

# Regulation of electronic communications market competition

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# Market analysis in France in 2006

For the Authority, 2006 marked the end of the first round of market analysis imposed by the European Commission's "Relevant Markets" Recommendation of 11 July 2003 on national regulatory authorities (NRAs) in the European Union's 27 Member States. As of 31 December 2006, the Authority had conducted analysis of the 18 markets listed in the recommendation<sup>1</sup>, in addition to having performed an analysis of the SMS call termination market, which is not included in the recommendation

<sup>1</sup> - See below.

## A. An adapted regulatory mechanism

The Law of 9 July 2004 – which transposes the "Telecom Package" Directives adopted in 2002 – enacted a shift in regulatory methods and concepts towards common competition law.

As a result, it is the regulator's responsibility to define the scope of a market, to verify whether sector-specific regulation is relevant, and to determine which player(s) enjoy significant market power (SMP) and to prove it. To achieve this, ARCEP performs a detailed analysis of the market which involves, in order: carrying out a public consultation, obtaining the opinion of the competition authority (Conseil de la Concurrence), and then notifying the European Commission of its analysis. The Commission has the power to veto a market definition if it is not part of the predefined list, as well as SMP operator designation, notably for the purpose of achieving Europe-wide harmonisation. In addition, as part of its market analysis the regulator must specify remedies, in other words the obligations that it plans to impose on SMP players. Here, from among the obligations listed in the Law<sup>2</sup>, the NRA must choose those that are the most appropriate to the competition issues revealed by the market analysis, and to ensure that they are proportionate to the regulatory objectives.

<sup>2</sup> - Cf. CPCE Article L.38.

This logic involves a shift in the focus of regulation to wholesale markets. First, the NRA has powers that allow it to develop new regulatory mechanisms for wholesale markets. Then, once these mechanisms are in place and proven to be working effectively, retail market regulation becomes less justified and is lightened, or even done away with altogether. Regulation therefore evolves: as competition increases, the list of remedies gets shorter. If the market becomes fully competitive, sector-specific regulation disappears and is replaced by common competition law whose application is the responsibility of the competition authority (Conseil de la concurrence). It is thus entirely natural that regulation imposed on a given market will change over time, according to national regulatory authorities' assessment of it.

The framework put into place in 2004 is clearly more flexible – allowing the regulator to adapt regulation to the actual state of competition in a given market and, when suitable, to lift it.

## B. Market analyses completed in 2006

In 2006, the Authority completed five new market analyses, including four which were listed in the European Commission's Relevant Markets Recommendation, and one which was not.

Two other markets (international roaming and mobile call origination) were analysed by ARCEP, but constitute special cases.

### 1. Leased lines

Three of the market analyses completed by the Authority in 2006 concern capacity services, or leased lines (Markets 7, 13 and 14)<sup>3</sup>, and were the subject of a decision<sup>4</sup> :

<sup>3</sup> - See below  
(Chapter 5, A).  
<sup>4</sup> - ARCEP Decision  
No 06-0592  
of 26 September 2006.

- ◆ concerning the definition of relevant leased line markets;
- ◆ designating France Telecom as the SMP operator in these three markets, and as such, subject to certain obligations.

### 2. Wholesale broadcasting market

The Authority also completed its analysis of the wholesale market for “Broadcasting transmission services, to deliver broadcast content to end users” (Market 18)<sup>5</sup>, which resulted in two decisions<sup>6</sup>:

<sup>5</sup> - See below  
(Chapter 5, B).  
<sup>6</sup> - ARCEP Decisions  
No 06-0160  
and No 06-0161  
of 6 April 2006.

- ◆ concerning the definition of a relevant wholesale market for terrestrial broadcasting of television programmes;
- ◆ designating TDF as the operator with SMP in this market, and therefore subject to certain obligations.

