

**TELEFONICA comments with regard to
BEREC BoR (15) 74**

**Draft BEREC Report on
Oligopoly Analysis and regulation.**

29 July 2015

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1. Executive Summary

Telefónica S.A. (hereinafter Telefónica) welcomes the opportunity to provide inputs to the BEREC's consultation on Oligopoly analysis and regulation.

BEREC accepts that perfect competition is unlikely to emerge in telecommunications markets, because of the large and continuing investments that need to be recovered, in order for investors to continue to have the confidence to invest.

In the current EU framework, the concept of “effective competition” is equivalent to a market state where there is(are) no dominant firm(s) but where competition is not “perfect”, in the strict economic sense. In this consultation BEREC tries to quantify a concept of effective competition, so as to allow NRAs to regulate markets, even in the absence of dominant position(s).

We welcome BEREC's acceptance that dynamic efficiencies are relevant in telecommunications markets and that policymakers should consider both the short-run and long-run effects on competition – this needs to be more readily accepted in the merger review process. The indicators proposed for BEREC's new oligopoly test are purely static in nature – this is clearly a significant limitation. The test proposed does not capture the dynamic efficiencies that BEREC accepts may be present. Picking the optimal balance of prices, investment, quality and innovation is a complex and highly subjective task. No two national markets exhibit the same set of prices, investment levels etc creating plenty of scope for ambiguity and decisions by one NRA undermining those of another.

In merger analyses, the competition authority measures the effect on competition before and after a merger, that is to say it is a **comparative test**. Whilst we believe the test is incomplete because it does not explicitly deal with dynamic effects, at least it is well established in case law and well understood by market participants. BEREC cannot stretch the SIEC test to become a **subjective absolute test**, to address its purported concerns about oligopolies. Such a novel approach would, we suggest, introduce huge uncertainties for market players on where the trigger for regulatory intervention will be. Merger case law will be of no assistance to NRAs, as it does not relate to an absolute test of competition. The period of uncertainty could be very long as NRAs and market participants will have no precedent against which to test decisions. A new set of case law on the application of NRA powers with regard to oligopolies would take many years to develop. It is of note that this novel regime would not apply to any other sector, so case law will be slow to emerge, being driven only by the cases bought by NRAs themselves.

A wholly subjective test will create uncertainty for investors, at a time when Europe is seeking to attract investment to improve infrastructure. The regulatory framework has been successful in many markets in removing SMP, such that the regulatory regime can be relaxed and markets left to function with limited interference from NRAs. To suddenly “move the goalposts” and perpetuate the threat of intervention by NRAs sends a very poor investment signal to the sector.

In any event, BEREC's concerns about the risks of poorly functioning oligopolies are misplaced because:

- (1) NRAs would still have substantial powers to address issues that might persist in markets, for example, by improving switching, increasing the availability of spectrum, easing technological restrictions to encourage innovation; and
- (2) Oligopoly markets are most likely to form either as a result of:
 - a. A merger process where the NRA has already been heavily consulted and if competition issues are identified remedies will have been put in place; or
 - b. SMP designations have been withdrawn, but many contractual / market structures bought about by the previous SMP regime would remain in place.

In both cases, investors would face double jeopardy if “oligopoly regulation” formed part of the regulatory framework. On the one hand they would have been told that either their merger presented no further competition problems, or in the case of removing SMP, that competition law was adequate to address any

market failure – yet there would always be the prospect that an NRA could play its “regulatory joker”, based on an ambiguous and subjective test with no economic foundation.

2. Market concentration and its impact on competition

2.1. Oligopoly theory and implications for social welfare

Regulatory decisions should be based on sound economic theory. Such decisions should prove that they increase social welfare; otherwise, they should not be taken. Furthermore, when seeking to change the laws governing regulation, policymakers themselves must base their proposals on accepted economic theories too, otherwise there is no sustainable basis for them – short of “industrial policy” or politics – both of which would have negative effects on the appetite of investors to risk capital in European markets.

The existence of oligopolies is not in dispute, in many industries and markets they function effectively, giving good consumer outcomes and attracting investment. Many national competition law regimes can address oligopolies in all industries, should they not function in consumer interests. It is difficult to understand why, uniquely, the telecommunications sector requires a novel *ex ante* regime to manage what in any other sector would be viewed as competitive markets.

On page 11 of the draft report, BEREC states:

“According to economic theory, perfect competition with a large number of suppliers and consumers results in prices that are equal to marginal cost and in the efficient use of resources in terms of both productive and allocative efficiency. In a static setting, this would maximise total welfare for society.”

When the perfect competition model is taken as reference for optimal social welfare, in fact it is assumed that a market in which there is only one good is better for society than one in which there is variety of goods. Telefónica welcome’s BEREC’s acceptance that effective competition includes some measure of product differentiation, economies of scale and the importance of investments (and maintenance of incentives to invest) etc etc etc.

“The concept of “effective competition”, as we use it in this paper, describes a situation in which an optimal balance between dynamic and static efficiency is reached. Hence, effective competition might deliver prices above a statically efficient level in the short term (e.g. prices above long-run average costs), while in the long run, the negative effects resulting from these higher prices are offset by increased investment or innovation.”

