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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE
EUROPEAN PARLIAMENT, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

on Market Reviews under the EU Regulatory Framework

Consolidating the internal market for electronic communications

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1. INTRODUCTION

The regulatory framework for electronic communications set up in 2002 involved a major overhaul in regulatory approach, linking sector-specific regulation and competition law in a novel way. The previous, more mechanistic approach to regulation was replaced by an **economic approach where regulation is based on competition law principles**. It requires national regulators to conduct “market reviews” in order to determine whether a particular market should be regulated. Where a given market is susceptible to ex ante regulation and a regulator finds one or more undertakings to have significant market power or “SMP” (equivalent to “dominance” under competition law) on that market, it must impose appropriate regulation. Conversely, regulation must not be imposed, or existing regulation must be withdrawn, where no undertaking is found to have SMP. The market review process is subject to scrutiny by the Commission under the Community consultation mechanism established under Article 7 of the Framework Directive.

The aim of the regulatory framework, with the Community consultation mechanism at the heart of it, is to foster competition, investment and innovation and hence help meet the objectives laid down in the i2010 Agenda, the Commission’s strategy to boost growth and jobs in the communications sector, and the relaunched Lisbon agenda on growth and employment.

This Communication assesses the functioning of the Community consultation mechanism for electronic communications and the experience gained so far in its application. In its first two years, the consultation mechanism under Article 7 has given the Commission deep insight into developments on e-communication markets across the EU. This process is unfortunately not yet complete, but the Commission nonetheless considers it appropriate to share this knowledge with a wider audience. The conclusions set out in this Communication are a first assessment of the procedures and findings of this new instrument. They provide input for the forthcoming review of the regulatory framework, including the Commission’s Recommendation on relevant markets, in 2006.

2. ARTICLE 7 PROCEDURES: OVERVIEW

The Article 7 consultation mechanism has three main aims: (i) ensuring **consistent regulation** across the EU on the basis of competition law principles; (ii) **limiting regulation** to markets where there is a persistent market failure; and (iii) bringing more **transparency** in the regulatory process. These procedures are thus instrumental in **consolidating the internal market** for electronic communications.

Article 7 of the Framework Directive¹ requires national regulatory authorities (NRAs) to notify the Commission and other NRAs of their findings as to market definition and SMP analysis and the regulatory obligations they intend to impose (or remove) (their “proposed measures”). The Commission then has one month in which to assess the notification of the proposed measures (the “phase one” procedure). The vast majority of cases are handled within this one month period by a letter to the NRA concerned, which may contain Commission comments as to how the measures in question could be further improved. In cases where the Commission considers that, in terms of market definition or SMP analysis, the proposed measures would create a barrier to the single market or if it has serious doubts as to the measures’ compatibility with Community law (and in particular the common policy objectives that all NRAs should pursue),² it can conduct a more detailed investigation lasting a further two months (“phase two”). Following this in-depth investigation, should its concerns be confirmed, the Commission may require the NRA to withdraw the draft measures (“veto” decision) and possibly resubmit the market analysis in question at a later stage. For transparency reasons, the Commission has so far adopted a decision in every case, even where it has no comments.

3. ENHANCED COOPERATION AND TRANSPARENCY

3.1. Commission and national regulatory authorities

The Article 7 consultation mechanism requires close cooperation between the Commission and NRAs, and between the NRAs themselves.

Before submitting a notification, NRAs may meet informally with the Commission to present the key elements of their analysis. Such **pre-notification meetings** allow the Commission and NRAs to identify and discuss issues of particular concern at an early stage. The Commission also uses these occasions to provide guidance to the NRAs as to the information and level of analysis required to support their conclusions.

Notifications from NRAs normally comprise all elements of their proposed measures together, although some NRAs notify in two stages, remedies following market analyses. The Commission notes that the latter approach unnecessarily prolongs the regulatory process.

Once a notification has been received, the Commission can make **written requests for further factual information** to the NRA concerned. NRAs have the **right to withdraw a notification** at any time during the procedure.

3.2. The role of other interested parties

The regulatory framework provides for “**national**” **consultation**, during which all interested parties are given an opportunity to comment on the NRA’s analysis and proposals for regulation. As the primary interlocutor for all stakeholders, the NRA informs the Commission of the view of third parties. Only occasionally, when circumstances so require, does the

¹ 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 (the “Framework Directive”), OJ L 108, 24.4.2002, p. 33.