### 3. Wholesale SMS call termination

In addition, ARCEP conducted an analysis of the wholesale market for SMS call termination on mobile networks<sup>7</sup> (a market which is not listed in the European Commission's Relevant Market Recommendation), which led it to conclude that this market should be subject to sector-specific regulation<sup>8</sup>.

<sup>7</sup> - ARCEP Decision  
No 06-0593  
of 27 July 2006.  
<sup>8</sup> - See below  
(Chapter 4, A, 2).

It should be noted that, during the review of the EU Regulatory Framework that began in June 2006, the European Commission proposed that SMS call termination be included in the list of markets to be subject to ex ante regulation.

#### 4. International roaming market

Over the course of 2005, ARCEP performed an analysis of the wholesale international roaming market (Market 17)<sup>9</sup> and proposed several means of intervention. This analysis, which was submitted to public consultation from 15 December 2005 to 21 January 2006, was not, however, notified to the European Commission.

**9 - See below**  
(Chapter 4, C).

This market was treated as a special case, in fact, as the Commission is in the process of drafting European regulation to address the issue.

The Commission's proposed regulation is to be debated by the European Parliament and the Council of Ministers in late May/early June 2007.

#### 5. Access and call origination on public mobile telephone networks

In late May 2005, the Authority had suspended its analysis of the market for access and call origination on public mobile telephone networks (Market 15) which it had notified to the European Commission in April 2005 – having estimated that the too recent arrival of MVNOs in the mobile market made it impossible to judge the state of competition in the market with certainty.

**10 - See below**  
(Chapter 4, B, 2).

ARCEP did nevertheless place the mobile market under surveillance until the end of 2006, at which point it committed to notifying a new market analysis to the Commission.

The market analysis deadline was, however, pushed back to be able to take into account the results of the new call for candidates for the possible award of a fourth 3G licence in France – a situation that would naturally affect the Authority's analysis, as a new player in the market could stimulate competition to a considerable degree.

### C. Diverse measures concerning market analyses

#### 1. The Conseil d'Etat ratifies an analysis adopted by ARCEP in 2005

The market analysis on alternative operator fixed call termination, adopted in 2005<sup>11</sup>, and which had been contested by the players, was upheld by the Conseil d'Etat in an order dated 29 December 2006<sup>12</sup>.

**11 - ARCEP Decision**  
No 05-0425  
of 27 September 2005.

**12 - Conseil d'Etat order**  
of 29 December 2006,  
UPC France, No 28825.

#### 2. The Authority specifies certain obligations

This past year, the Authority also supplemented certain obligations imposed in previous decisions. These included the obligations incumbent on France Telecom with respect to wholesale line rental, or WLR (VGAST: vente en gros de l'accès au service téléphonique), along with accounting separation and cost accounting obligations:

- ◆ Decision No 06-0162 dated 4 May 2006, specifying the technical and tariff-related terms of wholesale line rental, VGAST<sup>13</sup>;

**13 - Voir infra (chapitre 2).**

14 - See below (Chapter 6).

- ◆ Decision No 06-1007 dated 7 December 2006, concerning the cost accounting and accounting separation obligations imposed on France Telecom<sup>14</sup>.

3. The Authority decides on the mobile call termination tariff for 2007

15 - ARCEP Decision  
No 06-0779  
of 14 September 2006.

The Authority has also set the tariff for mobile voice call termination for mobile operators in Metropolitan France for 2007<sup>15</sup>.

D. Onset of market deregulation

As market competition increases, sector-specific regulation must become lighter and be replaced gradually, when justified, with common competition law.

This shift began in 2006 with the deregulation of certain markets where competition has developed, and in which alternative operators have been able to take advantage of better wholesale offers upstream.

16 - ARCEP Decision  
No 07-0089  
of 30 January 2007.

As a result, the Authority ruled that it was justified<sup>16</sup> in eliminating the regulation imposed on France Telecom in the national wholesale broadband access market<sup>17</sup>.

17 - See below  
(Chapter 3, D).