However, the concept of effective competition is not a well-defined state rather it describes a market that both lacks an SMP player, but which is also not perfectly competitive. It is not beauty or the beast, but it is hard to really define what it looks like.

Given this subjectivity it is surprising that BEREC says that it uses “effective competition” as the standard against which to measure oligopolies. BEREC looks to the SIEC test in merger cases to support its proposition that assessing the effectiveness of competition is tractable.

However, in a merger clearance process, the competition authority is being asked to determine whether one market structure (taking prices and investments into account) is no worse than the counterfactual market structure before the merger. **It is a comparative test.** In the context of a specific merger, a competition authority may be able to determine an *appropriate* balance between changes in the competitive landscape and improvement in investment conditions. This is assessed case-by-case based on a very data intensive process.

BEREC appears to be proposing that NRAs are asked to determine “how effective” competition is in a specific market– ie it is **an absolute, but subjective test**. An NRA would need to place a value on the effectiveness. In this regard, BEREC’s constant reference to the SIEC test is misleading.

Given the absence of a sound empirical basis for measuring the “effectiveness” of competition, Telefónica believes that it is wholly inappropriate to use a subjective test as the basis for opening up *ex ante* regulation of an entire industry.

2.2. Assessing effective competition in mergers

One element of BEREC's paper that is very welcome is the acceptance of dynamic efficiencies as highly relevant to the effectiveness of competition in the telecommunications market. On page 12 of the draft report, BEREC states:

"The concept of "effective competition", as we use it in this paper, describes a situation in which an optimal balance between dynamic and static efficiency is reached. Hence, effective competition might deliver prices above a statically efficient level in the short term (e.g. prices above long-run average costs), while in the long run, the negative effects resulting from these higher prices are offset by increased investment or innovation."

Recognition of this explicit trade-off is increasingly supported by empirical evidence. Telefónica hopes that DG Competition and national competition authorities will themselves begin to explicitly recognize that, rather than being a "defense" for price rises predicted by (incomplete) mathematical models, investment and price changes go hand-in-hand.

2.3. Improving assessments of Joint SMP in ex ante regulation

A substantial part of the draft report is devoted to the issue of Joint-SMP. BEREC observes in its Executive Summary that:

"A small number of cases of joint dominance have been brought over the past decade by NRAs to the Commission and many of them were overturned or withdrawn. This may reflect that it is hard to demonstrate joint dominance and that more guidance may be needed for NRAs on how to assess non-competitive outcomes...."

The views of NRAs as to whether their own decisions on joint dominance are right or wrong is likely to be subject to substantial observer bias, which may be reflected in the tone of the quotation (above). Of course, it may actually be the case that NRAs have been unsuccessful in bringing many joint dominance cases because the joint dominance does not exist. The validity of joint dominance findings by NRAs is subject to review by an outside body, the European Commission. It is the Commission's independent view that should be paramount here, ie that there are very few cases that can be sustained.

2.4. Assessing the "level" of competition is wholly subjective

Above we highlight how BEREC is proposing a novel subjective test for effective competition, rather than a comparative test, as we see in mergers. Whilst we have highlighted why this approach is wrong, for completeness we now explore the implications of such a test in practice.

At p.15 of its draft report, BEREC discusses the differences between effective oligopoly competition and tight oligopolies that provide "ineffective" oligopolistic competition. On p.16 BEREC highlights that the negative effects might include:

- Higher prices
- Lower output
- Lower quality and
- Less innovation; than an effectively competitive oligopoly.

Given the empirical nature of the test, NRAs would also need to place values on the prices, output, quality and innovation that would constitute an effectively competitive market, if the identified competition problems were overcome. Given the inter-related nature between prices and investment, this may a multi-dimensional problem to resolve.

Looking at some of these parameters in more detail:

- **What prices should there be in an effectively competitive market?** To put it another way, NRAs would need to demonstrate excessive pricing in the current market and also that this “excessive pricing” is not counteracted by higher investment and output (for example).

There is no significant jurisprudence on pure excessive pricing on which NRAs can draw in this regard, in that all the current case law includes excessive pricing with other aggravating factors (or as the result of these factors – price squeeze, tying etc). BEREC already accepts in this draft report that prices would be above marginal costs, in order to recover fixed and common costs and justify future investments. Further, some regulated prices (e.g. MTRs and FTRs) do not now include fixed and common costs – it is assumed that these will be recovered in other wholesale and retail markets. Is BEREC to now preclude the recovery of these costs via retail prices? What is the efficient level of fixed and common cost recovery on a product by product basis? How will NRAs implement Ramsay pricing across the full suite of operator services?

- **What is the optimal quality level in the market – Rolls Royce or family saloon?** Quality could be construed as either network quality or (customer) service quality. Network quality and the issues of capacity/investment are equivalent and we address them above. Regarding customer service quality, we believe that this is already well addressed by NRAs through their work on customer protection. It is unclear to Telefonica how an operator could act unilaterally to lower their customer service quality, given its importance in the competitive process. In an increasingly web-served world, the customer service cost of acquiring customers is low and in the absence of switching barriers, the ability of consumers to punish operators with poor customer service is high.
- **How innovative should network operators be?** Innovation – technological innovation - is generally not a domestic scale effect. The fixed and mobile technology ecosystems are global and innovation happens on a global scale. In the context of unilateral effects without individual/joint dominances – how would an NRA differentiate between a market participant that wishes to adopt a simple, predictable, low cost business model and one which is not innovating to the detriment to consumers? Finally, in order for a market to be considered to be a “tight oligopoly” BEREC states that product differentiation is high. Doesn't this create a disincentive to innovate in retail products?

