Convergence, consolidation, uncertainty: future-proofing electronic communications regulation

Discussion paper

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This discussion paper has been prepared within the framework of a CERRE Executive Seminar which has received the financial support of a number of stakeholders in the electronic communications industry, including CERRE members. As provided for in the association's by-laws, it has been prepared in complete academic independence. Its contents and the opinions expressed in the document reflect only the author’s views and in no way bind either the CERRE Executive Seminar sponsors or any member of CERRE.
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1. **Introduction**

By forcing everyone in the industry to revise their strategy and go back to the drawing board, the current economic crisis has made the future of electronic communications in Europe more open than it has ever been in the last decade. Strategies currently being established carry more uncertainty than before. Technological evolution is uncertain. As a consequence demand is more uncertain than it used to be, since there are potentially many ways to satisfy customer needs, and the success of a new offering might depend as much on timing and marketing as on the strength of the underlying technology. The industry structure on the supply side is also more complex than before. So-called OTT players are competing more and more directly with the more traditional industry members, i.e. the network operators, and fixed/mobile convergence is on the horizon (starting with bundled offers).

With the Commission’s recent release of new legislative proposals, whose details will be hotly debated in the months to come, we thought that it would be preferable to abstain from going into the mooted details of the proposals. Instead, ahead of a long legislative procedure, we find it preferable to use the opportunity to take a longer view, both backward- and forward-looking, to reflect on the proposals in the light of the experience with the current regulatory framework and of potential upcoming trends.

**Guiding principles**

The analysis conducted in this background paper rests on the following principles of good governance.

First of all, any legislative or regulatory action should rely on a good understanding of the issues to be addressed and of the policy objectives to be attained. In particular, one should beware of blending together lines of analysis that do not necessarily coincide.

Secondly, previous legislative and regulatory actions should be fully taken into account, as regards not only the specific outcomes, but also the principles laid out therein. In any event, if
the authority intends to abandon some of these principles, it should signal this clearly.

Thirdly, law and regulation should aim to be sustainable, in the face of technological, demand and supply uncertainty. This would imply that, for instance, the regulatory framework should not be rendered ineffective or obsolete if the market develops in one specific way or another. This would also mean that, as much as possible, choices as to where the market goes and how it goes there should be left to be driven by market forces, more specifically by consumer demand (especially in a time of austerity where private and public money must be wisely spent).
2. The multiple aspects of the internal market – Innovation and industrial policy

The Commission’s stated objective is to achieve the Digital Single Market; in legal terms, its proposals are based on Article 114 TFEU. Yet when it comes to electronic communications, there are many different aspects of the internal market, which do not always follow the same line of analysis.

First of all, we have the more ‘boiler-plate’ or usual internal market aspects, for instance the ability of telecom providers from Member State A to establish themselves in Member State B (and its corollary the ability of customers in Member State B to purchase services from that provider). Establishment of providers into another Member State has taken place in mobile, but not to the same extent in fixed (except as regards services for corporate users). It is not clear what would be gained by increasing the prevalence of cross-border establishment of telecom providers. For fixed providers, especially, greenfield establishment is not that attractive, and the alternative is cross-border consolidation, which could raise serious competition law concerns.

Similarly, the ability of customers in Member State A to purchase services from a telecom provider in Member State B – another ‘boiler-plate’ internal market aspect – realistically only concerns large corporate users purchasing pan-European services. For individual consumers, market competition typically takes place locally.

While the ‘boiler-plate’ aspects may not seem very convincing, the analysis can be refined by looking at less frequently invoked aspects of the internal market. For instance, the internal market also implies the ability of customers in Member State A to use services while in Member State B, which is a feature of mobile communications (and usually involves roaming). These services consumed abroad include not only mobile services as such, but also any services provided using mobile data communications, hereinafter “content provision”. Indeed, once data communications and content provision are factored in, it is conceivable that high charges for

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1 Content provision being construed broadly to include the provision of content as such (YouTube, etc.), but also services (e-mail, search, browsing) and applications (social networks, cloud computing, etc.), i.e. the whole content/service/application layer sitting atop the networks.
data consumption abroad create an externality on content providers. When customers reduce their consumption of mobile data while abroad, they are affecting not just their own welfare and that of other customers, but also that of content providers. In clear, customers refrain from browsing, using search services, consulting maps, downloading or streaming music and video, doing e-banking or e-commerce, etc., with content providers (wherever they location) suffering losses from this. Since the content providers are not involved in the transaction between the mobile subscriber and its mobile provider, where high data roaming charges are imposed, there could be an externality. In an ideal world with no transaction costs, etc., content providers might make a side-payment to mobile providers to reduce roaming charges and thus stimulate data consumption when abroad, but this does not happen in real life.