ARCEP also began lifting regulations<sup>18</sup> imposed on the incumbent carrier in retail residential calling markets<sup>19</sup>.

18 - ARCEP Decision  
No 06-0840  
of 28 September 2006.

These changes are proof of the soundness of the current framework, notably in that it is flexible enough to allow the NRA to adapt regulatory measures in a timely fashion, according to changes in market circumstances.

19 - See below  
(Chapter 2, B).

State of market analyses performed by the Authority as of 31 January 2007

| Markets                              | Status of the Decision |                                |                  |                            |  |
|--------------------------------------|------------------------|--------------------------------|------------------|----------------------------|--|
|                                      | Analysis performed     | Notification to the Commission | Decision adopted | Appeals                    | Re-examination   |
| Markets 1 and 2<br>Retail access     | X                      | X                              | X<br>27/09/05    |                            |  |
| Markets 3 to 6<br>Retail calling     | X                      | X                              | X<br>27/09/05    |                            | X<br>Deregulation<br>of residential<br>calling markets<br>28/09/06 |
| Market 7<br>Retail leased lines      | X                      | X                              | X<br>26/09/06    |                            |  |
| Market 8<br>Call origination         | X                      | X                              | X<br>27/09/05    |                            |  |
| Market 9<br>France Telecom fixed CT  | X                      | X                              | X<br>27/09/05    |                            |  |
| Market 9<br>Third-party LLO fixed CT | X                      | X                              | X<br>27/09/05    | X<br>Rejected: CE 29/12/06 |  |

| Markets  | Analysis performed | Notification to the Commission                               | Status of the Decision                               |  |   |
|--|--------------------|--|--|--|---|
|  |                    |  | Decision adopted                                     | Appeals                                  | Re-examination                            |
| Market 10<br>Transit   | X                  | X  | X<br>27/09/05  |  |   |
| Market 11<br>Unbundling  | X                  | X  | X<br>19/05/05  | X<br>Non-lieu à statuer :<br>CE 28/12/05 |   |
| Market 12<br>Bitstream   | X                  | X  | X<br>19/05/05  |  |   |
| Market 13<br>LL terminating segments                               | X                  | X  | X<br>26/09/06  |  |   |
| Market 14<br>LL trunk segments                                     | X                  | X  | X<br>26/09/06  |  |   |
| Market 15<br>Mobile call access and origination                    | X                  | X<br>Suspension 31/05/05                                     |  |  |   |
| Market 16<br>Mobile CT   | X                  | X  | X<br>09/12/04 (Metro. France)<br>01/04/05 (overseas) | X<br>Rejected: CE<br>05/12/05            |   |
| Market 17<br>International roaming                                 | X                  | European regulation being drafted by the European Commission |  |  |   |
| Market 18<br>Broadcasting  | X                  | X  | X<br>06/04/06  |  |   |
| <b>New market</b><br>SMS CT  | X                  | X  | X<br>27/07/06  |  |   |
| <b>New market</b><br>Wholesale national broadband<br>access market | X                  | X  | X<br>28/07/05  |  | X<br>Regulation<br>eliminated<br>30/01/07 |





# Fixed telephony

## A. Relevant wholesale fixed telephony markets

### 1. Market scope

Wholesale fixed telephony markets allow operators to offer their own retail electronic communication services by employing traffic delivery services purchased from other operators.

In accordance with the European Commission's Relevant Markets Recommendation<sup>20</sup>, the Authority distinguishes three types of wholesale market<sup>21</sup> :

- ◆ **the call origination market**, concerning call routing services provided by a local loop operator (LLO) to other operators so that they may provide electronic communication services to customers connected by the LLO;
- ◆ **the call termination market**, concerning call routing services provided by an LLO to other operators so that, by means of a connection from their network to the LLO's network, they may establish electronic communications for subscribers connected to the LLO. Because of the direction of calls routed in this way, the LLO is said to "terminate" calls to its subscribers;
- ◆ **the market for transit services** on the fixed telephone network, defined as traffic routing services on behalf of a third-party operator which are not otherwise covered by the call origination and call termination markets. For example, a service provided by Operator A to deliver traffic between the networks of Operator B and Operator C is part of the transit market.