To illustrate the challenge of setting the optimal competitive level across a range of parameters, it is helpful to look at a very recent report on mobile markets completed by WIK for Ofcom, as part of its current Strategic Review of the UK telecommunications market.¹ In this study WIK ranks a number of country markets against parameters such as prices, coverage, investment and concentration. WIK draws the conclusion that concentration and investment are not correlated. However, a closer examination of the data shows that it is also true that prices and concentration are not correlated either, based on the limited data set. In fact, one of the few factors that are strongly correlated (inversely) are prices and investment levels, as we show in the table below, based on the rankings in the WIK report.

¹

http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/annexes/Competition_and_investment_mobile.pdf

	Average price (with data)	Investment (capex/sales)
Austria	1	7
UK	2	10
Australia	3	n/a
France	4	9
Ireland	5	n/a
Netherlands	6	3
South Korea	7	4
Italy	8	5
US	9	2
Germany	10	6
Spain	11	8
Japan	12	1

If Ofcom were to decide that the balance of prices and prices in the UK is optimal, does that mean they are sub-optimal in Ireland, Netherlands, Italy, Germany and Spain?

BEREC expresses some concerns that NRAs have not been able to substantiate Joint SMP cases, due to the burden of proof required by the *Airtours* criteria. Yet it accepts that in the case of oligopolies it will need to develop a whole new field of analysis:

"[...] this does not mean that a direct transposition of the SIEC-Test applied in mergers & acquisitions regulation must be done to the ex ante regulatory framework. Assessing existing market structures using a prospective view (as it is done in ex ante market analysis) and assessing the impact on competition of a proposed merger or acquisition are different tasks, and criteria and tools used in each of these contexts may differ..." (p.55)

As this new approach is not comparable to the SIEC (and case law), it would not benefit from that precedent. A whole new set of case law would need to be created. In our view, novel decisions based on a novel test with no scientific basis are unlikely to be sustainable before the Courts.

2.5. Merger process and overhang of SMP remedies remove likelihood of negative effects

Oligopolies arising from mergers

A merger authority's decision to approve a merger means that it is satisfied that there are either no competition concerns, or that they are addressed through the remedies offered by the parties. It follows, that if an oligopoly market (however defined) is formed by the merger process, the relevant merger authority is satisfied that it will be competitive, within the timeframe of its merger assessment (typically 3-5 years).

By creating another layer of *ex ante* supervision, there is a risk of "double jeopardy" for all market participants. Merger's may be cleared by the merger authority and then that decision altered by the NRA. This will create huge uncertainty for market participants and severely undermine investment incentives. Markets without the possibility of exit become toxic places to invest.

The rationale for an NRA to intervene following a merger decision also appears flawed, when the NRA has already participated in the merger procedures and are able to provide its views and strongly influence the

whole process. It is wholly inappropriate to try and mitigate any perceived failing of the merger authorities by making further regulatory decisions – “two wrongs do not make a right”, so to speak.

Oligopolies arising from removal of SMP conditions

Telefónica believes that it is more likely that BEREC members have some residual concerns about the level of competition in previously regulated markets, once SMP conditions are removed, for example following fragmentation of the market or investments in competing infrastructure.

Conceptually there is already a problem with BEREC’s approach. In order for an SMP designation to be removed, competition must be effective, such that competition law alone is an adequate tool to condition behavior in the market. If that is the case, how can oligopoly regulation then be imposed?

We have a number of further observations in this regard:

- (1) Whilst SMP conditions may have been removed, contracts already exist for interconnection, access etc, and these commercial agreements would need to be honoured. SMP regulation will have created a contractual structure that can be enforced by contract law, not the common regulatory framework;
- (2) For SMP to be removed it follows that the market structure at a wholesale level tends towards effective competition and competition law is an effective tool in addressing any residual issues. There will likely be large retail participants with substantial countervailing buyer power at a wholesale level. These participants may be able to switch their business to other infrastructure providers. If SMP conditions have been sufficiently effective to allow de-regulation, again, it is hard to see how those conditions can unilaterally evaporate. The potential loss of large wholesale contracts can be effective in disciplining competitive behavior. A unilateral decision not to supply would lead to loss of substantial revenues. If all participants in the market decide not to supply, then the NRA would need to revisit the joint-SMP criterion, as the potential issue would be tacit co-ordination, not unilateral effects.
- (3) Market participants are not operating in a vacuum, in particular the operator that formally had SMP will be well aware that it has been deregulated because the market is deemed to be effectively competitive. The threat of future regulation on the basis of the behavior of the former SMP operator (e.g. through unilateral withdrawal of access, or a sudden offering of uneconomic terms) would of itself have a substantial conditioning effect on market participants. There is no need to create a new legal standard to provide such a threat.

