BENEFITS FOR CONSUMERS FROM COMPETITION IN THE "NEW ECONOMY"

THE CASE OF ACCESS TO THE INTERNET AND THE LOCAL LOOP

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Thank you Mr Chairman. I would like to answer three important questions.

Firstly, why is unbundling of the local loop so important?

Secondly, what is the European policy on unbundling of local loop?

Thirdly, what is the present assessment of the success or failure of ULL by the European Commission. Finally, I would like to conclude with several remarks.

[1] This speech is co-authored with Jérôme Fehrenbach and Juan Delgado Urdanibia

1. WHY IS UNBUNDLING IMPORTANT ?

Unbundling is a complex and controversial matter. It implies a very novel situation, whereby new entrants gain a right to actually take over fully or partly the relationship with the end customer. Several forms of access to the incumbent's facilities had already been implemented, such as carrier selection and interconnection, but none of these went so far, nor were so intrusive as the unbundled access to the local loop. Technically, it raises a number of issues. Economically, it affects this tremendous (and difficult to value) asset which is the "fixed" end customer. So far, consumers despite the various modes of access to the incumbent's network, had little choice but to retain a telephone subscription with the incumbent, except if they decided to cancel their fixed telephone subscription and to rely solely to mobile terminals.

Given these far-reaching implications of local loop unbundling, it is worth recalling now what is the rationale for LLU, why it makes sense economically.

We all have in mind what is at stake with the development of broadband services to consumers, namely the availability of easy, user-friendly, time-saving, efficient Internet access, the possibility to deliver rich contents (software applications, media) directly into companies or

into customers' homes. Broadband now usually mean data rates of 512 k bt/s downstream for residential customers, up to 2 Mbit/s for corporate customers. Manufacturers and service operators are confident that speed rates of nearly 2 Mbit/s could be achieved soon at large scale. Broadband services, which are still at a relatively early stage of development will increasingly become very promising distribution channels for media and entertainment applications. They will have a tremendous impact on access to knowledge and leisure.

The local loop equiped with ADSL devices is not the only technical channel over which broadband services can be delivered. There are indeed competing broadband platforms: cable modem, UMTS, wireless local loop, and soon satellite, etc. But when we mention these potentially competing platforms, we must not overlook a number of issues:

- there is an **issue of timing** : ADSL can be deployed on existing telephone networks very rapidly, whereas in a number of EU Member States cable networks still need costly upgrades to be appropriate for two way broadband communications; UMTS will in practice not be implemented before 2004 and the terminals are so far not ready to deliver a wide variety of content; I even do not

mention the level of commercial maturity of broadband services over satellite or digital TV;

- an issue of **price**, at least for residential consumers : ADSL and cable are relatively cheap, whereas broadband over satellite or WWL seem so far not to be within the reach of an average household;

- an issue of **geographic availability**: in some countries, only a very limited proportion of households are passed by cable networks, less than 10 % in Spain, Greece and Italy, less than a third in France ; in such countries ADSL over the local loop can deliver broadband services on a wide (nearly universal) scale to all citizens.

Therefore, it appears that at this point in time **the local loop is the most appropriate means to deliver broadband services relatively cheaply, rapidly and efficiently** to a widespread customer base. This is, I may say, even more true for Europe than for the US. In Europe, on average nearly 80 % of telephone lines are within 4 kms of a local exchange, against 60 % in the US, which make the European countries more proper for widespread ADSL services than on the other side of the Atlantic.

As a first conclusion, it is clear that the local loop will play a key-role in the years to come in the development of broadband services.

2. WHAT IS THE EUROPEAN POLICY ON UNBUNDLING OF LOCAL LOOP?

In April 2000, the Commission issued a communication on local loop unbundling entitled “Unbundled Access to the Local Loop : Enabling the competitive provision of a full range of electronic communication services including broadband multimedia and high speed Internet” [2]. In this Communication, the Commission examined the incentive effects of local loop unbundling on increased competition and economic efficiency. The argument presented there was that local loop unbundling can encourage the development of a more competitive market for voice telephony and high-speed services by allowing new entrants to upgrade the incumbents local loops and to offer directly themselves broadband services to users.