A substitutability analysis led ARCEP to limit the call-origination market to traffic routing services delivered up to the first level of the relevant switching equipment (or relevant routing equipment for interconnection) to be transited.

In the same way as for the call origination market, ARCEP has limited the call termination market to traffic routing services delivered between the last relevant level

**20 - Commission Recommendation of 11 February 2003 concerning relevant products and services markets in the electronic communication sector that could be subject to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and Council concerning a common regulatory framework for electronic communication networks and services.**

**21 - ARCEP Decision No 05-0571 of 27 September 2005.**

of switching equipment (or relevant routing equipment for interconnection) transited by a call, and the destination subscriber.

In accordance with the European Commission's recommendation, and in light of its own substitutability analysis, the Authority has defined a call termination market for each local loop network. This has led to the definition of as many markets as there are fixed-network local loop operators.

The Authority first studied the market for geographic call termination on the France Telecom network, then studied the market for geographic call termination on each of the alternative LLO networks.

As concerns transit services, ARCEP has defined the following service areas: Metropolitan France, the overseas *départements* and Mayotte, and Saint Pierre and Miquelon – territories over which it has jurisdiction by virtue of the code governing France's electronic communications and postal markets, CPCE (*Code des postes et des communications électroniques*). To take account of the existence of the various territories, and the specific nature of competition over providing routing services between them, the Authority has distinguished each pair of territories in the nation as a separate market for transit services. In doing so, the Authority has defined two types of transit market: the market for intra-territorial transit and the market for *inter*-territorial transit.

The supply-side and demand-side substitutability analyses also led the Authority to include in each of these wholesale markets the traffic delivery services that correspond to retail call markets – that is, the routing of person-to-person telephone traffic, narrowband Internet traffic and calls to service providers.

## 2. Significant market power

Through these analyses, the Authority concluded that France Telecom enjoyed significant power in the markets for geographic call origination and call termination on its network and in the market for *intra*- and *inter*-territorial transit.

ARCEP also concluded that each local loop operator is dominant in the market for geographic call termination on its own network

## 3. Obligations imposed on operators

### a. Obligations imposed on France Telecom

Au titre de ses analyses et s'agissant des marchés de la téléphonie fixe sur lesquels France Télécom a été désigné puissant, l'ARCEP lui a imposé les obligations suivantes :

- ◆ the obligation to grant reasonable requests for access and provide related services for connection to interconnection and access sites;
- ◆ the obligation to grant specific requests for access, namely requests for purposes of carrier selection and pre-selection, third-party billing, Internet flat-rate interconnection (IFI), and wholesale line rental<sup>22</sup>;

22 - See below.

- ◆ the obligation to provide access and interconnection under non-discriminatory conditions;
- ◆ the obligation to provide access and interconnection under transparent conditions;
- ◆ the obligation to publish an access and interconnection reference offer detailing the technical and tariff conditions of certain services in the relevant wholesale markets that are particularly fundamental for operators;
- ◆ the obligation to provide a wholesale line rental offer (VGAST<sup>23</sup>), and to publish an interconnection offer specifying the technical and pricing details and terms;
- ◆ the obligation to set cost-based interconnection and access tariffs, except in the cases of France Telecom's "double-transit" and (as of 1 January 2007) single-transit services where France Telecom is required to set prices that are neither excessive nor predatory;
- ◆ accounting separation and cost accounting obligations<sup>24</sup>.

23 - See below.

24 - ARCEP Decision  
No 06-1007  
of 7 December 2006.