² These objectives are set out in Article 8 of the Framework Directive and cover promotion of competition, development of the internal market and promotion of EU citizens’ interests.

Commission directly receive submissions from or meet with stakeholders (normally on request). As a matter of standard practice in second phase investigations, the Commission invites interested third parties to comment directly.

Although the Community consultation mechanism formally involves the Commission and the NRAs only, it seeks to ensure **transparency for all interested parties**. Such transparency helps to ensure greater quality and objectivity in the NRAs' analysis. Non-confidential versions of all notifications, and the NRAs' final measures, are published on the Commission's dedicated website³ within a few days of receipt.⁴ The Commission also publishes non-confidential versions of comments, no comments and veto decisions.

Most NRAs conduct the national consultation **prior to Community consultation**. This allows them to reflect the views of market players in the Community notification and to avoid the need for a second Community notification where the results of the national consultation lead the NRA to amend its draft measure. The Commission strongly supports this approach.

3.3. The role of national competition authorities

Market definition and analysis under the regulatory framework are based on competition law principles. Consultation between NRAs and the national competition authorities ("NCAs") is therefore essential. Sector-specific regulation and competition law enforcement are complementary instruments to promote the development of effectively competitive electronic communications markets to the benefit of users.

In most instances, the NRAs have consulted the NCA in advance and this has often improved the market analysis. The Commission therefore encourages NRAs to obtain the NCAs' views prior to notification.

4. INSIGHT GAINED FROM NOTIFICATIONS RECEIVED SO FAR

4.1. Definition of the relevant markets

NRAs must define relevant markets based on national circumstances, taking into account the Recommendation on relevant markets⁵ and the SMP guidelines.⁶ Markets that could be subject to regulation are selected on the basis of EC competition law principles. In its Recommendation, the Commission developed the "three criteria" test to assist the Member States in this regard.⁷ For the markets contained in the Recommendation, it is presumed that these requirements have been satisfied.

³ <http://forum.europa.eu.int/Public/irc/infso/ecctf/home>.

⁴ The Commission now plans to extend the availability of translations to the general public.

⁵ Commission Recommendation 2003/311/EC of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with the Framework Directive, OJ L 114, 8.5.2003, p. 45 (the "Recommendation").

⁶ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165, 11.7.2002, p. 6.

⁷ Namely: (i) the presence of high and non-transitory barriers to entry, (ii) the absence of dynamic market conditions tending towards effective competition and (iii) the insufficiency of competition law alone to address adequately any related market failure. See further Recitals 9 to 16 of the Recommendation.

So far, NRAs have defined the majority of markets in line with the Recommendation, but in a number of instances they have defined markets more **narrowly** or more **broadly**. The Commission has not objected to such diverging market definitions provided that each individual market definition and SMP analysis is in line with EC competition law principles. The Commission has also verified whether the sum of markets analysed by NRAs covers the entire scope of the corresponding markets of the Recommendation.

Overall, the market definitions included in the Recommendation and explained in the Explanatory Memorandum have enabled NRAs to carry out their analyses of electronic communications markets as required by the legal framework. It has been argued that where markets have been further refined this may lead to over-regulation and amount to an unnecessary administrative burden. However, in the Commission's experience to date, such refinement has actually helped to deregulate the sector, as it has allowed regulation to be rolled back in those markets where sustainable competition has developed. For example, the delineation of wholesale leased lines by bandwidth has permitted existing regulation in respect of very high bandwidth to be lifted.⁸

4.2. Analysis of significant market power

The EU regulatory framework aligned the threshold for SMP on the competition law concept of “dominance”, replacing the previous threshold for intervention, which was based on a fixed market share (25%). The competition law-based assessment of SMP often involves a thorough examination of legal and economic issues, including questions such as the presence of countervailing buyer power and the criteria for establishing collective dominance.

In assessing SMP, NRAs look at whether a given market is or will become effectively competitive within the lifetime of the market review. The Commission essentially verifies whether the NRA's assessment is in line with EC competition law principles and takes the utmost account of the SMP guidelines and is sufficiently supported by evidence. While market shares remain one indicator, other factors (including market dynamics, barriers to entry and potential competition) are just as relevant to the overall analysis.