Unlikely that oligopolies will emerge “organically”

It is hard to conceive of a market outcome whereby a tight oligopoly emerges organically. The only way would be through a series of exits by failing firms, under which none of the assets of the firms were redeployed in the market (e.g. spectrum licences and/or fixed infrastructure). Further, such firms would need to leave without selling on their residual customer bases (and therefore potentially be subject to a merger review).

What would be left, after the exit of all these firms would be an oligopoly. Infrastructure and customers are very expensive things to acquire in the market. It is very unlikely that they would not be picked up by the remaining market participants, triggering merger reviews.

2.6. Both fixed and mobile markets do not generally exhibit the characteristics of concern to BEREC

On page 15, BEREC states:

“We can conclude that effective oligopolistic competition delivers an optimal outcome in terms of total welfare, at least in the long term. It can be observed when benefits from increased innovation and investment incentives outweigh higher prices, or actual or potential competition limits the oligopolists’ power to raise prices above a competitive level.”

We agree with this analysis. Yet, whilst BEREC says that it supports the dynamic nature of competition, in fact, all indicators proposed for the analysis of the hypothetical “effective competition” standard in telco relevant markets (included in the SMP guidelines) are static in nature.

This is one of the more confusing elements of the proposed approach. Whilst BEREC accepts that the analysis needs to incorporate dynamic elements and cover issues such as prices, investment, innovation and quality; it proposes a set of static criteria for assessing whether a market is a “tight oligopoly” or not.

In any event, in Telefónica’s opinion even if these were the correct criteria to apply, the telco sector does not exhibit such characteristics.

1. **High degree of Market concentration.** This measure implies that concentration and the effectiveness of competition are strongly correlated. Yet BEREC itself says that NRAs should not focus on the number of competitors².

In this regard, we could refer to the statements made by Marc Furrer, chairman of the Swiss regulator (ComCom) at the last BEREC workshop on oligopolies (held in Bern on February 25), extracted from Cullen’s report

Marc Furrer, chairman of the Swiss regulator (ComCom), explained that competition was not about the number of players on the market but about the dynamism that players can bring to the market.

For him, the Swiss telecoms market missed the opportunity to have a more competitive structure when the Swiss competition authority refused in 2010 the merger between Orange Switzerland and Sunrise (TDC), the two alternative operators active on the Swiss market. The market would have moved from four players to three (Swisscom, the newly merged alternative operator, and the cable company UPC) but with each player being a strong integrated operator.

This situation could have boosted competition in Switzerland, Mr Furrer said. For him, the Swiss competition authority focused mainly on the mobile market going from three to two players. They should have taken a broader view, he said. Mr Furrer explained that the Swiss market has not evolved in the recent years, with Swisscom still being the dominant player in the broadband and mobile markets.

Below some further considerations on this:

- Building and operating networks require high fixed costs leading to economies of scale. Also there is a high rate of technological change requiring permanent investment and risk assumption. There are also some resources (eg spectrum) that are naturally scarce. As a result of this, the optimum number of network players cannot be big.
- It is necessary to make forward looking analysis considering what kind of future we want for the European industry. Issues such as the relationship between concentration, investment incentives, sustainable competition, dynamic efficiencies and consumer welfare should be addressed and given proper priority. The issue of “Oligopoly/concentration” regulation should not be looked at in isolation of the wider policy perspective. At this moment, a major challenge for the European industry is

² “Although the number of members of an oligopoly is a relevant issue to assess the potential for competition, the appraisal of oligopolistic markets is much more complex than just examining the number of members in an oligopoly” draft report, p10

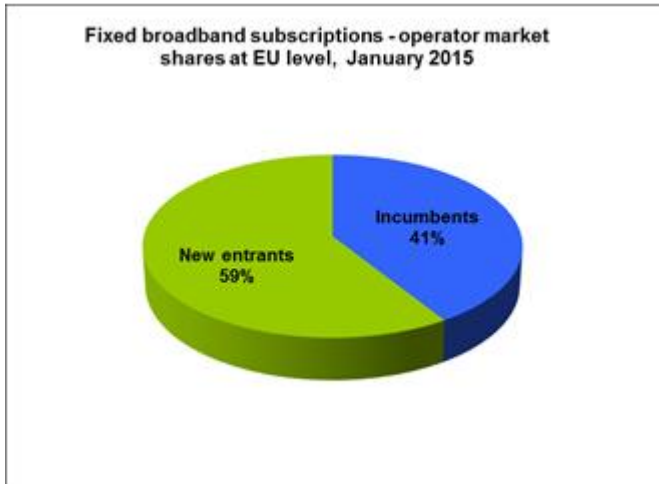
precisely to overcome current fragmentation, in order to allow for the creation of strong European players that can secure economies of scale and compete in the global arena. It may well be that greater concentration is the best way to ensure a sustainable competitive scenario which maximizes social welfare through a continuous cycle of innovation, transformation and investment.