#### b. Obligations imposed on local loop operators

ARCEP has defined obligations to be imposed on each local loop operator because of the power these operators have in the relevant market for geographic call termination on their own networks:

- ◆ the obligation to grant reasonable requests for access and provide related services for connecting to interconnection and access sites;
- ◆ the obligation to provide access and interconnection under non-discriminatory conditions;
- ◆ the obligation to provide access and interconnection under transparent conditions;
- ◆ the obligation to set geographic call termination tariffs that are not excessive.

Different regulation governs the incumbent carrier, France Telecom, and alternative local loop operators in the fixed call termination market: the Authority requires that alternative operators not charge "excessive"<sup>25</sup> tariffs, whereas the incumbent has an obligation to charge cost-oriented (or at-cost) prices.

25 - ARCEP Decision  
No 05-0425  
of 27 September 2005.

Because France Telecom boasts a more than 95% share of the retail access market, its call termination tariffs have a decisive impact on the total costs shouldered by third-party operators, and will thus have a hand in shaping their retail tariff strategy. As a result, if France Telecom were able to set its tariffs without regard to the actual cost of providing the service, it could create a major distortion in market competition – preventing alternative operators from offering retail tariffs as competitive as its own. This is why the Authority believes it is justified in demanding that France Telecom tariffs be based on associated costs.

The European Commission approved the obligations that ARCEP imposed on fixed alternative operators and on France Telecom (not excessive/cost-oriented tariffs).

## 4. Wholesale line rental (VGAST)

### What is VGAST wholesale line rental?

*VGAST (vente en gros de l'accès au service téléphonique)* is a wholesale line rental, or WLR, offer that encompasses not only the subscription as such, – which includes network access and services which are traditionally associated with a telephone subscription (caller display, incoming call signal, etc.) – but also all person-to-person calls, calls to special numbers and narrowband Internet access.

It is compatible with the simultaneous use of the high frequency band, notably in the case of wholesale broadband offers delivered at the regional or national level and shared access, regardless of the operator employing this high frequency band.

In addition, because *VGAST* subscribers are physically connected to the France Telecom network, subscribing to a wholesale line rental offer does not involve numbers being ported to the *VGAST* operator. France Telecom does, however, make phone numbers from its assigned block available to WLR operators.

The market analysis revealed that France Telecom exerts significant influence in the wholesale market for call origination and in all retail markets for fixed telephony access and communications.

The introduction of carrier selection has allowed competition to develop to a substantial degree in calling markets, but effective, fair and full competition cannot be fully achieved unless alternative operators are able to market a complete telephone service offering, whether analogue or digital, to customers connected to the France Telecom network.

26 - ARCEP Decision  
No 06-0162  
of 4 May 2006.

After a series of multilateral talks in a working group under its aegis, ARCEP made a decision<sup>26</sup> in May 2006, specifying the technical and pricing mechanisms for this new wholesale offer, which must be supplied at cost-oriented prices.

The *VGAST* offer has been available in Metropolitan France and in the overseas *départements*:

- ◆ since 1 April 2006, for the provision of an analogue telephone service on individual lines;
- ◆ since 1 July 2006, for the provision of an analogue telephone service on groups of lines, and for the provision of an ISDN service on either individual or groups of lines.

Since its launch, several players (including the leading pre-selection operators) operating in Metropolitan France and overseas, have signed a *VGAST* agreement with France Telecom, and now market a complete service offering based on wholesale line rental to their customers.

## B. Towards lighter retail market regulation

ARCEP has been responsible for regulating retail fixed telephony markets since they were opened up to competition in 1997. The state of competition has evolved considerably since then, including the introduction of several wholesale offers that the incumbent makes available to alternative telcos. These changes led the Authority to begin a process of deregulating retail markets in 2006.

As a result, a first decision on lightening residential calling market regulation was adopted by ARCEP in September. This marks the first step towards the complete elimination of asymmetrical retail market regulation. At the same time, the Authority plans on strengthening the symmetrical regulation that applies to these markets, and shifting the focus of its asymmetrical regulation to wholesale markets.

