

The Regulatory Framework for Electronic Communications Networks and Services: 'Pan European Benefits Disconnected By National Interests'

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Within the EU economy, the Information and Communication Technologies (ICT) sector was worth €614bn in 2005¹ of which, the electronic communications market accounted for 44.4%. This market, underpins the whole EU economy² as showed by the fact that ICT accounted for 40% of European productivity growth in 2005 (25% of overall growth)³. The EU's approach to electronic communications must therefore be viewed within its overall approach to ICT, based on the Lisbon agenda of 2000 and reinforced by the i2010 initiative⁴. The latter sees a key EU challenge as the creation of a single information space with an internal market which is open and competitive. It stresses the importance of ICT in achieving the economic growth and employment objectives of the former that are required if the EU is to meet the challenges of a 21st century information based, globalised economy.

To help achieve these aims the regulatory framework introduced in 2002 for electronic communications networks and services (the Framework) sought to harmonise regulatory procedures and principles. It is based on an idea of light touch ex ante regulation that will evolve as the market develops into a system based on competition law principles. The past year has seen an extensive review and public consultation by the European Commission regarding the Framework, the challenge of which has been to ensure the Framework is suitable for the next 10 years. Although legally required⁵, at a time of rapid convergence the review would have been needed to ensure that the overall aims of the EU were not hindered by overlapping regulations stifling industry innovation and growth. This work critically assesses the Framework by establishing its success and failure in terms of the following key objectives⁶:

- 1) Increased investment in the market
- 2) Promoting Competition
- 3) Promoting the interests of EU citizens, and
- 4) Contributing to the development of the internal market

The proposed changes will be discussed at each point to assess their likely impact. It will be argued that while there has been successes the failure to ensure effective

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¹ European Commission Communication European Electronic Communications Regulations and Markets 2005 (11th Report) COMM (2006) 68 final

² According to the Commission Communication 'Working Together For Growth and Jobs. A New Start for the Lisbon Strategy' COMM (2005) 24 02/02/2005

³ Supra note 1

⁴ COMM (2005) 229

⁵ Article 25 Framework Directive

⁶ As stated in article 8 of the Framework Directive. Point 1 is mentioned in article 8 as a means of promoting competition but is discussed separately as it is part of the overall EU economic objectives

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implementation of the Framework means even with the proposed changes a Framework of pure competition principles remains some way off.

1) The Impact on Investment

Prior to the Framework, there had been a decline in market investment. In a study by London Economics⁷, 12% of companies and trade associations surveyed cited regulation uncertainty as a main reason for this. The EU hoped the Framework would provide certainty, leading to higher market investment, which in turn would add growth. The issue is therefore, whether the Framework has been conducive to increased investment and has that investment taken place. Increased investment has occurred but whether this is due to the Framework is unclear and varies between different players in the market. Since 2003 aggregate investment levels have rose year on year to a level in 2005 of €45bn⁸. 23% of respondents stated regulatory factors as their main reason⁹. The highest reason given was 43% for new market opportunities. At the time the Framework came into force the EU was about to admit 10 new states. Therefore, it could be argued that the Framework contributed to these opportunities by providing regulatory certainty over a wider area.

Specific questions were also asked regarding the Framework and investment. In all sub-sectors of the wholesale and retail electronic communications markets, the majority opinion was that the Framework improves incentives to invest¹⁰. Yet, the most agreed with statement was that “The regulatory framework deters investment in new technological developments”. The reasoning for this paradox could lie in who made up the sample. The Commission has noted¹¹ that when viewed relatively to revenues, investment is predominantly from new entrants, while incumbents have felt the framework has ‘hindered new investment’. Further, “Uncertainty about the terms of access discourages the entry of new companies into e-communications” was disagreed with, lending weight to the suggestion that more incumbents were surveyed and they feel new players have entered the market driving overall investment but deterring them from investing. If this is the case, the question is why. Potentially, they may not want to outlay capital until they know the competition’s strategy or may be unwilling to invest and then have the new entrants share the fruits of that investment through increased knowledge or shared access. Alternatively, they may have already made significant investments prior to the Framework in anticipation of technological advances or competition. This can be seen with Deutsche Telekom who invested heavily in new technologies in 2002 at a time when the overall market investment was in decline due to the stage of the economic cycle and the dot.com bubble bursting.

