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Legislation and Regulation in the Transatlantic Framework

Telecoms and Media

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Introduction

I am very pleased to give a European perspective on recent developments in our sector at this transatlantic seminar.

Let me concentrate in my contribution on three issues:

- The common agenda that, I believe, US and the EU are facing;
- The recent EU Telecom Reform that has been adopted (but that will have to earn its merits in its implementation);
- The growing impact of media on the development of the sector as future transformation in the telecom sector will depend to substantial extent on the development of the media sector.

The Agenda

I believe we have now a common agenda in the US and the European Union for the sector.

Both sides of the Atlantic have to recover from the dramatic Internet slump that has turned into a sharp slump for the telecom sector itself. This is now a sector in deep crisis but it remains a sector of large promise. We have both to face new issues, as we move from traditional voice regulation to future issues such as regulation of cable, fibre and mobile. In Europe, we have to face a media paradigm shift, as traditional revenue models in that sector stagger, exactly when we need a vigorous media sector for the interactive broadband transition.

For Europe, this then sets the agenda:

- Telecom reform, currently underway, with major implementation measures on the definition of markets that should be in the future subject to regulation, to be published for consultation during these very days;
- Broadband, which the European Commission wants to use as growth machine to move Europe out of its current telecom depression, as set out in the 'e-Europe 2005' plan just announced—and as does the US;
- Digital television where we have seen a series of failures of platforms that will have to be countered by restructuring and re-thinking of business models. And it seems to me from the recent FCC notices and reports that the difficult transition to digital television figures high on the US agenda as well.

Where do we come from

Before I move into this, let me have a quick look back at the European vs. the US approach.

The EU framework of Directives for full liberalisation of telecoms of 1998 basically compared with the US Telecom Act of 1996 that liberalised, in principle, fully US telecoms. But the European framework was developed against a different background.

The US telecom scene, after its initial phase of liberalisation of terminal connecting equipment during the sixties and seventies and value-added services—or in the terms of Computer Inquiries I and II "enhanced services—during the seventies and early eighties was deeply marked by the 1982 AT&T consent decree, and the subsequent splitting of the Bell system of the time into 'local' Bell Operating Companies and the long-distance companies. The resulting dichotomy of the US telecoms sector into local and long distance dominated US regulatory thinking and debate for the period up to the 1996 Act.

In Europe, we never had this legacy. Therefore our starting point was quite different when the 1987 Green Paper laid out the principles for liberalisation of telecoms for the EU. It is only since the US Telecom Act of 1996, that overall the US and the European telecom agendas look fairly similar, centring on issues like interconnection and access to the incumbent's network, universal service, treatment of the Internet—even if in the US the post-1996 period and the proceedings and litigation that followed, are still quite largely characterised by this legacy: for example by the link between competitive entry into the local areas, and the possibility for the ILECs to enter long-distance.

In the EU, we have not had the same legacy, and the 1998 EU Liberalisation Framework had no basic regulatory distinction between long distance and local. We had a short debate in the early nineties about liberalising long-distance voice only between Member States, but complex problems were anticipated, and therefore the decision was taken to liberalise *all* voice services within a single framework (but with transition periods up to 1998), with no lines of business restrictions for incumbents, except those that may result from general anti-trust law.

So, where are we in Europe? As most here will know, the European Commission issues each Autumn a report on progress of effective market liberalisation based on the 1998 framework that gives detailed information for each of the fifteen EU Member States on effective competition, licences issued, fees, operators, universal service performance, rights of way. The report benchmarks progress against EU objectives.

The 2001 report and its bulky annexes were issued November of last year and are available on the EU web site (http://www.europa.eu.int/information_society/topics/telecoms/implementation/index_en.htm).

I will therefore only mention a few figures that emphasise the main points.

The four-year period since 1998 has been characterised by profound liberalisation and market restructuring of large parts of the European telecoms sector. The period was characterised by:

- Extensive liberalisation of markets, leading to dramatic cuts of international and long distance rates, and substantial gains for the European consumer;
- Continuing rapid mobile expansion, substantially outpacing original forecasts, though with a decreasing turnover per client;

And, initially,

- By the Internet boom, combined in Europe with the mobile boom that brought substantial support by capital markets for the restructuring of telecom markets;

- Effective national regulators ('National Regulatory Authorities', the NRAs) were established in all fifteen Member States, and became the anchors of the new regulatory system in Europe. Interconnection regimes started to work, with rapid cuts in interconnection rates down to US levels. The foundations of the regulatory framework for the new competitive telecom markets were put in place overall remarkably smoothly. Growth was at an average of 9% / annum, and continued in spite of the Internet slump throughout the period.