- Infrastructure competition automatically triggers a process of innovation and investment³, which allows differentiation of supply and choice and encourages a virtuous cycle that increases over the final consumer, through improved service and reduced unit price while allowing to obtain an adequate margin to continue the investment process. By contrast, the traditional competition model in services only generates reductions in short-term nominal prices, with consequent negative effect on other levers such as quality, innovation, etc.
 - As an example of the positive effects of infrastructure competition we could refer to the mobile market, which has proved capable of reducing prices, continuing investment processes and dynamic evolution of their networks and services, with every time shorter investment cycles without any enhanced risk of tacit collusion. Fixed infrastructure markets such as Spain and Portugal have seen an investment oriented regulatory framework deliver competition on multiple indicators; price, coverage, speed and bundles. Whereas countries that have focused on service level competition are restricted to price competition only.
 - The idea that access regulation would lead to more innovation and investment (the ladder of investment hypothesis) has proven to be largely wrong. In fact, the existing infrastructure competition and new network developments (mobile, cable, fiber) were not generally driven by LLU access seekers until they were pushed to act by lack of regulated wholesale access to NGNs (as happened in Spain)
2. **High entry barriers and no significant entrants.** There are clearly no barriers to provide services using networks as the OTTs performance have shown for voice and instant messaging. In the field of network access if there are still enduring bottlenecks regulation should only be concerned with the bottleneck(s), but not with the market structure.

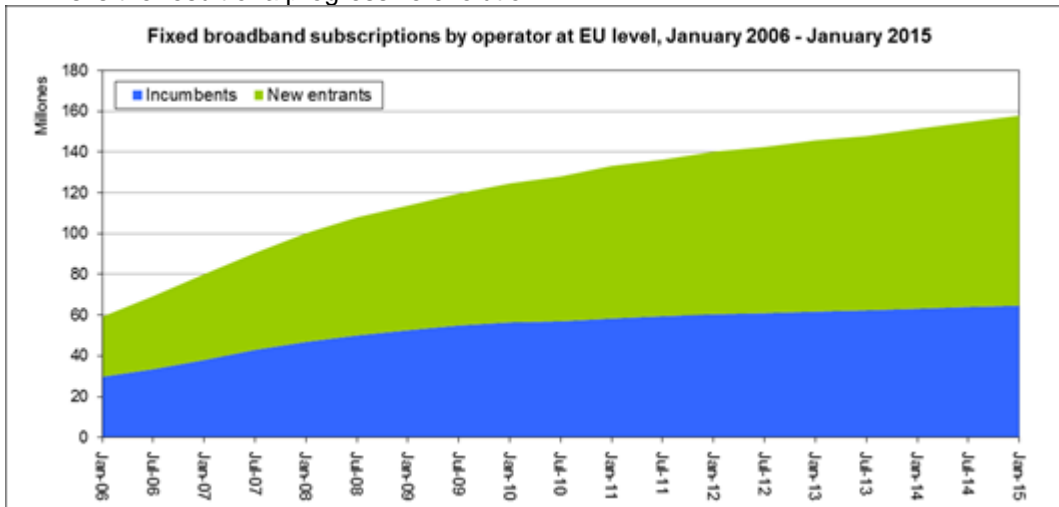
Anyway, it seems quite clear that, in the current scenario, in the field of network access, entrants in the market are quite significant and there are no clear high entry barriers. Below the data from the Digital Agenda Scoreboard supporting this conclusion:

³ Also related to adjacent markets such as devices: new generation devices oblige to innovate in the networks which have to support the data traffic of those devices

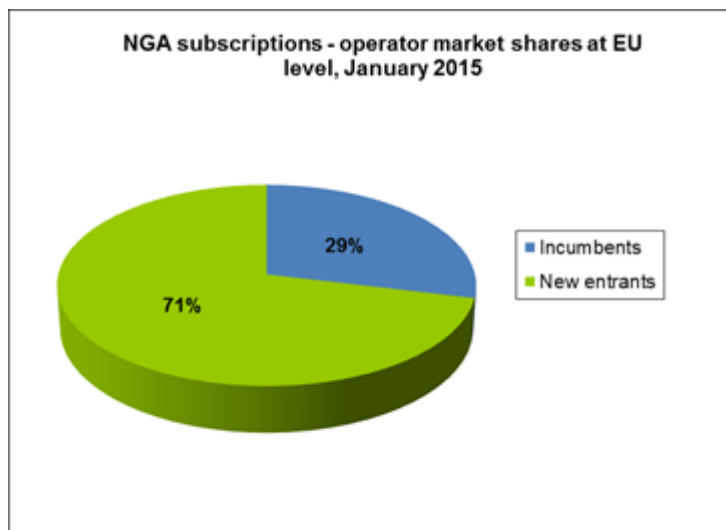
- Incumbents Market Share in the Fixed broadband access is much lower than the new entrants



