifically its low retail profit margin) and the observations on the pricing pressure on the Czech broadband market as a whole it seems reasonable to conclude that any wholesale price increases will be passed on to the retail level for a significant part. Further, BEREC states that ČTÚ has provided sufficient evidence regarding the inclusion of cable and Wi-Fi services in the relevant retail product market. Finally, BEREC remarks that a wholesale price increase would not lead customers to switch to the retail arm of the SMP operator.
- (33) As regards the geographic market definition BEREC considers that ČTÚ has provided sufficient evidence showing that significant differences in competitive conditions exist in the wholesale broadband access markets in the Czech Republic. These conditions in BEREC's view can be mainly attributed to the presence of cable and to a lesser extent to FTTx networks in the communities contained in Segment A. In addition to this, BEREC also notes that although Wi-Fi services seem fragmented on a national level they can have significant presence at the level of municipality.
- (34) Pursuant the Article 7(5) of the Framework Directive, the Commission has to take utmost account of the opinion of BEREC.

V. ASSESSMENT

- (35) Under Article 7(4)(a) of the Framework Directive, where the intended measure covered by paragraph 3 aims at defining a relevant market which differs from those identified in the Recommendation in accordance with Article 15(1) of the Framework Directive and would affect trade between Member States, and the Commission has indicated to the national regulatory authority that it considers that the draft measure would create a barrier to the internal market or it has serious doubts as to its compatibility with EU law and in particular objectives referred to in Article 8, the draft measure shall not be adopted for a further two months. Under Article 7(5) of the Framework Directive, within this two-months period, the Commission may take a decision requiring the national regulatory authority concerned to withdraw the draft measure and/or to take a decision to lift its reservations expressed in the serious doubts letter.
- (36) First of all, the Commission considers that the draft measure falls within Article 7(4)(a) of the Framework Directive and that it would affect trade between Member States.
- (37) ČTÚ's draft measure concerning the WBA market in the Czech Republic falls within Article 7(4)(a) of the Framework Directive because ČTÚ includes cable and Wi-Fi in the relevant market, although these platforms do not allow the provision of wholesale non-physical or virtual network access including bitstream access, differently from the definition of market 5 envisaged in the Commission's Recommendation 2007/879/EC.
- (38) The Commission considers that the draft measure would affect trade between Member States because the conditions for the access to the relevant market determine the cost and the ability of other operators (including those established in other Member States) to provide electronic communications services. The draft market definition and the resulting proposal to deregulate segment A of the Czech market may therefore have an influence, direct or indirect, actual or potential, on the ability of any undertaking established in other Member States to offer electronic communications services in the Czech market. The lack of regulation of this market in substantial parts of the Czech Republic would affect the ability of access seekers (including those established in other Member States) to offer broadband services in the Czech market.
- (39) Further and as further reasoned below, the Commission considers that ČTÚ's conclusion on the relevant market definition (including both product and geographic market), on the basis of which it has made the assessment leading to the conclusion that there is no need for ex ante regulation of one of the two geographic markets, is not compatible with EU law, and particularly with the obligation that NRAs shall, taking utmost account of the Recommendation 2007/879/EC and the SMP Guidelines¹⁹, define and analyze relevant markets in accordance with the principles of competition law.
- (40) The Commission considers that the segmentation of the product and geographic market proposed by ČTÚ is not supported by sufficient evidence. Further, the

¹⁹ Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications and services (2002/C 165/03), ("the SMP Guidelines").

Commission notes that pursuant to Article 8(2)(a) to (c) of the Framework Directive, NRAs shall contribute to the development of the internal market by ensuring that there is no distortion or restriction of competition in the electronic communications sector and by encouraging efficient investment in infrastructure and promoting innovation. The Commission considers that in the case at hand, ČTÚ's relevant market definition overstates the constraints of internet access provided through different platforms on the WBA market, as explained in paras (50) to (69) of this Decision, and therefore that it does not fulfil the goals of the Framework Directive and particularly those enshrined in Article 8. The Commission also notes the specificity of the Czech context where the WBA and LLU access seekers have a limited presence.