We have seen a substantial increase of choice for consumers in Europe:

- By the end of last year, 80% of consumers had the choice between at least five long distance providers (95% between at least two);
- 30% of consumers had a choice between at least six providers of local calls (45% between at least two), though with substantial spread between EU Member States.

This set the scene for the review of the 1998 EU telecom regulatory framework that was to draw conclusions from the experience since liberalisation on 1st January 1998, and that led to a reform of the framework, just now passed through the legislative process at EU level.

In summary: Introduction of competition was successful

But

This was mainly concentrated on the long distance and international markets. The market share of the incumbents in the local market, the crucial bottleneck in telecoms markets, is after four years of liberalisation still at 95%, with the only exception of two Member States where it is now down to some 70%.

Progress to date is therefore founded on a fragile base. I believe this basic weakness of liberalisation schemes is a common experience on both sides of the Atlantic—looking back also at the experience in the US since the 1996 Telecom Bill.

And we have now entered a new critical phase. We have seen:

- A dramatic set back of the financial situation of the sector, of both competitors *and* incumbents, due to the generalised crisis of high tech stocks that has now fully reached the telecom sector, as testified by the crisis news during these very days.
- In Europe, very high licence fees during the 3G mobile (UMTS) licence process 2000/2001 resulting in a number of European countries from the auction process. The licence fees cumulated across the fifteen Member States to some 110 billion €, bypassing by far the total annual turnover of the mobile sector of some 80 billion € (2001). This leveraged the European telecom sector as a whole with substantial liabilities, and made financing of the sector substantially more difficult, at the very time when both introduction of competition into the local loop and the financing of the next network generations, both mobile and fixed, were needing fresh finance and investors' trust.

As a result, the European telecom sector is currently threatened to be squeezed between high debt levels and difficulties to refinance from the capital markets, though we believe that the sector will overcome this difficult transition based on its fundamentally sound long term prospects. Financing of new investments has become difficult across the board, in both fixed and mobile, and we have seen spectacular market exits during these very days, in Europe as in the US—KPNQWest being one of the major recent examples.

The Reform

This leads to make some remarks on the reform of the telecom regulatory framework adopted in April by the European Parliament and the EU Council of Ministers, and now on the agenda in all fifteen Member States for implementation.

Whatever good intentions, any regulatory model nowadays will have to pass one basic test: will the Reform rekindle "e-growth" in Europe?

What is the essence of the reform? Let me summarise in very short terms.

The main points are:

- Further opening of the local bottleneck, by more strictly enforcing the unbundling of the incumbent's network;
- Regulation based on determination of market power according to proven concepts of antitrust; and
- Generally, a growing role for general anti-trust rules and methods.

The aim is to generate the opening of the remaining bottlenecks and more flexibility, in order to create new growth potential—the only durable way to overcome the current problems.

A few remarks on the chronology of the Reform:

- The EU unbundling regulation is in force since January 2001.
- The main elements of the revised framework that consolidates the 1998 EU Regulatory Framework are now in place: the new Framework Directive, Authorisation Directive, the Access (Interconnection) Directive, the Universal Service Directive and the Spectrum Decision, all adopted on 7th March 2002 by Council and Parliament and published in the EU's Official Journal on 24th April. The revised Privacy Directive will follow soon (<http://europa.eu.int>).
- Member States have 15 months to enact the modifications to national law that the implementation of these Directives implies.

Unbundling

As the November Implementation Report stated, unbundling remains difficult territory in Europe, as it has been, to my understanding in the US ever since the 1996 Telecom Act.

In Europe, unbundling is seen as a means to substantially accelerate the deployment of xDLS (the various modes of digital subscriber line technologies)—seen as a shortcut to high speed Internet (high speed at flat rate via the normal telephone copper wire). This is, of course, a topic also well known in the US.

Looking at figures, we are still at the very start with unbundling in Europe, with the number of unbundled lines in many Member States more in the symbolic range, and the total less than one million lines. But effective unbundling is one necessary requirement for the new markets having a chance to develop in a competitive environment. There remains the threat that the existing dominant positions in the local loop will be expanded into the new xDSL markets, as the current high shares of the incumbents in xDSL indicate.

The main Reform

Let me move onto the main reform. As I have said, the overall aim is more market-based regulation:

- The determination of those operators exercising 'Significant Market Power' ('SMP') and the regulation of those operators remains the basis of telecom regulation in Europe;

But

- This determination must be made in the future by the national regulators according to the principles of general competition law and will be subject to periodic reviews. The principles of determination of relevant markets and of dominance in those markets, as established under antitrust, replaces the fixed definitions written into the current framework.

This should give the EU's regulatory framework more flexibility to adjust to the situation of market convergence. The introduction of the principle that only operators dominant either single or jointly, be subject to the full weight of regulation should introduce automatic 'sun setting' of the more heavy parts of regulation, once dominance disappears and regulatory checks are effectively replaced by the constraints on market behaviour set by competitors.