⁷ In association with PricewaterhouseCooper ‘An Assessment of the Regulatory Framework For Electronic Communications – Growth and Investment in the EU e-Communications Sector’

⁸ Taken from a speech by Viviane Reding at the Annual Meeting of BITKOM 27th June 2006

⁹ They believe regulatory certainty, made up of clear legislation with comprehensive guidance and a timely implementation procedure is one of the main factors in choosing to invest. Better performing regulatory regimes have also been shown to contribute to higher investment levels by the OECD.

¹⁰ Table 4.7 at p110 of the study

¹¹ European Commission Communication on the Review of the EU Regulatory Framework for Electronic Communications Networks and Services COM (2006) 334 final

No specific investment reforms have been proposed. However, some respondents suggested raising its profile by having an objective of sustainable investment on a par with promoting competition. This would at least make National Regulatory Authorities (NRAs) more focused in that their actions must actually achieve investment rather than merely encourage it. Although, it could be questioned whether it matters if the Framework actually encourages investment as technological necessity means investment will take place, as stated by some of the respondents. Perhaps all we should expect is a system that ensures a level playing field for participants, which is certain in nature.

Comments regarding investment post-Framework introduction should be cautioned with the fact there was a downtrend prior to this primarily due to the global economic situation. Ultimately though, the Framework must be said to have been fairly effective in encouraging investment in the market especially from new entrants. Yet inefficient implementation has offset pan-European investment by leaving a level of uncertainty amongst market players¹². If the Framework had been more consistently implemented, investment would be higher¹³. A comparison of UK and Germany (who have contrasting levels of effective implementation) shows that market investment is 0.42% and 0.27% of GDP respectively¹⁴. As the statement “In order to encourage more network investment, fundamental changes should be made to the regulatory framework within the next 2 years” was also disagreed with it appears the Framework does have the support of the market to drive investment.

2) Promoting Competition

Market competition, particularly retail has increased¹⁵. This is illustrated by figures showing that for those states with published figures, the market share of the leading mobile phone operator fell in 19 states and the EU average is 43% (down 6%)¹⁶. Mergers and acquisitions reached their highest levels for 5 years in 2005 at €70bn¹⁷ and The Financial Times has reported how private equity firms are showing a growing appetite for telecoms companies¹⁸. However, competition is far from consistent across Member States and there is a clear difference between those who have effectively implemented the Framework and those who have not. The UK, which has the highest score for effectiveness of implementation,¹⁹ has the most diversified mobile market in Europe²⁰ with a subscriber market share of 2,267 per operator. Germany (15th highest score), has a more concentrated market with 3,081 market share per operator.

¹² As noted in the study at p114.

¹³ A report by SPC Network Ltd ‘European Telecommunications Lost Investment: An Analysis of the ECTA Scorecard’ indicates that if all member states had an effective implementation score of 100% investment would increase by 13.1 billion euros (31.7%).

¹⁴ Supra note 8, Germany has been chosen to minimise the influence of general economic factors as both have a similar overall GDP and market demographic

¹⁵ The EU proposes to remove 7 retail markets from its Recommendation on Relevant Markets

¹⁶ www.epp.eurostat.ec.europa.eu

¹⁷ Supra note 1

¹⁸ 24/11/06 discussing the 1.19bn purchase of Ceske Radiokomunikace by a private equity group

¹⁹ ECTA Regulatory Scorecard 2006

²⁰ Using the Herfindahl-Hirschman Index of market concentration, as reported in a research paper by Ofcom ‘The International Communications Market 2006’ published Nov 2006

However, it is also worth noting that even in States that have appeared to liberalise their domestic market, there is still insufficient competition. In Slovenia the number of mobile phone operators has increased to six, comparing favourably with the UK. Yet this hides the fact that within the last year, two operators have been sold to the same company with the heads of both, citing the government's failure to open the market to competition. The entire telecommunications market is dominated by Telekom Slovenije, which is 75% controlled by the government, meaning the regulator is the main shareholder²¹. Both said they had to fight to get the access to Telekom Slovenije's infrastructure guaranteed under the Framework. Slovenia is perhaps a prime example of domestic conditions impacting on the Framework. With the public against foreign ownership and an election looming the government has been keen to stress how well the economy has performing without further liberalisation²² and market competition.