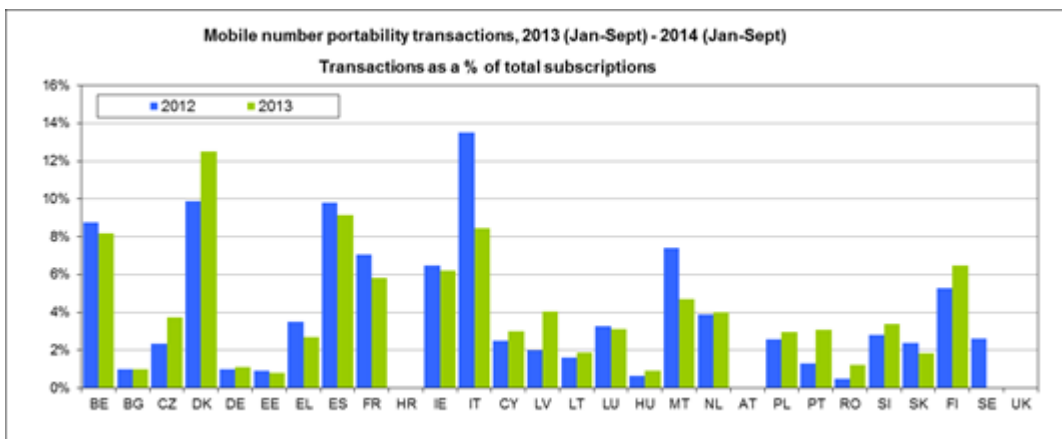
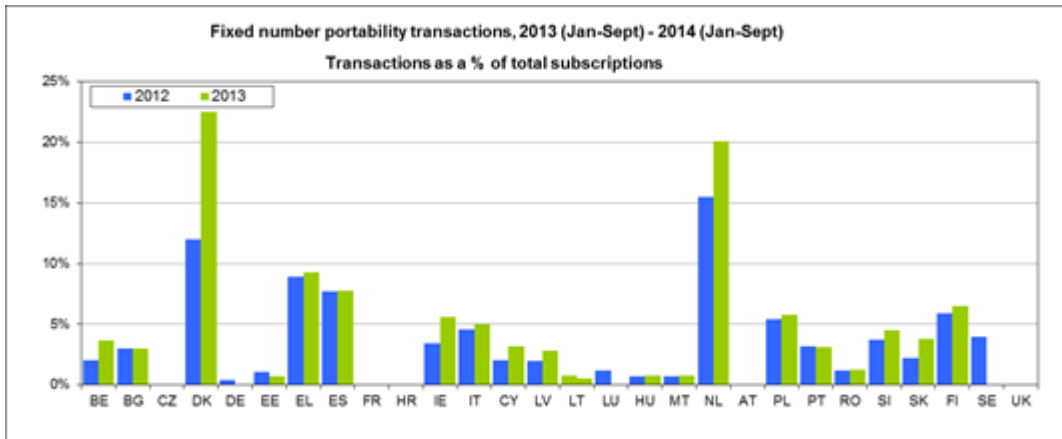
- This is the result of a progressive evolution



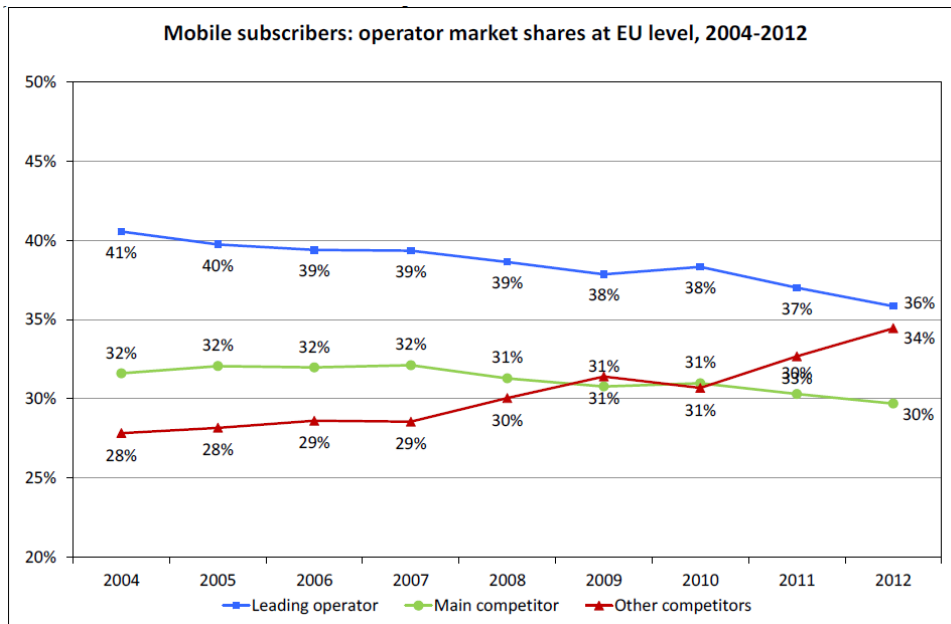
- But when it comes to the new networks (to which the new regulatory framework will apply) the different market share of incumbents and new entrants is dramatically different.



3. **High level of product differentiation.** In Telefónica's opinion is precisely the search for differentiation the main driver leading to a healthy competition and an objective to be pursued, not something that should be avoided. Below some considerations on this subject:
 - Perfect competition cannot be a reference for the model we want for ICTs. It leads to homogeneous products without economies of scale and without any differentiation and where innovation is not an option. Is it what we really want?. In fact in the real world it is difficult to find a market where all the assumptions of the perfect competition model holds. Why should it be such a good reference for our sector?
 - What do we pursue for the European industry? Perfect homogeneous products, so that we can perfectly compare their prices in order to push for a constant reduction?. If this keeps being the future regulatory focus the future of the European Industry is really in danger.
 - it is also striking the reference "telecom products might be fairly homogeneous compared to other retail goods" with the fact that before, in page 12, it is said that the Telecom sector does not behave a la Bertrand just because there is a variety of different products.
 - As it is recognized by BEREC it is precisely differentiation what prevents tacit collusion from arising.
4. **Capacity constraints.** Those could be created precisely by a wrong regulatory approach hampering investment or not being able to adequately allocate scarce resources as spectrum. (eg: Digital Dividend management in the 4G development) but not by the sector concentration.
5. **Low price-elasticity and low cross-price elasticities due to e.g. switching costs.** Obviously this is not the case in our sector. As a token of this we could refer to the high level reached by portability in Europe, that reflects the high degree of competition reached. Below the data from the Digital Agenda Scoreboard