- (41) In addition, the Commission considers that the proposed measure would create a barrier to the internal market, inter alia, as the conditions for wholesale access determine the costs and the ability of other operators (including those established in other Member States) to enter the corresponding wholesale and retail markets to a significant extent.
- (42) The Commission notes that Article 16 of the Framework Directive lays down that the national regulatory authorities shall carry out an analysis of the relevant markets taking into account the markets identified in the Recommendation and taking utmost account of the Guidelines. As a result, ČTÚ's analysis of whether any operators have SMP on the WBA markets in the Czech Republic must be based on its analysis of the relevant market. Therefore any amendment or withdrawal of the market definition will have to be reflected in a new SMP analysis, taking into account the new product and geographical definition of the market.
- (43) The Commission also notes that in accordance with Article 16(2) of the Framework Directive where an NRA decides whether to impose, maintain, amend or withdraw obligations on undertakings, it shall determine whether a relevant market is effectively competitive; this must be done on the basis of the relevant market definition. As a consequence, any amendment or withdrawal of the market definition will have to be reflected in a new proposal for draft remedies. Once the market definition has been withdrawn, based on the present Decision, the remedies proposed by ČTÚ on the basis of the current market analysis will no longer have a basis for their imposition.
- (44) The Commission considers that the proposed relevant market definition is not compatible with EU law for the following principal reasons:

Application of indirect constraints at the market definition stage results in a flawed market definition

- (45) In line with the Commission's guidance²⁰, indirect pricing constraints, where they are found to exist, should be taken into account when assessing if any operator has SMP on the relevant market. The Commission has in the past criticised that indirect constraints are taken into account at the market definition stage, although it did not

²⁰ 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 the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (C(2007) 5406), pp. 34-35. See also the Commission's comments letter in case UK/2007/0733.

challenge the resulting market definition by way of a veto where this would not have led to a different regulatory outcome than that being proposed. In this case, it would appear that a different market definition excluding (such indirect constraints from) either cable or Wi-Fi, or both infrastructures, would lead to a different SMP finding.

- (46) The Commission disagrees with BEREC's opinion that it should be for the NRA to decide on a case by case basis whether this analysis should be conducted at the market definition stage or at the SMP analysis stage. The Commission considers that the market definition must form a rigorously and objectively based conceptual framework for any competition analysis. In line with established jurisprudence of the Court of Justice regarding abuse of dominance, in a market power analysis the definition of the relevant market is of essential significance, because the possibilities of competition can only be judged in relation to those characteristics of the products in question by virtue of which those products are particularly apt to satisfy an inelastic need and are only, to a limited extent, interchangeable with other products²¹.
- (47) The Commission also notes BEREC's comment that the market definition is a means to an end, namely to determine whether end users are sufficiently protected by effective competition. The Commission considers that such analysis of the conditions of competition should be conducted on the basis of a sound and robust market definition and that constraints from neighbouring markets should be taken into account only at the stage of the SMP analysis. In previous cases²² the Commission has set out the conditions under which indirect constraints can affect market definition if applied rigorously.
- (48) The Commission considers that the threshold for including a particular infrastructure in a wholesale product market on the basis of indirect constraints and therefore in the absence of the possibility of direct substitution at the wholesale level must be high, so as to satisfy the conditions laid down in para (53) of this Decision. 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 behaviour of the incumbent on the wholesale market. The Commission notes that in this case this definition has a direct impact on the regulatory outcome because ČTÚ proposes to deregulate substantial parts of the Czech WBA market, notably in Segment A as defined by ČTÚ. The Commission notes that this concern was also shared by the Czech Competition Authority²³ in its comments on the draft measure provided in the context of the national consultation.
- (49) Ultimately, as is demonstrated below, the outcome in the present case, as regards the existence of SMP in respect of a relevant set of products/services and in a given geographic area, turns on lack of evidence and the substantive analysis of the evidence available.

²¹ See point 44 of the SMP Guidelines. This principle was initially laid down in Case 6/72 *Europemballage Corporation and Continental Can Co Inc v Commission* [1973] ECR 215 at para 32.

²² E.g. case UK/2007/0733.

²³ Úřad pro ochranu hospodářské soutěže, in its opinion on the draft measure dated 28 March 2012.