Therefore, competition has increased where the Framework is implemented effectively however, the data also suggests competition has occurred even where implementation has been ineffective or in the case of Greece, non-existent²³. The question is whether the increase has arisen not through the Framework being in place, but due to wider economic factors. This could be true when comparing economically unequal states but carries less weight for states that are more equal in economic size but have different records in their implementation of the Framework. As noted previously, the mobile phone market is more competitive in the UK and this is also the case in terms of the broadband market. In Germany, the leading three operators account for 76.1% of retail subscriptions, in the UK it is 55.1%²⁴.

3) Promoting the interests of EU citizens

Technological advances are driving penetration in broadband and VoIP²⁵, and increase data rates. Substitution and convergence between fixed and mobile telephony networks will raise number portability issues along with broadband migration codes²⁶. To ensure a digital divide does not spread, the EU proposes to look at the area of universal service obligations in a separate review in 2007. Therefore, this work concentrates on whether citizen's interests have been promoted through security and network integrity provisions; as without consumer confidence and buy-in the Framework falters.

By the Commission's own admission²⁷ there is a growing security threat, 'partly due to the lack of appropriate security measures'²⁸. This is heightened by Member States

²¹ Plans have been announced to sell 50%, Financial Times Special Report: Slovenia 13/12/2006

²² The economy has outperformed many in the Eurozone and has enabled Slovenia to join the Euro whereas countries such as Lithuania have missed out due to inflation caused by investment in more liberalised markets. Discussed in the Financial Times Special Report

²³ The necessary legislation has only been enacted during 2006; the share of fixed telephony calls by alternate providers increased 5.1% in the first six months of 2005, compared to 2004. Taken from the EU 2006 Report on the National Reform Program Implementation for Greece.

²⁴ 'The International Communications Market 2006' published by Ofcom in Nov 2006

²⁵ Voice over Internet Protocol – telephone calls made using the infrastructure of the Internet

²⁶ Currently switching broadband suppliers is seen as arduous. Though from February in the UK these codes will fall under the general authorisation conditions but not where the supplier uses their own telecoms network following Local Loop Unbundling.

²⁷ Supra note 11

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differing in their application of the obligation for providers of publicly available electronic communications services, to take measures to safeguard their services' security²⁹. This issue grows in importance as pan-European services develop. It has now been proposed to impose specific requirements on providers to 'implement and maintain security measures to address security incidents and to prevent or minimise the impact of such incidents on customers'. They would also have to respect NRA guidance and have 'liability clauses for not taking the appropriate security measures'³⁰. This would also be supported by a measure requiring security breaches to be reported as well as risks. To emphasize the increased importance if the issue a new chapter will be wrote into the Framework Directive.

Arguably, the fact that this is not the current situation was a massive oversight when the Framework drafted. This will force operators to invest in security and make them accountable to their consumers. It is concerning though, that states such as Sweden have only given the proposals a cautious welcome. However, if the measures are to be ultimately successful then the EU needs to work globally to combat the problems such as spam which do not respect national borders.

4) Contributing to the development of the internal market

Viviane Reding has acknowledged that the internal market is currently fragmented³¹. A study by Hogan and Hartson LLP³² (the Study), has stated that those surveyed feel 'implementation needs to be completed, and in some cases improved'. Without the Framework being implemented and applied in a uniform manner an internal market cannot be fully functional.