As it was already said, the communications underlines the fact that even if the incumbents 'local loop access' is not the only technical infrastructure enabling the provision of retail services to end-users, none of the technological

[2] JO C272 - 23.9.2000.

alternatives are considered as equivalent, at least at present. The incumbents' local loop network is presently developed nation-wide in all the Member States. Given the investment required to carry out a nation-wide duplication of the incumbents' local network, the barriers to entry for any competitor are too high.

In order to avoid the risk that unbundling of the local loop would not be available universally within the deadline fixed by the recommendation/communication, the Commission subsequently adopted on Regulation mandating local loop unbundling[3]. The Regulation was promptly adopted with the new 'Amsterdam' procedure, allowing for adoption of directives in one single reading.

Two points were discussed in relation with the EU regulation, one concerning full unbundling versus shared unbundling, the other the pricing of the local loop.

Why, the EU regulation covers both line sharing and full unbundling ?

As you know, unbundling is available in two forms:

[3] OJ L336 - 30 December 2000.

- **line sharing**, whereby new entrants are enabled to exploit the highest bandwidth of the frequency spectrum, to deliver broadband services only ;

- full unbundling, whereby alternative operators can offer both voice and broadband services using the full bandwidth spectrum over the local loop.

One may wonder why full unbundling is indispensible, as the objective is primarily to promote competition on broadband services. Here, I think we have to consider a rational market entry strategy for alternative operators, especially those addressing the residential market. It really makes sense, both from a marketing viewpoint and from a cost-saving viewpoint, to propose a comprehensive range of services similar to that of the incumbent: it creates economies of scales and economies of scope. It is indeed a powerful argument to attract or retain consumers to propose a single invoice for more than one service, or to offer tarif options adapted to the full range of telecom services used by the consumer. Therefore, to put alternative operators in the position to compete exactly at arm's length with the incumbents, it was necessary to impose full unbundling and line sharing.

At what prices, the local loop should be made available to competitors ?

In the context of the preparation of the European policy on ULL, several papers were published by economists on this issue. The main point discussed in these papers was the price at which local loop should be made available to competitors of incumbent which has constructed the network. I present here two papers with different views.

In a first paper prepared for Commission services, J. Gual and P. Seabright agree that competition in the local loop may become effective only if competitors are able to have access to existing networks rather than being obliged to build their own network. They distinguish two basic economic issues in relation with the pricing issue: "The first is that, given the networks are in place, access to these networks should be available to the operator that would make most efficient use of them. The second issue is that investment in future networks should be encouraged by the promise of prices that enable a proper return, including a return to risk-taking." For them "efficiency-based pricing guarantees that the infrastructure is used by the most efficient operators. Fixed costs are recovered in the most efficient way." The relevant cost of

access is therefore an estimate of the long run marginal cost of access.

In a second paper entitled “Competition in EC Telecommunications – Cross Subsidisation, Access and Predatory Pricing”, P. Nicolaides and R. Polmans (1999) underline that the setting of prices charged to competitors for access to the network is crucial in the emergence or not of effective competition. The general principal on pricing for access is “cost orientation” meaning that services have to be priced in such a way that prices are in line with costs. However for the authors even if cost orientation appears to be reasonable, this principal suffers many weaknesses. The temptation for the incumbents will be to charge all costs and to exaggerate costs and charges. Moreover cost orientation imposes a very heavy information burden on regulators. The existence of asymmetric information between regulators and incumbents is the main problem. They conclude that it would appear, therefore, that more drastic and structural solutions may have to be considered. The breaking up of the dominant incumbents would at a minimum enable price and cost comparisons. Then there will be less need to adhere to pricing rules." Therefore, for the authors, if competition does not develop at a satisfactory pace, then

the solution would not necessarily be to tighten pricing or costing rules but to consider more radical structural, approaches with structural separation of LL from incumbent.