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

- (50) In this particular case, the Commission considers that ČTÚ has not provided sufficient evidence to prove that indirect constraints are sufficiently strong to warrant such a wide market definition. The Commission's analysis refers to both the constraints exercised by cable and by Wi-Fi on the wholesale (WBA) market.
- (51) ČTÚ starts by conducting an examination of substitutability of access through xDSL, FTTx, cable and Wi-Fi on the wholesale broadband access market and finds that neither cable nor Wi-Fi exercise direct constraints on the wholesale market on xDSL and FTTx platforms. Although a wholesale offer on cable is theoretically possible, ČTÚ considers that in the Czech context this is not feasible in practice and mentions in particular that the cable network only covers 35% of households. As to Wi-Fi, ČTÚ states that a wholesale offer would not be possible technologically and in any event that the very fragmented structure of the Wi-Fi provider segment (more than 1,000 operators) makes it unlikely.
- (52) ČTÚ 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. ČTÚ states that such indirect constraints are sufficient to include cable and Wi-Fi in the product market.
- (53) ČTÚ sets out the test to assess indirect constraints recommended by the Commission in response to previous cases²⁴. Specifically, the analysis of indirect substitution should consider whether:
- 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;
 - there would be sufficient demand substitution at the retail level to retail services based on indirect constraints such as to render the wholesale price increase unprofitable; and
 - 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.
- (54) Each of the three elements of the test above must be met for the indirect constraints to be considered sufficiently strong. Whilst the analysis of indirect constraints exercised by Wi-Fi fails all three elements of the test, the analysis of indirect constraints exercised by cable fails the first and third limb of the test.

²⁴ Cases UK/2007/0733 (SG-Greffe (2008) D/200640); FI/2009/0900 (SG-Greffe (2009) D/2294).

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 (referring to indirect constraints exercised by both cable and Wi-Fi).

- (55) First, and with respect to the constraints exercised by both cable and Wi-Fi, the Commission considers that ČTÚ has not demonstrated that a hypothetical wholesale price increase by Telefónica and by access seekers would be passed on to consumers. ČTÚ cites low profit margins of less than [...] % in Telefónica's ADSL services in 2007-2009 and assumes similar margins among other xDSL providers, i.e. ISPs. BEREC agrees that such margins together with observations of pricing pressure on the Czech broadband market as a whole are sufficient to conclude that the wholesale price increases will be passed on to the retail level to a very significant part.
- (56) However, the Commission disagrees with ČTÚ and BEREC and considers that this finding is not supported by the evidence for the following reasons. ČTÚ's review of profit margins are limited to the ADSL business of the SMP operator between 2007 and 2009. First of all, the ability of ISPs to absorb a wholesale price increase would principally depend on the margins generated by ISPs, which in turn would depend not only on the wholesale input costs but also on their distribution costs, which may not be the same as that of the SMP operator. ČTÚ did not explain why it considers the SMP operator's margins to equally apply also to ISPs although the SSNIP test depends on this assumption. Even if one were to conclude that inferences can be drawn from the SMP operator's profit margins, then these figures should at the minimum be up to date. However, the Commission considers that the 2007-2009 figures are too outdated to support ČTÚ's findings of indirect constraints. Further to that ČTÚ indicated that in May 2011 Telefónica changed its pricing structure and product offering substantially, and ČTÚ has not explained why it expects profit margins to have remained the same since 2009, neither for Telefónica nor for other ISPs.
- (57) Further, as regards existing customers of Telefónica, ČTÚ states that it is common for Telefónica to enter into contracts with customers, most often for 12 to 24 months, in which case it cannot alter its retail prices in the short and medium term to respond to a hypothetical wholesale price increase. Given that they are present in the same market, similar contract structures are to be expected for alternative operators as well, in which case they may not be able to raise its retail prices in response to a wholesale price increase at least for a significant number of customers. ČTÚ has not explored the impact of longer term contracts on ISPs' pricing behaviour.
- (58) Finally, ČTÚ has analysed the ratio of wholesale prices against retail prices. The data presented by ČTÚ indicates the ratio between wholesale and retail prices ranging from 62 to 75 % for the analysed services from May 2011. The ratio in itself does not demonstrate that there is no possibility for Telefónica, or other ISPs, to absorb a wholesale price increase without raising retail prices without a clear knowledge of distribution or other relevant costs. The case for a direct pass through of wholesale prices appears to be particularly weak when it comes to higher speed services, where the wholesale price represents a relatively lower proportion of the retail price, and which will grow in importance over time.
- (59) The Commission therefore considers that the evidence does not demonstrate that a hypothetical price increase at the wholesale level would be passed on to the retail level, and that it would not be possible for Telefónica or other ISPs to maintain its

xDSL retail prices stable after such increase and thus to continue to compete with cable and/or Wi-Fi at the retail level.