The role of portability as a key competition enabler, has been stressed by all Policy Makers. As an example of this, in the recent “draft ECC Report 238 on 3rd Party access to Number Portability Data (NP Data)” launched for public consultation by the CEPT until last 23 June, it is included the following graph, from the Digital Agenda Scorecard 2013, to illustrate the positive impact NP has made on the mobile market over the last 8-10 years.

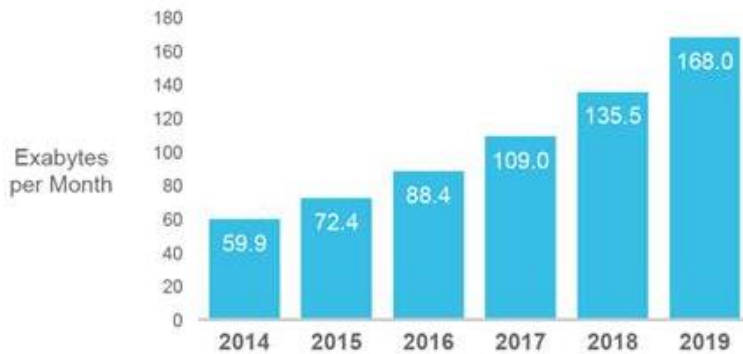


Mobile subscribers: operator market shares at EU level, 2004-2012
(Source: COCOM, taken from DAE Scorecard Report 2013)

6. **No countervailing buyer power.** That is not clearly the case for network access, as the figures depicted above (point 2) show. Mobile market also provides very clear examples (eg: wholesale services for MVNOs). In the field of service provision competition is particularly fierce after the arrival of the OTTs, many of which are providing services for free.
7. **Mature technology and little incentive to innovate.** This issue is mentioned on page 16 and seems to be contradictory with the very negative vision that is developed on differentiation on pages 50 and 51 for competition. It is necessary to point out that in some cases, regulation is hampering innovation by delaying new technologies (for example, delays in copper switch off) and its focus on replicability. Moreover, it is hard to say that technologies in our sector are mature, while what we can see is that they are constantly evolving. Indeed, as reflected above (point 3.2.), our markets are in a continuous innovation process: there is a demand for more speed, more capacity...and we need to deploy next generation networks (LTE, fiber)

8. **Low growth of demand/mature market.** This is also mentioned on page 16. Anyway it is not the case in our sector, as there is a constantly growing need for more bandwidth and new functionalities.

As an example of this, see below Cisco forecasts for the evolution of IP traffic (Globally and in Europe)



Source: Cisco VNI Global IP Traffic Forecast, 2014–2019

IP Traffic, 2014–2019							
	2014	2015	2016	2017	2018	2019	CAGR (2014–2019)
By Type (Petabytes [PB] per Month)							
Fixed Internet	39,909	47,803	58,304	72,251	90,085	111,899	23%
Managed IP	17,424	20,460	23,371	26,087	29,274	31,858	13%
Mobile data	2,514	4,163	6,751	10,650	16,124	24,221	57%
By Segment (PB per Month)							
Consumer	47,740	58,137	71,453	88,730	111,015	138,415	24%
Business	12,108	14,289	16,973	20,258	24,469	29,563	20%
By Geography (PB per Month)							
Asia Pacific	20,729	24,819	29,965	36,608	44,223	54,434	21%
North America	19,628	23,552	28,219	33,641	41,458	49,720	20%
Western Europe	9,601	11,231	13,506	16,396	20,046	24,680	21%
Central and Eastern Europe	4,087	5,270	6,896	9,385	12,601	16,863	33%
Latin America	4,297	5,373	6,663	8,299	10,356	12,870	25%
Middle East and Africa	1,505	2,180	3,178	4,659	6,800	9,412	44%
Total (PB per Month)							
Total IP traffic	59,848	72,426	88,427	108,988	135,484	167,978	23%

Source: Cisco VNI, 2015

In conclusion: Telefónica believes it is not feasible that Tight Oligopolies, as described by BEREC, are present or will emerge in our sector. This is because the dynamic competition in which our market is evolving, characterized by a constant and progressive technical and commercial innovation will not allow it.

3. Increasing the regulatory perimeter substantially reduces investment incentives

Negative impact on investment incentives

As stated in our previous response to BoR (14) 172, we would like to reiterate our view that this debate is not timely and points to a direction that would not favor the healthy development of the EU telecoms industry. Whilst BEREC accepts that telecommunications markets [ref] tend to have a small number of highly invested participants, it fails to appreciate the impact of its proposal on the willingness of participants to invest in the future.

For example, suppose two market participants merge and the NRA then believes that a “tight oligopoly” has arisen as a result. The NRA places obligations on all firms in the market, under BEREC’s proposals.