### Before deregulation... regulation

To guarantee healthy competition, the Authority has been involved, since its creation, in supervising the retail tariffs that France Telecom charges in fixed telephony markets. One of the central goals of this regulation of retail markets is to ensure that alternative operators have enough economic leeway to develop their business.

Under the old framework, the minister was responsible for tariff control, subject to the Authority's public opinion. In September 2005, the Authority adopted a market analysis decision on fixed telephony and, in doing so, defined the new framework within which it alone would regulate the markets in question.

In its analysis, the Authority demonstrated that France Telecom enjoyed SMP in all of the defined, relevant retail markets (residential access markets, national residential calling market, business access market, etc.). Given the time needed for the newly-introduced access and interconnection obligations to come into effect, the Authority felt it was necessary to impose specific obligations in these retail markets to allow fair and lasting competition to develop.

As a result, France Telecom was forbidden, a priori, from engaging in certain practices: discriminatory practices, anticompetitive bundling, excessive prices and predatory pricing in all of these relevant markets. The decision also requires that France Telecom perform cost accounting for the services provided in these markets, and inform the Authority beforehand of its tariffs, in cases where they are not already subject to universal service tariff controls.

## 1. New competitive landscape justifying the first step towards lighter regulation

The gradual implementation of access and interconnection obligations, combined with the progress made by retail markets, justified a re-examination of the remedies imposed on France Telecom in these markets.

France Telecom is indeed having to contend with increased competition due to the growing use of IP telephony services. Added to this, wholesale line rental (VGAST) – which the Authority<sup>27</sup> requires France Telecom to provide – has been available since Q2 2006 for analogue connections, and since July 2006 for basic and grouped-line ISDN connections. By giving alternative operators the opportunity to offer their customers a complete telephony service that includes access and calls, and by removing France Telecom's control over access, this offer is expected to limit the incumbent carrier's competitive advantage and the leverage it still enjoyed over calls.

The lasting development of France Telecom's wholesale offers – and wholesale line rental in particular – is the essential criterion which can single-handedly justify lightening retail fixed market regulation and enable the creation of fair and effective competition.

Because this development has not been homogeneous across all of the retail markets concerned, the Authority has planned on deregulating retail markets in several stages.

## 2. First step taken towards lighter regulation

28 - ARCEP Decision  
No 06-0840  
of 28 September 2006.

The process began in September 2006<sup>28</sup> with a first stage that involved just the residential calling markets, as these are where competition has made the greatest strides and are, by nature, the most transparent. As a result, most of France Telecom's obligations in these markets have been eliminated: the incumbent carrier is no longer obligated to submit each of its retail market calling tariffs for approval. The only obligations upheld in these markets for the meantime are non-discrimination and cost accounting – both of which could be lifted later on.

Worth noting is that this initial easing of regulation does not affect offers that combine an access and a calling offer, as the remedies applied to access markets have not yet been modified.

## 3. Towards full deregulation of retail markets

Parallel to the implementation of this first phase of the process, the Authority launched a public consultation on the roadmap for deregulation in summer 2006. This consultation suggested several possible directions for the gradual alleviation of retail market regulation, from residential to business markets, from calling to access markets, and from analogue to digital line offers. This process will move forward as certain criteria are met, such as the effective operational implementation of VGAST (wholesale line rental) in certain market segments, or the publication by an efficient alternative operator of cost models for telephone service provision – which will serve as a reference for the market players.

ARCEP has set itself the target of full deregulation of these markets before completion of the market analyses that are currently underway, in other words by 1 September 2008 – provided, of course, that it be justified by the assessment of the various

criteria listed in the text submitted to public consultation in summer 2006. Although it removes certain ex ante measures which the Authority currently has the power to impose, to prevent possible anti-competitive behaviour, the proposed roadmap does not of course prevent common competition law from continuing to apply to all of the markets concerned<sup>29</sup>.