There would be sufficient demand substitution at the retail level to retail services based on indirect constraints such as to render the wholesale price increase unprofitable (referring to indirect constraints exercised by Wi-Fi only).

- (60) The Commission considers that, without prejudice of its findings in sufficiently different competitive circumstances in other markets in the future, in the present circumstances of the Czech market as described by ČTÚ, Wi-Fi cannot be considered a substitute at retail level. The Commission, on the other hand and differently from BEREC's understanding, did not raise doubts in its serious doubts letter on ČTÚ's analysis that cable is substitutable to xDSL and FTTx at the retail level.
- (61) ČTÚ conducted surveys to test consumer behaviour in the event of a SSNIP in March 2011. In those surveys, it found 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%. However, only 21% of residential customers and 4% of business customers would be willing to switch to a cheaper service offering a lower speed.
- (62) The Commission considers that the survey conducted by ČTÚ does not demonstrate substitutability between Wi-Fi and xDSL/FTTx for several reasons. First of all, and as noted by BEREC, the survey does not take into account the real availability of an alternative technology. Given the extremely fragmented nature of the Wi-Fi offer over the national territory, the survey does not take into account whether a Wi-Fi offer of comparable speed to the xDSL/FTTx product that the consumer is currently using is actually available. The research conducted by ČTÚ was based on the most common xDSL service offered at the time, 8 Mbit/s, but ČTÚ notes that since May 2011 Telefónica offers services of 2, 16 and 25 Mbit/s at both wholesale and retail level. Even if a consumer would consider switching to a different service of comparable bandwidth, it is not clear from the research whether such switching would be a real possibility.
- (63) Further, the data that is presented by ČTÚ shows that substitutability is unlikely to be possible for an important section of consumers, i.e. business users. Only 4% of business customers would be willing to switch to a different provider unless the same speed was guaranteed. Indeed, according to ČTÚ's data only 6% of business users use Wi-Fi as the main access technology, and only 4% use cable.
- (64) Further, ČTÚ states that Wi-Fi providers have the highest market share in the segment of internet connections with speeds of no more than 2 Mbit/s, and that in 2011 over 80% of Wi-Fi connections offered a speed of 10 Mbit/s or less – even if according to ČTÚ some Wi-Fi providers are investing in infrastructure and their focus on the low-speed segment is rather a commercial decision to attract more price-sensitive customers. Furthermore, ČTÚ notes that the fragmented nature of Wi-Fi providers means that the characteristics of Wi-Fi access are very variable across the national territory, and the same is likely to be true about upgrade investments by Wi-Fi providers.
- (65) The Commission therefore considers that the substitutability analysis between Wi-Fi and other internet access technologies is not supported by the data provided by ČTÚ

and that Wi-Fi, based on the evidence available and analysis conducted in this particular case, cannot be deemed to constitute a substitute for other technologies. This holds true particularly if considered on a forward looking basis in view of the capability and growing importance of FTTx, VDSL and cable in the Czech market and especially for customers in the Czech Republic that become increasingly accustomed to higher speeds, such as business customers.

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 (referring to indirect constraints exercised by both cable and Wi-Fi).