What sort of reward is that for market investors that took no part in the merger? Are they to be “punished” with regulation by virtue of the decisions of other participants? What sort of message does this send to investors – that the potential reward for being a large and relevant market participant is regulator supervision?

Credit Suisse⁴ has published an interesting report addressing BEREC’s proposal on the possible extension of the regulation to oligopolies and their impact on the industry.

The conclusions are literally as follows:

“BEREC proposes to regulate more. The EC has in the past described a process of gradual de-regulation of the sector. However BEREC, the body of national regulators, last week came out with their initial view on the topic and suggested regulation should be extended rather than withdrawn, i.e. that incumbents/cable, or concentrated mobile markets should be treated as instances of ‘tight oligopoly’ and assessed for potential market failure, with the same menu of potential remedies applied to incumbent telcos today.

This would be a much worse regulatory regime than investors are hoping for currently, and could be very negative in extreme instances. *Indeed, the biggest shocks to the sector have come from such arcane regulatory debates (e.g. ULL and BULRIC MTRs).”*

Emphasis added

The ex-ante regime has not be designed to exist in perpetuity, but is there as an interim measure pending effective competition emerging in the sector.

“The new framework will continue to pay off into the future as effective competition becomes established and more and more markets are freed from ex ante regulation. As such it facilitates the transition to ex post controls based on general competition law, as markets where sustainable effective competition has taken hold are identified in periodic reviews and removed from the scope of ex ante regulation.”⁵

BEREC’s proposals effectively try to “move the goalposts” now that the process of liberalization is showing fruitful signs and the presence of alternative infrastructure providers are leading to effectively competitive fixed and mobile markets.

As a principle, we believe that ex-ante intervention should be thoroughly justified. It should not to be taken for granted that it should always exist, particularly taking into account that it implies a very intrusive intervention which collides with fundamental rights, such as the right to property. Thresholds for ex-ante regulatory intervention have to be high. Its need must be very rigorously analyzed and, if applied, is should be on transitory basis and be focused on the achievement of very specific objectives.

In our opinion, ex-ante regulation in the Telecom Sector has already played its role for introducing competition in the market and now it is the time to think on the progressive removal of ex ante supervision

⁴ Credit Suisse – “Regulation at a crossroads”, 22nd June 2015

⁵ ERG Common Position on the approach to Appropriate remedies in the new regulatory framework (2004) p.24

and the handover to competition law. In fact, ex-ante regulation is now proving to be counterproductive, as it is hampering the required investments in new networks, dragging out the development of the digital economy in Europe. Ex-ante regulation has significant counter effects on investments and innovation which should never be overlooked. In particular, current regulation with its focus on number of players, its focus on replicability (sometimes putting breaks to innovation), and strict price reduction goals is hampering investment in Europe and, at the same time, European competitiveness in the global arena.

Ex-ante regulation, if needed, should be concerned on the lasting/enduring bottlenecks (or Key Network Inputs⁶), if any, of the networks. Once they have been addressed, it should be left to market forces to find out the most proper market structure. This Market Structure, as such, should not be the trigger for ex-ante regulation, but the outcome of the competitive forces. In the hypothetical case that this outcome raises competitive concerns they should be addressed by the horizontal competition tools, as applicable to any other sector.

4. No justification to treat the telco sector any differently from any other industry

It is noteworthy that a number of Member States already have powers for national competition authorities to review the effectiveness of markets more generally. It is therefore unclear why BEREC feels the need to have further sector-specific legislation that may overlap or conflict with domestic approaches to the supervision of markets more generally.

We note that this separate supervision by National Competition Authorities (NCA) has many attractions – in particular, that there is a separation between the NRA as the sector regulator making “day-to-day” regulatory decisions and the NCA which can take a step back and look at the sector more objectively and in comparison to its past case history in other sectors. This is similar to the separation of the review process of the EC in findings of SMP.

Such a separation of responsibilities avoids the concerns expressed in the industry that what BEREC is seeking is a “regulatory joker”, to play when things are not going its way under the framework.

5. NRAs need to evolve with their industry, not extend current regulatory models

We have shown in this response that the telecoms market is an increasingly dynamic environment with a much wider range of actors than NRAs have encountered in the past. The boundaries of markets are becoming blurred, with unregulated products being bundled with regulated products and unregulated actors competing head-to-head with regulated entities.

The response of NRAs, through BEREC, should be similarly dynamic. BEREC should not look to perpetuate the model of regulating ECS providers, just because they are “in-scope” of the regulatory framework, rather it should look for ways of monitoring and guiding markets that reflect their fluid nature and inherent lack of predictability.

NRAs should seek new tools, obtain new expertise and shift the balance of their resources towards consumer protection and (where relevant) *ex post* competition analysis.

It is Telefónica’s strong view that the current regulatory framework is no longer fit for purpose and requires a wholesale review. BEREC’s proposal to “stick with what they know” and extend the perimeter of the current regime to include “tight oligopolies”, looks like a step in the wrong direction, potentially leading to include in the regulatory scope most Electronic Communications Markets, including currently regulated and unregulated markets.

⁶ This concept encompasses those network resources for which it is necessary to introduce some form of access regulation to allow sustainable competition at retail level.