29 - Cf. Part 11, Chapter 2.

## C. Supervision of France Telecom tariff decisions

### 1. Tariff opinions in 2006

Over the course of 2006, France Telecom submitted 100 tariff cases to ARCEP, of which 92 were subject to investigation and eight were for informational purposes. They concerned the creation, trial or large-scale rollout of new services, and changes to pricing offers, notably the introduction of new options such as unmetered calling and bundled services (access plus calling).

Around a quarter of the requests for inquiry concerned services that fall under the scope of universal service, one of which related to multi-annual tariff supervision measures<sup>30</sup>.

30 - ARCEP Decision  
No 06-0725  
of 25 July 2006.

Of these 92 requests:

- ◆ 87 were investigated by the Authority;
- ◆ three were still being investigated as of 31 December 2006;
- ◆ two were withdrawn by France Telecom before ARCEP issued an opinion.

In some cases, the Authority grouped several tariff decisions requested by France Telecom into a single inquiry, thereby reducing the number of opinions issued.

In all, ARCEP issued 69 statements (opinions or decisions), of which 47 were made public<sup>31</sup>, on France Telecom tariff decisions. All of the statements were favourable.

31 - Cf. [www.arcep.fr](http://www.arcep.fr).

Two thirds of the Authority's tariff opinions or decisions concerned the residential market.

All markets combined, of the tariff decisions on which ARCEP issued a statement:

- ◆ 70% of them concerned telephone calling prices;
- ◆ close to 12% concerned telephone access and service subscription, along with associated services;
- ◆ 12% concerned leased line services;
- ◆ 6% concerned special numbers.

## 2. Inquiry lead times in 2006

**32 - CPCE Article R.20-30-11 for universal service and CPCE Article D.315 for the other cases.**

ARCEP has three weeks, from the time it receives the complete file, to issue an opinion or to make a decision of opposition<sup>32</sup>.

In 2006, the average lead time for issuing a statement (from the time the investigation of the case is completed to the date the opinion or decision is issued) was 10 days, compared to 12 days in 2005 and 16 days in 2004. The average period of analysis (from the day the file is received to the day the opinion or decision is issued) was the same as in 2005, however: i.e. roughly one month.

## 3. Summary: 1997-2006

Of the 1,083 tariff decisions that France Telecom has submitted for investigation since ART was created, the Authority issued 771 favourable statements and 136 unfavourable statements (i.e. on 18% of the cases).

### Background

**33 - ARCEP Decision No 06-0840 of 28 September 2006.**

In summer 2006, the Authority began the process of lightening the regulation that governs retail fixed telephony markets. During the first phase, which started in September 2006<sup>33</sup>, ARCEP put an end to the tariff controls applied to France Telecom in residential calling markets<sup>34</sup>, except for those that fall under the scope of universal service

**34 - See above.**



# Broadband markets

## A. Retail market

In 2006, the broadband market continued to enjoy healthy growth – with a base that increased by 34% during the year.

As of 31 December 2006, there were close to 12.6 million broadband subscribers in France, of which 11.9 million were DSL and 0.7 million were cable subscribers<sup>35</sup>. DSL thus continues its solid dominance of the market, accounting for 94.4% of broadband connections, while alternative technologies (satellite, WLL and WiMAX) still account for only a fraction of access links.

At the end of the third quarter of 2006, France ranked 8th in Europe (among the EU-25) in terms of broadband penetration of the population, and 2nd in terms of number of DSL connections<sup>36</sup>.

These results are closely bound up with the dynamism of competition in the retail broadband market, which has led to the widespread availability of double play bundles in non-unbundled zones and of triple play bundles in unbundled zones, along with a further narrowing of the digital divide. The state of competition in this market is a direct result of the state of upstream wholesale market competition, notably wholesale LLU markets and broadband access offers delivered at the regional level, i.e. bitstream offers.