- (66) Finally, the Commission, unlike BEREC, considers 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. Given the above mentioned potential ability of ISPs to absorb Telefónica's wholesale price increase without raising their own retail prices, Telefónica may equally be able to maintain its retail prices without necessarily encountering a margin squeeze risk.
- (67) Further, the low profit margins in the ADSL product lines of Telefónica in 2007-2009, besides not being sufficiently up to date, only relate to the ADSL products lines, and do not take into consideration that Telefónica is a vertically integrated operator that is also active in other markets and offers the widest scope of bundled services in the Czech market, so that a profitability analysis cannot be limited to a single stand-alone product. Hence, the Commission considers it possible that there would be an incentive for Telefónica to raise wholesale prices without increasing its retail prices, therefore foreclosing access seekers from the WBA market. This would particularly be the case if, as ČTÚ proposes, regulatory remedies would be lifted in large parts of the country, and particularly in the most populated urban areas where the competition is more intense, and where Telefónica may have an incentive to eliminate competition from less established competitors that rely on WBA to reach customers.
- (68) The Commission notes BEREC's argument that Telefónica would not have an incentive to discontinue its wholesale offer in the de-regulated regions because of the risk of losing end customers to alternative infrastructures. However, the Commission considers that in the absence of any obligation on Telefónica, the company could well have the incentive to suspend its wholesale products if there was a sufficient prospect of gaining profitable end customers such as business customers, which are less likely to consider switching to alternative infrastructure even if the option exists.
- (69) The Commission notes the low level of development of alternative offers based on the incumbent's network in the Czech Republic, whether through physical unbundling or WBA. Indeed, ČTÚ states that Telefónica continues to represent 94.8% of the Czech WBA market on xDSL. ČTÚ also states that currently there is no wholesale offer on FTTx. The Commission considers that it is not likely that, as ČTÚ states, the small size of alternative operators on Telefónica's network would constitute a disincentive to increasing prices. On the contrary, the weakness of the WBA competitors would create an incentive for Telefónica to raise wholesale prices in the short term without raising retail prices, with the prospect of excluding xDSL competitors that have not been able to invest in LLU in relatively short time period.

Conclusion

- (70) The Commission notes that the indirect constraints that have been presented by ČTÚ could constitute an element in the assessment of SMP in the market and, potentially, could affect the determination of remedies. However, the Commission considers that the reasoning and information put forward by ČTÚ is not sufficient to support an inclusion of cable and Wi-Fi in the product market definition in the case at hand. The Commission has taken BEREC's opinion into utmost account and does not share its conclusions for the above stated reasons.

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

- (71) In line with the concerns on the product market definition and on the basis of the information provided, the Commission considers that the segmentation of the geographic market into segment A and segment B is not in conformity with competition law principles. 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. It is necessary, in that assessment, to take particular account of the nature and characteristics of the products or services concerned, the existence of entry barriers, consumer preferences, the existence of appreciable differences in the undertakings' market shares, or price differences²⁵.
- (72) In line with its discussion in relation to the product market, the Commission, unlike BEREC, considers that ČTÚ has not demonstrated indirect constraints exercised on the WBA market by the retail offers of cable and Wi-Fi operators, and that their presence results in separate relevant markets at wholesale level. Indeed, the geographic market criterion of a 40% market share threshold of the SMP operator, which ČTÚ adopts, is calculated on the basis of a product market definition that the Commission does not share.
- (73) The Commission notes that, in accordance with principles of competition law²⁶, in the electronic communications sector the geographic scope of the relevant market has traditionally been determined by reference to two criteria: the area covered by the network and the scope of application of legal and other regulatory instruments. This corresponds generally to the territory of the Member State, although NRAs can in principle find sub-national geographic markets, particularly where alternative infrastructure is uneven across the territory of a Member State.

²⁵ Commission notice on the definition of relevant market for the purposes of Community competition law (97/C 372/03), para 8; joined Cases C-68/94 and C-30/95 *France and Others v Commission* [1998] ECR I-1375, '*Kali & Salz*', paragraph 143; joined Cases T-346/02 and T-347/02 *Cableuropa and Others v Commission* [2003] ECR II-4251, paragraph 115.

²⁶ See also the Commission's Explanatory Note accompanying the Recommendation on Relevant Markets, SEC(2007) 1483 final.