4.3. Imposition and withdrawal of regulatory remedies

Where SMP is found, NRAs must impose remedies on the operator(s) concerned. The Commission considers whether these remedies are **appropriate**, i.e. whether they are based on the nature of the problem identified, proportionate and justified in the light of the policy objectives set out in the Framework Directive.⁹ While the Commission has no power of veto over remedies, it may make comments which NRAs must take utmost into account. The Commission must be notified of the measures adopted; it monitors how Member States have taken account of the comments made, and acts accordingly.

A significant proportion of the Commission's comments so far have related to the **appropriateness of the remedies proposed**. The Commission has commented on remedies

⁸ See cases UK/2003/0035 – 0039 in relation to terminating segments of leased lines.

⁹ Pursuant to Article 8(4) of the Access Directive.

which solved only part of the competition problem identified,¹⁰ appeared to be inadequate¹¹ or might have produced effective results too late.¹²

In addition to taking the utmost account of the comments made by the Commission, NRAs should ensure full and effective enforcement of the remedies proposed within the shortest possible timeframe.

If the enforcement of a proposed remedy requires additional time (e.g. because an appropriate cost model is still to be developed), NRAs should already provide in the notified draft measure for temporary remedies addressing the competition failure identified.¹³

Generally, NRAs have applied similar sets of remedies to similar market failures. However, the **detail and implementation of those remedies have differed considerably** from one Member State to another. Such differences are manifest, for example, in pricing (e.g. methodologies for cost orientation), which has significant implications for the internal market. The question thus arises as to whether, and if so how, greater consistency in the application of remedies can be achieved. The question will be addressed in the upcoming review of the regulatory framework.

4.4. Requests for withdrawal of measures ('veto' decisions)

The Commission has adopted a decision requiring NRAs to withdraw their proposed measures in four cases out of 229 (assessed by 30 September 2005).¹⁴ Such "veto" decisions ensure that no measures are taken at national level that would be incompatible with Community law and in particular the common policy objectives that all NRAs should pursue. So far, the Commission has vetoed draft measures where it has found the evidence supporting a market definition or SMP analysis not to be sufficient.

In all these cases the Commission exercised its power of veto to ensure coherent application of competition law principles across the EU.

4.5. Horizontal issues

The consultation mechanism occasionally reveals failures in the transposition of the EC regulatory framework into national law. By putting such implementation issues under the spotlight, the consultation mechanism may provide additional impetus to resolve these issues as a **complement to the Commission's other powers**, particularly its power to start infringement proceedings.

¹⁰ As in a case where mobile termination rates were only regulated for calls originating on mobile networks or abroad, but not for calls originating on fixed networks.

¹¹ As in cases where price regulation was not based on the most appropriate cost model or where choices of cost model and cost accounting rules were left to the undertakings concerned.

¹² As in a case where cost-oriented mobile termination rates based on an LRIC cost model were left to private negotiations between operators first, before the regulator intervened in the context of dispute settlement.

¹³ This could be, for example, a benchmark or retail minus-based price control obligation, pending the adoption of a full cost model for cost orientation.

¹⁴ See Commission decisions: COM(2004)527 in cases FI/2003/0024 and FI/2003/0027, COM(2004)3682 in case FI/2004/0082, COM(2004)4070 in case AT/2004/0090, and COM(2005)1442 in case DE/2005/0144.

To ensure continuity of the regulatory framework, all **existing SMP obligations must remain in force until an appropriate market review is completed**. In cases where no regulation is currently imposed, NRAs can only impose new regulation following the completion of an appropriate market review. In exceptional circumstances, where there is an urgent need to act, NRAs may adopt provisional measures.¹⁵ The validity of the provisional measures must be limited in time and the related market analysis should be notified as quickly as possible. This horizontal approach contributes to one of the main objectives of the consultation mechanism, namely ensuring consistent regulation across the EU.

5. MARKETS OVERVIEW

This section provides a brief overview of the main trends and conclusions that can be drawn from the market review process, notwithstanding that the first round of market analysis is not yet complete. It is complemented by the Commission Staff Working Documents annexed to this Communication, which provide a more detailed overview, in tabular form, of all cases assessed by 30 September 2005.