The essence of the reform therefore is:

- More flexibility, moving away from voice-centric regulation;
- Thereby accommodating the convergence of markets;
- Integration of general competition law principles;

With the overall result of:

- Regulation more focused on the actual market situation.

The reform is necessary to introduce the new degree of flexibility that markets require as we move into convergence. However:

- Difficult issues of market definition are ahead;

And

- Market definitions will become key in EU regulation, as demonstrated by the publication of the Commission's guidelines on market definition and the calculation of significant market power (in draft) last year and the public debate ever since.

Market definitions

Let me detail this further.

The 1998 framework has written into its Directives the markets to which it applies—basically voice markets defined according to technological definitions.

In the future, the Framework will be based on market definitions established according to competition law principles that take as point of departure substitution effects and competitive constraints. Markets are no longer written into statutory provisions in a rigid manner but will be based on determination by regulatory procedures.

This should bring the flexibility to move away from a rigid voice based regime, towards new market definitions being more receptive to the new requirements of converging markets.

This also means that the main content of the new framework will be fixed in the accompanying 'soft legislation', just about to be released during these very days:

- Guidelines for market definition and determination of Significant Market Power, available for some time for public comment, as I have said, soon to be published in their definite form;

- *Recommendations* for markets to be subject to regulation (which are to be reviewed periodically) which will be in practice the crucial part of the Reform
(<http://www.europa.eu.int/comm/competition/liberalization/others/#telecom>).

It is there where the future range of regulation will be decided—if the reach of sector specific regulation will be taken back, or if, in practice, the new rules will tend to expand in fact regulation, such as to mobile and cable. It will be interesting to see reactions once the documents are out for public comment.

The essence of the EU Reform Framework will therefore be in its way of implementation, with the additional complication that the Reform introduces a new balance between the EU-level and the Member States' regulatory process, and new checks and balances aiming at avoiding a divergence of regulatory regimes between Member States—that otherwise could result from fifteen different regulatory processes for the determination of market power and the regulatory remedies to be applied.

I believe, the most critical issue at stake will be the impact of the new system on future regulation of mobile and cable in Europe, most vital for future market expansion that we so urgently need.

Broadband

This leads me on to my next point, interactive broadband deployment, now at the centre of interest in both the US and Europe.

The new 'e-Europe 2005' plan just published for submission to the Sevilla European Summit of the Heads of State is designating broadband as the key enabler for a revived communications environment.

In Europe, we still face relatively low take up in both fixed and mobile broadband (the future 3G system). Broadband penetration of households is still in the low percentage points with a wide variance between Member States, though rising. Different from the US, in Europe ADSL is outpacing cable for that purpose in an overall ratio of 2:1, though cable modems lead in some Member States.

This is partly due to widely varying cable penetration in the Member States, in a number of cases far below the US penetration (though in others above). It is also due to the issue of cross-ownership between telephone incumbents and cable networks that have been slow to be resolved, even if the EU has pushed very hard towards separation and divestiture. And it is, of course, due to regulatory regimes that are simply too rigid to allow rapid upgrading of cable, quite apart from the fact that by now cable has been hit by the slump as has been the phone sector.

According to most forecasts, ADSL will remain in the lead in Europe for broadband deployment that retains, in spite of the current crisis, a high potential, with 60-70% penetration of households expected in the latter half of the decade.

Whatever the figures will be, a critical role will be the availability of new forms of content via these new distribution platforms.

And this leads me to my last point: the media paradigm shift.

Media paradigm shift

As is well known, television has developed in Europe in a context very different from the US.

Let me take a quick look back.

In the EU television in the eighties was characterised in all Member States by structures of national public broadcasters based on income from licence fees levied on individual households. The nineties have seen in most Member States and at European level the massive entry of private broadcasters based on advertisement revenues. Finally, the end of the nineties saw the arrival at a large scale of pay-TV, pay per view and the associated subscription based revenues as a third income stream for the sector.

Total television revenues in Europe now amount to some 60 billion €, smaller than mobile revenues (now at 80 billion €), or the total telecommunications services market turnover (now at 200 billion €), and still only half of the US TV market.

But TV is obviously of crucial political, cultural, and social importance—and it is the main driver for the new platforms. For the second half of the decade, interactive TV is forecast to become the main driver of broadband deployment.

Digital-TV homes in the EU are estimated at some 40 billion homes by the mid of the decade—roughly comparable to expectations in the US.

