PRICING POLICY (TELECOMMUNICATIONS): THE DT CASE

Subject:	Pricing policy Abuse of dominant position Market entry
Industry:	Telecommunications
Parties:	Deutsche Telekom
Source:	Commission Statement IP/02/686, dated 8 May 2002

(Note. Briefly, the Commission's argument is that DT has abused its dominant position by charging excessive prices to potential line-sharers, thereby restricting market entry by newcomers. DT has two months in which to respond.)

After investigation, the Commission has sent Deutsche Telekom AG (DT) a statement of objections setting out the preliminary conclusion that the German incumbent telecommunications operator has abused its dominant position through unfair pricing regarding the provision of local access to its fixed telecommunications network (local loop). The Commission is concerned about DT's practice of charging new entrants higher fees for wholesale access to the local loop than the amounts paid by DT's subscribers for retail access. This discourages new companies from entering the market and, therefore, creating new jobs, and reduces the choice of suppliers of telecoms services as well as price competition for consumers. The Commission's action, which stems from complaints by Mannesmann Arcor and local and regional carriers in Germany, follows the sending of statements of objections to France Télécoms's subsidiary Wanadoo, over predatory pricing for high speed Internet access services, and to Dutch KPN over the price charged to terminate calls on its mobile network.

According to Commissioner Monti, "After four years of complete liberalisation of the telecommunications markets in Europe, competition has come to a critical stage. This is particularly acute in the local loop where many promising new entrants have already been forced to give up their business. Much can still be done to foster competition in this field and that is clearly one of our priorities now. We have already acted in Italy and Spain to ensure a balance between the monthly telephone subscription fees and the call charges, allowing the new entrants in both countries to compete better with the incumbent operators."

Access to the local loop

The "local loop" is the physical circuit between the customer's premises and the telecommunications operator's local switch. Traditionally it takes the form of pairs of copper wires. New entrants on the telecommunications markets need access on fair and non-discriminatory terms to the local loop (so-called "local loop unbundling") in order to be able to offer retail services to end-customers, as it would be technically, environmentally and economically impossible to replicate such a network which was built over a century.

Effective local loop unbundling is key for the spread of electronic communications services and thus for the success of the New Economy. It was imposed on the incumbent operators by way of legislation at EC level and, in some Member States, such as Germany, also at national level. However, the current assessment leaves no doubt that local loop unbundling is not developing fast enough. The regulatory framework is not the only tool available. The conditions of local loop unbundling, such as pricing, are also subject to scrutiny under the EC competition rules.

Situation in Germany

In Germany, DT offers local loop access at two different levels. Besides the retail subscriptions to end customers,. DT also offers unbundled access to the local loop to competitors, which allows them direct access to end-users. DT is thus active on the upstream market for wholesale local loop access to competitors and on the downstream market for retail access services to end-customers. Both markets are closely linked to each other.

DT's local access network is not the only technical infrastructure allowing for the provision of wholesale access services to competitors and of retail access services to end-users. But the otheroptions, which include fibre-optic networks, wireless local loops, satellites, power lines, and upgraded cable TV networks, are not yet sufficiently developed and cannot be considered as equivalent to DT's local loop network. Therefore, in the Commission's preliminary view, DT holds a dominant position on the markets for both wholesale and retail local loop access. Regarding wholesale access, DT is the only German network operator having a network with nation-wide coverage to which it grants competitors access on a wholesale basis. Regarding retail access, even after four years of competition, DT still has more than 98 % market share and the remaining 2% is divided up between numerous competitors.

Margin squeeze

As set out in the statement of objections, the Commission believes that DT abuses its dominant position through unfair pricing practices amounting to a margin squeeze between its wholesale and retail tariffs. A margin squeeze is deemed to exist because of an insufficient spread between DT's tariffs for retail subscriptions and wholesale local loop access. The Commission has received several complaints against DT by new entrants on the German telecommunications market, such as Mannesmann Arcor and a large number of local and regional carriers, alleging such a margin squeeze for access to the local network.

It is the Commission's view that DT could have avoided the margin squeeze since 1998, either by reducing the wholesale access fees, or by increasing the retail subscription fees, or by combining the two. DT's most recent tariff changes at both retail and wholesale level are to be seen as a step in the right direction, but are far from being sufficient in order to rebalance the local loop access tariffs. In general, it is the Commission's position that vertically integrated operators like DT must indeed fix their retail prices at a level sufficiently above the wholesale prices so as to allow new entrants to compete.

The Commission can use Article 82 of the EC Treaty to prohibit abuses of dominance. DT now has two months to present arguments contesting the Commission's preliminary analysis and may also expand on those arguments at an oral hearing. It is only after this has happened that the Commission will adopt a final position.

Background information

More than a year after the EC Regulation on local loop unbundling came into force (on 1 January 2001), fewer than 800,000 subscriber lines have been unbundled across Europe. The large majority of them (nearly 700,000) are in Germany, where unbundling was already mandated by national law in 1998; but, even there, unbundled lines account for less than 2% of the total. This very slow progress has been analysed in-depth in the Commission's 7th Implementation Report of November 2001 (COM(2001) 706) and in a consultant report published on the DG Competition website in March 2002. The relative failure of local loop unbundling so far can be attributed to the behaviour of incumbent telecommunications operators, which accumulate the obstacles to effective third party, access as well as to the economic conditions of access to the copper pair and to collocation facilities. Under Community law, there are two possible solutions to tackle these problems: the one relies on sectorial regulation and the other on the EC competition rules, notably Article 82 of the EC Treaty.

Using its powers under the telecommunications legislation, namely the EC Regulation on Local Loop Unbundling, the Commission launched infringement proceedings in December 2001 against the three Member States (Germany, Greece and Portugal) that had failed to implement the provisions of the Regulation on so-called shared access. Shared access is essential for operators seeking to offer broadband services. As a result of this action, immediate remedies were taken in the Member states concerned, and the cases regarding Greece and Portugal have been closed. On 20 March 2002, the Commission opened proceedings against five Member States (Germany, France, Ireland, Netherlands and Portugal) in relation to the lack of a complete and sufficiently detailed unbundling offer, particularly in regard to sub-loop unbundling (so that an operator can install equipment closer to customers' premises than the local exchange).

Under the competition rules of the EC Treaty, the Commission launched a sector inquiry on local loop unbundling in 2000, which is still ongoing. Such sector inquiries are not only a useful monitoring instrument, but also a tool to gather evidence of possible abuses of a dominant position. Besides the present Deutsche Telekom case, the Commission also recently opened proceedings in France against Wanadoo's ADSL tariffs and in the Netherlands against KPN's mobile termination rates. ■