5.1 Fixed networks and services

In all Member States, the incumbent has continued to be dominant on the market for retail “access” – i.e. connection to a fixed telephony network enabling calls and related services to be made and received. However, competition is gradually emerging on both the domestic and international calls markets. This process has been facilitated by the application of appropriate remedies (notably carrier selection/pre-selection¹⁶ and wholesale line rental¹⁷) and the introduction of competing technologies, in particular VOIP.^{18, 19}

Wholesale markets, conversely, have shown few signs of sustainable competition save, in certain limited cases, for the market for transit services.²⁰ The provision of call origination, which is needed by alternative operators to enable them to provide their own retail telephony and dial-up Internet services, is still an enduring bottleneck for competition. However, where effective remedies are applied at this level, they help to develop sustainable competition in the downstream retail (calls) markets, thereby enabling retail regulation to be phased out. As regards wholesale termination (services which operators buy from each other to enable their customers to make calls to different networks), all operators, irrespective of their size, have been found to be dominant, since, in line with the Recommendation, each operator’s network

¹⁵ Pursuant to Article 7(6) of the Framework Directive.

¹⁶ Facilities allowing customers to make calls using an operator other than the access provider either for each individual call (carrier selection) or systematically (carrier pre-selection). Under the Universal Service Directive, where an operator is found to have SMP “for the provision of connection to and use of the public telephone network at a fixed location”, NRAs must require the operator concerned to allow carrier selection and carrier pre-selection.

¹⁷ Permitting alternative operators to offer retail access services together with call services to end customers. As opposed to carrier selection and carrier pre-selection, which must be imposed on operators having SMP on the relevant market, an obligation of wholesale line rental is imposed (where appropriate) at the regulator’s discretion.

¹⁸ Voice over Internet Protocol: the transport of voice traffic using Internet Protocol technology. VoIP traffic can be carried on a privately managed network (“IP telephony”) or the public Internet (“Internet telephony”).

¹⁹ The Commission contributed to the emergence of VOIP technology in 2003 through the financial instrument of the Multi-Annual Programme (MAP) managed by the European Investment Fund.

²⁰ Conveyance and/or switching or routing of calls.

constitutes a separate market on which it has a monopoly for terminating calls. Regulators have been able to reflect differences in the size of operators by imposing lighter remedies on smaller ones (i.e. by applying “asymmetric” remedies). The Commission has supported this approach where justified. In addition, the Commission has been keen to ensure that remedies in this market are effective: for example, an accounting separation obligation can render internal transfers visible and complement other obligations, while cost controls may provide the necessary transparency and legal certainty for market players, as well as helping to reduce termination rates.

Finally, as regards the “last mile” of the telephony network, connecting it to the end user (otherwise known as the “local loop”), the incumbent has invariably retained its near 100% market share. Effective access (by means of “local loop unbundling”) and price regulation at wholesale level has been essential as a means of fostering the development of competition in the downstream markets, where alternative operators depend on local loop access to provide their services.

5.2 Mobile networks and services

Unlike fixed markets, the markets for mobile networks and services have proven to be generally more competitive and regulation is as such much more limited. There is no regulation at retail level, and wholesale regulation has on the whole been restricted to wholesale termination.

Three wholesale mobile markets have been identified, in accordance with the Recommendation: (1) access and call origination,²¹ (2) call termination and (3) international roaming. Mobile call origination enables operators or service providers (sometimes known as “virtual” network operators or “MVNOs”) to supply calls to retail customers by using another mobile operator’s network. Call termination is the mobile equivalent of fixed call termination, and thus similar principles (as regards market analysis and remedies) apply. International roaming enables customers to make and receive calls when travelling abroad.

As regards the market for access and call origination, regulatory intervention has in the main proved unnecessary given the level of competition generally observed. However, a limited number of NRAs have nevertheless considered regulation necessary, where one mobile operator was found to have single dominance or two or more together found to be “collectively” dominant.

As was the case for fixed call termination, all mobile network operators have been found to have SMP in the market for mobile call termination, in accordance with the principle of “one network, one market”. Moreover, where MVNOs have the ability to set their own termination prices independently of the “host” network, they may also be found to be dominant.²² The regulatory remedies imposed have led to a gradual reduction in mobile call termination charges, although this reduction has not been equally steep in all Member States.