- (74) The Commission's notice on the definition of the relevant market for the purposes of Community competition law²⁷ further outlines the Commission's approach to geographic market definition where it states that the Commission "*will take a preliminary view of the scope of the geographic market on the basis of broad indications as to the distribution of market shares between the parties and their competitors, as well as a preliminary analysis of pricing and price differences at national and Community or EEA level. This initial view is used basically as a working hypothesis to focus the Commission's enquiries for the purpose of arriving at a precise geographic market definition*"²⁸.
- (75) As regards the definition of sub-national markets, the Commission considers that a geographic delineation which is primarily based on the number of alternative infrastructures present in a municipality is not by itself sufficiently detailed or robust to identify real differences in competitive conditions for the purposes of market definition. In assessing whether conditions of competition within a geographic area are similar or sufficiently homogeneous, additional structural and behavioural evidence is necessary²⁹.
- (76) In this case, the Commission considers that ČTÚ has not demonstrated that the WBA geographic market is smaller than national and that sub-national markets can be found. The Commission considers that the evidence provided by ČTÚ points towards a nation-wide wholesale market in the present case.
- (77) This is first of all demonstrated by the fact that ČTÚ states that Telefónica's wholesale offer is national and that its wholesale pricing policy is based on a nation-wide average and results from its own commercial strategy³⁰. Further, there are no significant WBA wholesale offers on the market other than Telefónica's, which according to ČTÚ, has 17 WBA customers, the most significant being T-Mobile. The Commission, like BEREC, notes that ČTÚ identifies some pricing differentials at the retail level in areas where at least three infrastructures are present (based, amongst other things, on Telefónica's own regional retail offers which are implemented to acquire new customers). However, the Commission considers that the evidence of variations in retail prices is not sufficient to identify separate geographic markets at the wholesale level as these retail price differentials are not reflected in differences in the pricing of the wholesale offer.
- (78) Additionally, ČTÚ notes that Telefónica's nation-wide network, primarily based on xDSL, but also FTTx, is still unique in its territorial reach. In this way Telefónica's position is unmatched by competitors relying on any alternative platforms, given that cable only reaches 35% of households and Wi-Fi providers are very fragmented. In particular when considering business customers who require multi-site connections,

²⁷ Commission Notice on the definition of relevant market for the purposes of Community competition law (97/C 372/03), paras 28-31.

²⁸ The notice outlines further that it will also need to be established whether companies in different areas do indeed constitute an alternative source of supply for customers and whether companies located in different areas would face impediments to developing their sales on competitive terms throughout the whole geographic market.

²⁹ See case UK/2007/0733.

³⁰ In a response to the RFI, ČTÚ explained that this is as a result of Telefónica's commercial strategy and not of a regulatory obligation imposed on it.

the offer of Telefónica seems to be unavoidable for those customers that prefer to contract with one single nation-wide provider.

- (79) Furthermore, the Commission considers that the information provided does not indicate that the territorial unit chosen to divide the geographic market, i.e. the municipality, represents a sufficiently stable and homogeneous area of competition, so as to constitute the basis of separate geographic markets, as explained below. The Commission agrees with BEREC's view that the conditions of competition within a geographic market need not be completely homogeneous throughout the geographic market. On the other hand, they need to be sufficiently homogenous and stable, and the Commission disagrees with BEREC that the evidence supports this in the Czech case.
- (80) In a response to an RFI, ČTÚ indicated that overall the criteria to define the two segments (number of technologies and market share of the incumbent) are sufficiently correlated to other criteria such as retail prices, barriers to entry and marketing strategies to warrant a stable delineation according to the municipalities.
- (81) In this respect, first of all the Commission notes that ČTÚ's observations are primarily related to the retail market, and not the wholesale market. Further, as to the non-uniformity of pricing, the Commission notes the comment of the Czech Competition Authority that whilst Telefónica has retail pricing offers that are present only in some parts of the national territory and not across the Czech Republic, the discount offers are not geographically limited, but rather any customer resident in any part of the national territory can take advantage of such offers by traveling to the retail outlets in the discount areas. Given the proximity between A and B municipalities, this does not point towards the stable nature of the borders between A and B areas. Finally, as regards barriers to entry, in ČTÚ's analysis these are primarily justified by population density and the resulting economies of scale. However, segment A includes a range of differently sized municipalities, from villages to the capital city of Prague, which presumably present very diverse population densities and resulting economies of scale.
- (82) In conclusion, the Commission considers that ČTÚ's proposed product and geographic market definition is not compatible with EU law, more precisely with the requirements laid down in Article 15(3) and Article 16(4) of the Framework Directive in light of the objectives laid down in Article 8 of the Framework Directive. Whilst the Commission notes that the arguments made by ČTÚ in favour of geographic segmentation of the territory might contribute to a retail market definition or a definition of appropriate remedies, the Commission does not consider that these arguments are sufficient to identify two separate wholesale geographic markets. The Commission has taken BEREC's opinion into utmost account and does not share its conclusions for the above stated reasons.