After the boom time of the late nineties, media in Europe are now squeezed between a flattening of advertisement revenues, and high content prices. We have seen the development of unhealthy monopolistic market structures in critical content and as a consequence substantial hold back of new media deployment. The growth model of platforms to date no longer seems to hold. As a consequence, the media sector in Europe faces a paradigm shift in its basic structures.

Media and antitrust

The monopolistic tendencies in the sector have meant that anti-trust is now playing a key role in the media sector in Europe.

All instruments of EU anti-trust have been concerned:

- The Merger Regulation, the control of concentrations;
- Anti-trust (Articles 81 and 82), anti-competitive agreements and abuse of dominant positions;
- Article 86, the EC Treaty's public service provisions

Antitrust applies to the sector alongside the national media specific regulations. According to EU law:

- Plurality of the media is regarded as a legitimate interest of a Member State under EU Law.
- Member States retain the right to issue national media laws relating to limits on media ownership;

We have seen the formation of major media groups in Europe where EU merger control has been triggered (thresholds for EU merger control: 5 billion € world-wide, 250 million € each in EU, two thirds rule. Lower thresholds in certain multi-MS cases).

Let me just cite a few major examples:

- Kirch / Bertelsmann / Premiere
Prohibition in order to check market power in the German digital pay-TV markets;
- AOL / Time Warner
Approved, after commitments. A major concern was access to upstream content;
- Vivendi / Seagram
Green light subject to commitments. At stake was Vivendi / Canal+'s dominant position in certain European pay-TV markets, and its privileged access to content.

At issue is access to content rights, programmes, channels, and the monopolisation of distribution platforms. Our current agenda is topped by the issue of access to sport rights, with a key decision on the European Champions soccer league TV rights ahead this year, as announced two weeks ago in Brussels.

(<http://www.europa.eu.int/comm/competition/antitrust/cases/index>).

We try to develop a consistent position on the pooling of sports rights and required competition safeguards. A main concern under antitrust is to keep downstream TV and New Media markets open. This concerns particularly Internet content rights and content rights for the new 3G mobile broadband systems. And we must avoid the anticompetitive and market foreclosure effects that can result from the link up of upstream content and downstream distribution platforms.

The recent difficulties of digital platforms in a number of Member States means that restructuring is required and that major cases are ahead. We will face new challenges in this regard with the current restructuring of the digital platforms in a number of EU Member States, such as the UK, Italy, Spain, and Germany.

Generally, the European Commission's basic position is clear:

- It is positive on restructuring and build of new platforms;

But

- It will not allow monopolisation either horizontally nor vertically;

And

- We will have to carefully consider efficiency arguments brought forward.

Do we move towards a global model?

In conclusion, let me then come back to our overarching topic at this seminar: do we move towards a global model?

I believe we converge on many issues, both in telecoms regulation and in anti-trust, particularly between the US and Europe, despite occasional disputes.

Firstly, we seem to converge on the global objective: towards broadband and away from focusing merely on voice. This is shown by the emphasis in current FCC proceedings under guidance of chairman Michael Powell, and by our own policy goals.

Secondly, we have to bring new flexibility to regulation and rely more on assessment of new markets, instead of on the legacy classifications of the past. This is the essence of the current telecom reform in Europe where we want to move away from legacy regulation that is voice based. I believe this is also in current US mainstream thinking, as testified by current FCC proceedings and by initiatives in Congress.

Thirdly, we will have to relax constraints on the media sector to allow it to play its full role in the future convergence environment.

And *fourthly*, we have to make investment incentives the main goal of regulation, both for incumbents and competitive carriers, if we want to move the sector out of depression, and generate sustainable consumer benefit.

So there is still not a model regulatory framework on either side of the Atlantic—but there is work in progress towards common goals on both sides, and of course within the WTO.

As regards the new EU telecom framework, the major tests are ahead in implementation—will implementation of the reform bring more flexibility as planned, or will we end in complex reviews, litigation, and disputes? The new regulations will have to be tested in the marketplace, and the coordination mechanisms between national regulators now being put in place will have to prove their value in working.

Will we engender more growth or do we risk expanding regulation? Regulation *never* comes without cost whatever objectives and benefits are. Will we be able to secure pro-competitive structures and efficiencies to generate direct consumer benefits?

Finally, will we be able to generate the convergence between the US and EU concepts in regulation and anti-trust that is needed to achieve the global economies of scale?

The US and Europe together can create the basis of a global model—accounting as they do for half of the global economy.

We have now a set of broad common convictions for the sector and we are moving towards common objectives, quite apart from occasional divergences on frequencies and standards that are often due to our respective legacies and that we should overcome to give our industries' better economy of scale and our consumers best value for money.

Regulation can only be justified if it achieves intended public goals. It must be continuously checked against that basic standard. We are doing this on both sides of the Atlantic, as current proceedings show, and I trust that we will reach similar conclusions.