Once content provision is factored in, another internal market aspect appears, namely the ability for customers in a given Member State to do business with content providers from across the EU, using electronic communications services, and conversely the ability of content providers to conduct business with customers across the EU, using electronic communications services. From the customer side, this brings the network neutrality cluster of issues in the picture. Yet from the content provider side, this aspect of the internal market can go beyond the mere ability to serve customers across borders. Content providers might also want to offer pan-European services, which not only cross borders but also present a uniform ‘look and feel’ across the EU. This is where fragmentation across the EU begins to matter.

Similarly, as regards electronic communications services to corporate users in particular, electronic communications service providers themselves also seek to deploy pan-European offerings, going beyond the mere ability to offer services cross-border, to encompass the ability to offer a definite set of services across the EU.

When the internal market analysis include a pan-European aspect, it also begins to connect with industrial policy and innovation policy: the ability of providers – existing ones and perhaps more importantly emerging ones – to scale up their offerings to a pan-European level is a crucial factor in stimulating competitiveness and innovation.
In our view, the core aspects of the Commission proposals are not the ‘boiler-plate’ internal market aspects, but rather the less standard ones, namely the externalities on content provision created by restrictions on consumption abroad and the difficulties in scaling up to put on the market pan-European offerings. It is an internal market analysis which is closely linked with the Digital Agenda.
3. **Fragmentation and convergence – a paradox**

In the light of the above, we face a paradox when assessing the extent of the problem caused by regulatory fragmentation and the extent of the benefits which would be brought about by regulatory convergence.

From a bottom-up perspective, literally starting from the wires in the ground and the cell towers, it seems clear that Member States would and should reach differentiated regulatory solutions. After all, they do not have the same geography (territory, population) and they do not share the same history of telecom development. There is much path-dependency at work: for instance, Member States where cable TV networks were widely deployed before liberalization have a different starting point than those where the incumbent network was liberalized as the sole available network. Even within Member States, a measure of geographical differentiation in regulation is now accepted.

Taking a top-down perspective, however, might lead to the opposite conclusion. For a content provider, seeking for instance to offer cloud computing services across the EU (and worldwide), it would seem natural that electronic communications services (which serve as inputs for its cloud computing services) are supplied under uniform conditions across the EU.

Both convergence and differentiation/fragmentation can be justified, depending on the perspective. In order to solve this paradox, policy expectations must be made explicit. At first sight, we find it unrealistic to expect, for instance, price uniformity across the EU, or a specific industry structure across the EU (x number of pan-European providers). Indeed no serious reflection has been made on how that industry structure would be like: ‘managed’ pan-European restructuration, with national champions as a starting point, has been attempted in the banking, air transport and media sectors, for instance, all of which would deserve to be examined seriously for the lessons they may entail for electronic communications.
So it seems unavoidable that some level of differentiation will and should remain, because of different facts on the ground. The crucial point is whether the ability of national regulators to pursue differentiated routes also extends to policy considerations, as they are reflected in the remedies imposed on SMP operators, for example. Calls for some regulatory experimentation to be allowed within EU electronic communications regulation were resisted, and in practice not much experimentation occurs. Certainly, from the top-down perspective, such experimentation is seen as a threat to pan-European offerings.