Creation of barrier to the internal market

- (83) The Commission also believes that ČTÚ's draft measure would create a barrier to the internal market. The Commission notes that the conditions for the access to the relevant market affect the cost and the ability of other operators (including those established in other Member States) to provide electronic communications services. The draft market definition and the resulting proposal to deregulate segment A of the Czech market may therefore have a negative influence direct or indirect, actual or

potential on the ability of any undertaking established in other Member States to offer electronic communications services in the Czech market. In the case at hand, the lack of regulation of this market in substantial parts of the Czech Republic would affect the ability of access seekers (including those established in other Member States) to offer broadband services in the Czech market, in particular those which require wholesale input from a range of different geographical areas, included or excluded from the market definition in the draft measure. On the basis of the above, the Commission considers that the draft measure would create a barrier to the internal market.

VI. CONCLUSION AND PROPOSALS FOR AMENDING THE DRAFT MEASURES

- (84) Following the detailed examination of ČTÚ's notified draft measure, its submissions, third parties' submissions and having taken utmost account of BEREC's opinion, and for the reasons stated above, the Commission concludes that the evidence available does not support the product and geographic market definition proposed by ČTÚ.
- (85) Therefore, the Commission considers that the draft measure with regard to market definition is not compatible with EU law, in particular with Articles 8 and 14 to 16 of the Framework Directive.
- (86) The Commission has not found the indirect constraints put forward by ČTÚ to be sufficient to include Wi-Fi and cable in the relevant wholesale market, thus resulting in a full geographical segmentation and partial deregulation of the Czech wholesale broadband access market. In the light of the data and evidence provided by ČTÚ, the Commission invites ČTÚ to reassess the possibility of taking the indirect constraints into account at the stages of (i) SMP analysis and (ii) when identifying the most appropriate and effective remedies, rather than at the market definition stage.
- (87) The Commission notes that the regulatory framework does not exclude 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.³¹ Based on the general principle that remedies should be tailored and proportionate to the identified competition problem, it can be appropriate for NRAs to impose remedies which take account of locally/regionally differentiated competitive conditions while retaining a national geographic market definition. The geographic differentiation of remedies may be appropriate in those situations where, for example, the boundary between areas where there are different competitive pressures is variable and likely to change over time, or where significant differences in competitive conditions are observed but the facts would not point to sub-national markets. In addition, a differentiation of remedies may be appropriate where premature removal of *ex ante* regulation could have significant detrimental consequences for consumers and the competitive process. It is also important that any proposed market boundaries would be sufficiently stable over time³².

³¹ For example cases AT/2008/0757, FR/2008/0914, and PL/2011/1184.

³² See case UK/2007/0733.

HAS ADOPTED THIS DECISION:

Article 1

Český telekomunikační úřad shall withdraw the entire draft measure notified to the Commission on 11 May 2012 and registered under case number CZ/2012/1322.

Article 2

The Commission invites ČTÚ to reassess the possibility of taking the indirect constraints, and any variations in their geographic scope, into account at the stages of (i) SMP analysis and (ii) when identifying the most appropriate and effective remedies, rather than at the market definition stage.

Article 3

This Decision³³ is addressed to:

Český telekomunikační úřad (ČTÚ)

P. O. Box 02

CZ 22502 Praha 025

Czech Republic

Done at Brussels,

For the Commission

Neelie Kroes

Vice-President

³³ Pursuant to point 14 of the Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of the Framework Directive, the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. ČTÚ is invited to inform the Commission within three working days following receipt whether it considers, in accordance with European Union and national rules on business confidentiality, that this document contains confidential information which it wishes to have deleted prior to such publication. ČTÚ should give reasons for any such request. The request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32.2.298.87.82.