The biggest factor affecting implementation of the Framework appears to be an unwillingness to do so by Member States³³, perhaps due to domestic political and economic reasons. For example in Germany, a law was passed in December protecting a €3bn investment in ultra fast internet lines by the incumbent Deutsche Telekom³⁴; of which 14.62% is state owned³⁵. Further, as noted, Slovenian public opposition is thought to be delaying plans to privatise the incumbent operator until after the next election.

Due to delays, in some instances the first round of post market analysis notifications to the Commission may well be incomplete while some states move on to a second round. A related issue is delay caused by the time taken to complete the market

²⁸ The issue is not just applicable to the internet, as the recent Greek Vodafone bugging scandal illustrates.

²⁹ Article 4 e-Privacy Directive

³⁰ Staff Working Document on the Review of the EU Regulatory Framework for Electronic Communications Networks and Services - Proposed Changes SEC (2006) 816

³¹ Speaking at the ECTA Annual Conference in Brussels 16/11/2006

³² With Analysys Consulting Ltd 'Preparing the next steps in regulation of electronic communications - A contribution to the review of the electronic communications regulatory framework'

³³ The Framework was not transposed into national law by the required deadline in 7 Member States. In total the Commission has initiated 90 infringement proceedings against all 25 Member States due to incorrect implementation.

³⁴ Reported on MSNBC 16/12/2006 at www.msnbc.msm.com/id/16229648/

³⁵ During the review, Germany led calls for the introduction of a regulatory holiday for incumbents to allow them to invest in emerging markets.

analysis process (regardless of when it is started) which has been said to be ‘onerous and pose problems for NRAs, particularly for smaller NRAs’ by the European Regulators Group³⁶ (ERG). This is a problem as a drawn out process diverts NRA resources from enforcement and creates a level of uncertainty amongst undertakings looking to enter a market, not forgetting that the technologies in question are changing rapidly. The Study suggests that the process will only get more burdensome. Firstly, as incumbent’s market share decrease, it will be harder to establish Significant Market Power. Additionally, as technologies converge further and new platforms take hold, the process of defining markets will be more complex and existing markets may need redefining. Lastly, through the possibility of increased litigation as incumbents strive to maintain market share and revenues. Although they note the possibility that it may speed up as NRAs are more experienced and there is a more expansive body of work to refer to. Although, it must be said the former view would seem the more likely. However, the Commission’s proposals may well be impracticable in some cases, while others not actually achieve their purpose³⁷. One proposal is to rationalise the process into a new Regulation, with the market analysis to start within 12 months of domestic implementation and be completed within a further 12 months. Sweden has called this unrealistic, while the UK questions whether it will improve the quality of analyses³⁸. A solution may be to let NRAs set their own timeframe for their overall process with explanations and submit this for Commission approval³⁹. This way flexibility is maintained by allowing domestic factors and complexities to be taken into account while not allowing the process to be open-ended.

Another obstacle to the internal market is a lack of harmonised remedies following the market analysis review. The Commission has noted⁴⁰ that ‘NRAs have applied similar sets of remedies to similar market failures. However, the detail and implementation of those remedies have differed considerably’. This may prevent operators moving into different state markets as they may be unsure how the Framework will be applied impacting competition. The Commission proposes to extend its veto powers to cover proposed remedies on the basis this ‘would contribute to a consistent approach’⁴¹. It is questionable what this would achieve without a right to impose its own remedy as NRAs must currently take into account the Commission’s comments. The Study notes it will more likely increase delays as NRAs spend longer drawing up justifications for their remedy and potentially have to start again if it is vetoed. Further, as in the view of the UK it ignores the fact that NRAs have more knowledge and understanding of local market conditions. Strengthening cooperation by NRAs, perhaps through the ERG⁴², may be the best course of action.

³⁶ European Regulators Group and Independent Regulators Group Response to Call For Input on the forthcoming review of the EU regulatory Framework for electronic communications and services.

³⁷ A further proposal to reduce the detail needed on certain notifications still requires the NRA to carry out a full analysis and consultation therefore having negligible impact on NRA workloads.