In that respect, the proposal to introduce pan-European harmonized input offerings might offer a way out of the paradox, by creating a basis for content providers (and providers of electronic communications services to corporate users) to operate at EU scale. Having achieved that, perhaps there would be more room for regulatory experimentation, and even incentives for operators voluntarily to improve upon the regulated harmonized input offerings. This would require, however, a clear articulation of the rationale for these pan-European harmonized input offerings: they would then be not so much a feature of the SMP regime, but rather a measure to achieve the internal market by offering a solution to the convergence/differentiation paradox.
4. The mirage of home-country control

Against the above, doubts are allowed on the real significance of a system of home-country control in electronic communications, and on its appropriateness. Home-country control is an answer to the ‘boiler-plate’ internal market aspects set out above, which might not be the really important aspects at this juncture.

As for its significance, home-country control will not displace the need to obtain scarce resources (spectrum, numbers, rights of way) in each Member State, one by one. So electronic communications providers seeking to operate in another Member State will still face significant challenges in establishing themselves, unless they proceed by way of acquisition, or they enter partly or entirely on the basis of wholesale inputs procured from incumbent firms (MVNO, etc.).

Another core regulatory burden on operators comes from the SMP regime. It is not clear whether SMP regulation would be administered by each Member State for its territory (as is the case now), or whether the NRA of the home country will have a role to play in the imposition of SMP obligations across the EU for providers under its jurisdiction. In the former case, the added value of home-country control becomes even more limited, as compared to the current approach. In the latter case, however, a hard, lucid look is warranted, in the light of past experience. The historical evidence is against NRAs carrying out a proper assessment or supervision of practices occurring outside their jurisdiction, affecting consumers in other Member States. In the electronic communications sector, the European Commission had to intervene via a special (and controversial) regulation to correct the failure of NRAs to regulate roaming, which is the closest we have come to an instance of home-country control. Furthermore, looking beyond electronic communications, home-country control failed in the financial sector, and is now replaced by centralized supervision, with the Banking Union.
5. **What is left of the 2002 regulatory framework?**

The 2002 regulatory framework not only contained a specific institutional architecture, with the NRAs, the network of NRAs, Commission supervision, the SMP procedure, etc., but it also rested on two central principles, reliance on economic analysis to drive regulatory efforts and technological neutrality. Technology neutrality, in particular, takes its full meaning as a principle of regulatory sustainability (law and regulation should stay stable over time) and avoidance of technological pre-emption (law and regulation should not make technological choices in the place of firms and, ultimately, of customers).

In practice, the combination of these principles with that institutional architecture resulted in a framework where only the most general regulatory objectives and principles are set out in EU legislation. These objectives and principles are then further developed and implemented through the work of the Commission and BEREC, and eventually through the work of the NRAs.

To some extent, this framework is undermined when policy choices are made directly in EU legislation. This goes all the more when those policy choices contained in EU legislation are based on technological categories. This trend was started, for better or for worse, with the Roaming Regulation, and the Commission seems to be intent on continuing it. If the 2002 framework requires so many adjustments via legislation, then maybe it is no longer considered adequate. Should this be the case, then this should be made explicit.

Should policy choices be made directly in EU legislation, then these choices should at least be made with the same care and regard for the principles of the regulatory framework as if they were made by the regulatory authorities. In that respect, some trade-offs must be made, and made explicit. For instance, if access regulation is loosened up in order to increase the return of investors in next-generation networks, and at the same time operators of such networks are put under a strict network neutrality rule (no discrimination between traffic whatsoever), then the

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2 Certainly the framework is undermined when choices are made by national legislatures instead of NRAs, as the ECJ ruled in a number of cases.
Legislature might be taking with one hand what it gives to the operators with the other, and in so doing effecting a wealth transfer from the customers to the content providers. At the same time, if access regulation is loosened up, one could suggest that, in return, network operators should be pushed to be more innovative in their operations and not just invest in fibre or 4G capacity as a form of commodity. In other words, operators could strive to innovate in network management, content delivery, quality of service, etc. Such innovation could be incentivized via an appropriate network neutrality rule, but then if operators do innovate in their respective ways, introducing more fragmentation than now (with best-efforts routing everywhere), the EU might adversely affect the ability of content providers to deploy pan-European offerings. Such fragmentation in the offerings might be prevented via standardization (of QoS interconnection), but this again has impacts on the incentives to innovate.

Such choices are hard to make, and there is reason to believe that they might not be made optimally at the EU legislative level.