As regards wholesale international roaming, no NRA had as yet notified this market on 30 September 2005. The market analysis requires cross-border data collection, on which NRAs are cooperating in the context of the European Regulators Group. In the meantime, the

²¹ As compared with fixed telephony, where access and call originations are delineated separately.

²² The point made above in relation to fixed networks and services on the effectiveness of remedies is equally applicable to mobile call termination.

Commission has also created a website bringing together a sample of already published roaming tariffs of mobile telephony operators across the EU in a bid to contribute further to the transparency of roaming charges.²³

5.3 Broadband and broadcasting

Wholesale broadband access or “bitstream” access enables alternative operators to provide broadband services to end-users by combining their own backbone network with parts of the incumbent’s network. Bitstream access is generally considered to be an essential stepping stone for new entrants towards investment in full-scale roll-out of their network on the basis of local loop unbundling (first through “shared” and then through “full” unbundled access). In all cases up to 30 September 2005, NRAs have required incumbents to provide bitstream access. This has helped competition, inter alia in the provision of retail broadband services, to flourish. Until now, the wholesale broadband access market has only comprised services based on the traditional telephony network (or “PSTN”) – i.e. ADSL. In order to include competing technologies (such as cable or satellite) within this market, the Commission has insisted both on evidence of a veritable cable or other technology-based wholesale product, and on evidence indicating substitutability between such wholesale product and ADSL.

The wholesale market for broadcasting transmission services is a market where NRAs have most deviated from the Recommendation. Lack of substitution between different platforms (cable, satellite or terrestrial) at wholesale level has led NRAs to subdivide the market by platform used. While the factual circumstances of the market appear to vary substantially across the EU, in most Member States the main bottlenecks for competition seem to arise in national analogue and digital terrestrial transmission systems. Consequently, only terrestrial transmission has so far been subject to market analysis and SMP remedies.

6. CONCLUSIONS AND OUTLOOK TO THE FUTURE

The Commission considers that the market review process, including the Article 7 consultation mechanism, set up under the Framework Directive has led to **more consistent regulation** and therefore represents an important step towards the creation of an **internal market for electronic communications**.

The system of market reviews has ensured that regulation is based on a thorough economic analysis and is **strictly limited** to markets in which there is persistent market failure. This has resulted in better regulation. As regards the development of a **joint European regulatory culture**, it is important to point out that all NRAs follow a common methodological approach, based on EC competition law principles. A **transparent** consultation mechanism further contributes to this development.

Consistency has mainly been ensured in relation to *where* regulation is appropriate (the markets and the market position of players operating in them), but to a lesser extent *which* regulation (remedies) is appropriate. The Commission is currently working with NRAs to ensure that their discretion with regard to remedies is exercised in a consistent manner.

²³ IP/05/1217, 4 October 2005.

Whereas certain markets have exhibited the characteristics of enduring bottlenecks, a number of markets have already become **effectively competitive** in several Member States, allowing **existing regulation to be rolled back**. For example, retail calls, mobile access and call origination and trunk segments of leased lines are markets where effective competition has been identified.²⁴

The consultation mechanism has created greater **transparency** in the regulatory process. The fact that market players are systematically consulted by the NRAs, the Commission takes a position in every case and all final documents are published are just some examples of this transparency.

The system of market reviews established by the regulatory framework has on balance proved to be a success. Even though it necessitated some initial investment in analytical and organisational capacities on the part of the NRAs and the Commission, it has led to an approximation of regulatory approaches and has thereby helped to pave the way towards an internal market for electronic communications. It has also ensured that all regulators base their decisions on sound economic considerations and that regulation of markets for electronic communications has been kept to the minimum necessary.

Although a large number of national markets remain subject to regulation there are signs of sustainable competition in other markets. This is true in particular of retail markets, but it is conditional on the effective enforcement of regulatory remedies at wholesale level or on the existence of alternative infrastructure. The introduction of new technologies may create additional competitive pressure, which can lead to less of a need for regulation.

The Commission will look for ways, in the context of the review, to decrease the administrative burden on companies and NRAs and to streamline procedures even further. The Commission has launched a call for input on the review of the regulatory framework, which also covers the market review procedures.

²⁴ These developments will be taken into account in the review of the current list of 18 markets in the Recommendation. For further details of competitive markets where no SMP regulation is applied see Annex I.