The EU regulation underlines that costing and pricing rules for local loops and related facilities should be transparent, non-discriminatory and objective. Pricing rules should ensure first that the local loop provider is able to cover its appropriate costs in this regard plus a reasonable return and secondly that there is no distortion of competition, in particular no margin squeeze between prices of wholesale and retail services of the notified operator.

Although commercial negotiation is the preferred method for reaching agreement on technical and pricing issues for local loop access, experience shows that in most cases regulatory intervention is necessary due to imbalance in negotiating power between the new entrant and the notified operator, and lack of other alternatives. In certain circumstances the national telecommunications regulatory authority may, in accordance with Community law, intervene at its own initiative in order to ensure fair

competition, economic efficiency and maximum benefit for end-users.

3. WHAT IS THE PRESENT ASSESSMENT OF THE SUCCESS OR FAILURE OF ULL ?

1) What is the present presentation of ULL in the EU?

One year after the entry into force, the local loop unbundling regulation has not produced the expected results. It is difficult to say that some countries are doing their work better that others because, in general, problems are spread all over Europe.

To date, all Member States have mandated full unbundling and all the incumbents have published an unbundled reference offer. According to the last figures, only 650.000 lines have been fully unbundled in the whole EU (which means 0.35 per cent of the total number of lines). More than 85% of unbundled lines are in Germany which introduced mandated access in 1998. Germany, Denmark and Finland concentrate more than 95% of the fully unbundled lines. In Spain the number of fully unbundled lines is only around 30.

Nowadays, all Member States but Germany have a shared unbundled offer (the Commission has recently opened cases to three countries for the incompleteness of

the unbundling offers). There are only around five thousand shared unbundled lines in Europe mainly in Denmark, Finland and the Netherlands.

2. What are the competition concerns related to ULL?

The Commission has recently conducted an enquiry to detect the main problems faced by new entrants in the process of unbundling the local loop and to adopt the necessary remedies to speed up the process. Apart from the technical difficulties of the process per se and the global economic situation affecting the industry, there are several potential competition concerns that can be addressed by using competition tools.

- Supply on **discriminatory conditions**

In some Member States, new entrants report that incumbents are discriminating against them by **favouring their downstream activities** or affiliated sales agency in the provision of unbundled local loops and related facilities in particular collocation, that is the rental of space in the premises of the incumbent and the right for the staff of new entrants to access the incumbent's buildings.

This discrimination takes different forms. For example, in a number of countries operators claim that the incumbents are discriminating in favour of themselves by not allowing

operators to collocate in rooms that have already been occupied by their own or their subsidiaries facilities. In most cases, new entrants claim that they are not offered the same wholesale terms and conditions as the incumbent subsidiaries to provide ADSL services.

New entrants also report situations where incumbents provide services to new entrants which are **inferior in quality** whether in terms of functionality, range of services, reliability, without price reductions.

- **Excessive pricing**

Several new entrants report *prima facie* excessive pricing by incumbents on certain components of the Reference Offer for Unbundling of local loop (one-off fees, rental of collocation space, etc.).

Prices for the local loop generally imply a one-off fee plus a rental fee. Monthly prices for full unbundling range from Euro 8.23 in Denmark to Euro 16 in the UK. In some countries (e.g. Germany, Greece, Spain, France, Italy and UK) the price for full unbundling is above the PSTN retail rental fee. This may cause some competitive distortions.

Monthly prices for shared access range from Euro 4.12 in Denmark to Euro 7.80 in Portugal.

Although prices are not fully comparable along the different countries since as they may not correspond to identical services, these broad differences may indicate that some prices may not be fully cost oriented as required by the local loop regulation.