³⁸ In their respective responses to the Commission Communication on the Review of the Regulatory Framework for Electronic Communications Networks and Services COM (2006) 334 final

³⁹ This analysis is also shared by the Hogan and Hartson study

⁴⁰ Communication on Market Reviews under the EU Regulatory Framework ‘Consolidating the internal market for electronic communications’ COMM (2006) 28 final

⁴¹ Supra note 29

⁴² Although care should be taken to ensure that the ERG does not duplicate the Commission.

An additional problem impacting the internal market is that operators' individual rights of use have conditions that vary between states. The Commission recommends a common approach to the authorisation of pan-European services. This is logical as the point of the internal market is to stimulate cross border activity. The proposal is that where a service has a pan-European scope or internal market relevance, an authorisation in one Member State will be valid throughout the EU with no change in conditions. This would reduce the burden on NRAs by allowing them to concentrate on enforcement and on operators who do not have to continually obtain authorisations. The proposal is vague on specifics leading to doubts from the UK, Sweden and Holland as to how it will work in practice although not dismissing it in principle. It is suggested, using the Study as a guide as to how it could be implemented, this idea should be looked into as if national market differences could be overcome (for example leaving NRAs some scope to impose conditions), it would aid a more harmonised internal market.

To aid the internal market, legal certainty is needed as to what the grounds are for an appeal against a NRA decision in a Member State, and what the situation will be while that appeal is underway. The technological nature of the market also dictates that speed is of essence. Under the Framework as it stands, discrepancies between different states appeal process have occurred. The Study notes that, some states treat appeals as part of their administrative court process, while others have specialist ad hoc bodies. This potentially causes a discrepancy between the expertises available. An issue therefore, is whether the Framework should create a specific supranational body to hear appeals. The Study argues the added regulatory controls this would entail are probably not justified on two grounds. Firstly, decisions will primarily be based on local facts which will be better appreciated by a domestic body. Secondly, the purpose of the Framework is to move to regulation by competition principles. Therefore, long term these specialist courts are not needed. A set time period⁴³ and certainty as to the position in the interim period would be more beneficial. The Study proposes introducing set criteria that must be satisfied for a NRA decision to be suspended pending an appeal⁴⁴; this has been accepted by the Commission. While the UK's Response calls this as 'an encroachment on national competence for the operation of national legal systems' it is a welcome change and should have been in the Framework from its conception. No proposals have been made to set an appeals timeframe but if the timeframe for the analysis process is shortened then this may be reduced as an issue. The proposal instead, is to monitor appeal numbers and length through states reporting to the Commission, leaving the possibility of future reform.

Despite the deficiencies, positive points can be taken from the current situation. As noted cross border mergers and acquisitions have increased and operators have moved into new national markets⁴⁵. Therefore, while improvement is undoubtedly needed, access into national markets, helping to create an EU wide market, has increased.

Conclusions

⁴³ According to ECTA some appeals have taken up to 3 years.

⁴⁴ Amending Article 4 of the Framework Directive

⁴⁵ For example Telefonica O2 (created from a Spanish and British firm) have just recently moved into the Slovakian mobile market

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Ineffective implementation arises repeatedly when viewing the Framework, offsetting any successes as the internal market is fragmented. Therefore, the hope of a regime based on pure competition principles is still some way off. The EU feels an independent European Regulator would ensure consistent application. NRAs would still analyse domestic markets and act as contact points but would work within guidelines and decisions of the new body. Independence is needed in the system to ensure the Framework is not compromised by national interests but this creates another regulatory layer which may not appreciate differences in national markets leading to a stifling of competition by imposing a one size fits all approach. Tougher penalties for states as well as governments would arguably be more effective. The key reforms are facilitating access to spectrum resources for market players with a coordinated management decision making mechanism and functional separation of incumbents. However, experience of the Framework shows the latter is more likely to succeed. A final issue is whether a delayed competition regime matters. With so many prevalent public policy issues, such as universal service, it is questionable whether market forces can be trusted to cater for the needs of everybody and ensure there is no European digital divide.