Apart from the connection fee and the monthly fee, there are other recurrent and non-recurrent costs incurred by the new entrants such as the collocation costs and the associated facilities. If those additional costs (which are often not subject to regulation) are too high, entry in the market may not be profitable.

For example, the rental price for collocation in one country is more than twice or even three times the rental price for collocation in some of the main European cities with no apparent justification.

An anecdotal but significant figure is that the price of escorted engineer or technicien visits to the incumbents' premises ranges from less than Euro 30 per hour to more than Euro 300 per hour.

The combination of high prices and the fact that the incumbents (and in some countries their subsidiaries) are not subject to those high costs makes it impossible for new entrants to compete.

- **Predatory pricing and price squeezes**

In a number of countries, new entrants report that the margin between incumbent's retail ADSL prices and the prices charged for full or shared local loop unbundling access do not allow new entrants to offer service at a profit.

The Commission has two ongoing cases on this issue in which new entrants are unable to match incumbents' retail offers because of high wholesale prices. In several countries the retail rental fee is above the wholesale rental fee which makes impossible the existence of competitive alternative offers at retail level.

- **Refusals to supply**

New entrants in several Member States make allegations that incumbents refuse to provide sufficient collocation details and network information to facilitate unbundling

The refusal to provide information on network structure or to provide collocation space makes it impossible to unbundle the loops of certain users depriving them from the benefits of competition in the provision of final services.

In some countries collocation has been denied on the basis of space deficiencies, legal difficulties or security risks and no alternative solution has been proposed. The verification of those justifications is often very difficult.

Operators also experience problems in getting information on network configuration and specific information on loops characteristics and availability.

- **Unjustifiable delays**

The speed at which new entrants are able to roll out their services is of great importance in such a dynamic market as the telecom market. In some cases, delays have implied the non-effective implementation of collocation to date. Furthermore, the delays in the provision of collocation give a first mover advantage to the incumbent in the provision of broadband services and other advanced services.

For example, collocation in some sites has been made effective up to 12 months after the initial application. The delivery time for unbundled lines unjustifiably varies from country to country from one week to ten weeks.

Another cause of delays is the centralised approach followed in most countries for the unbundling of lines in

contrast to the more flexible and decentralised approach followed in bitstream access

CONCLUSION

At this point in time, we clearly stand at a crossroads. One year after the entry into force of the Regulation, the progress has been very slow and overall disappointing. In Spain, for example, of the nineteen operators that showed initial interest in the unbundling of local loop, only seven are still interested in the process. Of course, we know that this cannot be attributed to the position of the incumbent but, in any case, special attention should be put in order to ensure that market conditions are such that do not distort business and investment decisions by new entrants in any direction. We should not dispair, however. It is still time to act. Unbundling was a very novel and challenging process for all the parties involved, and we believe that there is on such an issue a steep learning curve.

In particular, if prices for local loop unbundling and associated facilities are well above costs, the entry of efficient operators in the market may be halted. This would imply a slower development of innovation and new

technologies (specially related to high speed Internet access), narrower customer choice and higher prices.

It is a fact that competition not only favours the consumer by increasing customer choice and achieving better prices because of the entry in the market of new operators but also creates incentives to incumbents to offer more customer oriented products and more competitive offers.

Some technical problems had also perhaps initially been underestimated, incumbents had maybe not planned all the implications of unbundling. It is now probably time for all the parties involved reflected on how to make unbundling simpler, easier both for new entrants and incumbents. New entrants complain about entry barriers, but these barriers, symmetrically, also have a cost for the incumbents. The Regulation will continue to apply, and the Commission is determined to use its competition tools wherever necessary to facilitate the enforcement of the regulation.

We are too much convinced of the merits of unbundling to give impetus to the development of broadband services to reappraise our commitment in this regard. In this context, unbundling must be made, as I said, easier and become a

standard process similarly to interconnection. We are confident that in this regard the combined actions of NRAs and competition authorities can be very fruitful.