### 1. A dynamic sector in the throes of change

Since 2005 the broadband Internet sector has been undergoing a massive consolidation, characterised by takeovers and merger-acquisitions between France Telecom's rival operators. Two of the most outstanding events of 2005 were the mergers of Tiscali and Telecom Italia France, and of Neuf Télécom and Cegetel.

This market concentration continued throughout 2006: on 26 October 2006, the Minister of the Economy approved Neuf Cegetel's takeover of AOL's Internet Access business, which has been in effect since 1 November 2006.

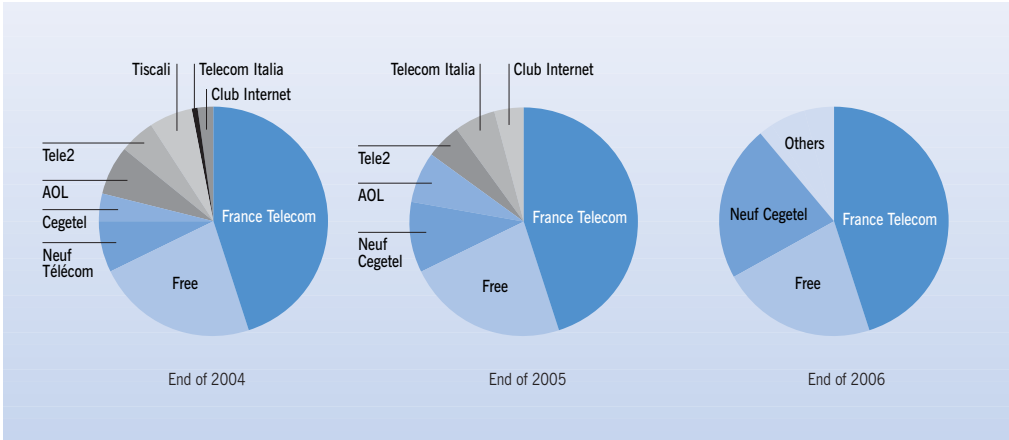
**35** - Source: ARCEP broadband observatory: <http://www.ARCEP.fr/index.php?id=9183&L=0>.

**36** - Source: ECTA, October 2006: <http://www.ectaportal.com/en/upload/File/Broadband%20Scorecards/Q306/FINALBBSQ306.pdf>.

At the same time, on 3 October 2006 SFR announced that an agreement had been signed with the group, Tele2, allowing it to take control of Tele2 France’s fixed telephony and ADSL operations.

These mergers and acquisitions have translated into the increasing vertical integration of alternative operators, as the sector appears to be moving towards the creation of an oligopoly composed of three or four major players.

Changes in residential ADSL retail market share over the past three years



A similar trend has taken hold in the cable market: the concentration that began in 2004 and 2005 continued this past year with the merger of the country’s two main cable providers: Cinven and Altice, owners of Numericable, took over their competitor Noos-UPC in July 2006 and now control virtually all of France’s cable networks.

2. Growing ubiquity of triple play bundles

2006 was also marked by the growing ubiquity of triple play bundles in zones where television services are available. With more than 1.5 million subscribers to date, TV over ADSL is now one of the chief driving forces behind the growth of pay-TV.

All of the leading DSL and cable providers now market TV services through their service bundles, and most also offer VoD (video on demand) programmes which are enjoying increasing popularity.

Despite the inclusion of new channels in triple play offers in late 2006, the question of whether to provide access to the most popular channels via the offers distributed by DSL operators remains unanswered. Moreover, the average revenue per user (ARPU) generated by content tends to remain rather low.

A revamping of the current models that govern relationships between content providers and network operators appears necessary, particularly to encourage the development of broadband and so to make it a successful endeavour for the various stakeholders and, ultimately, for consumers.

2006 was also marked by the merger of Vivendi (via the Canal+ Group) and TPS – an operation on which the Authority submitted its opinion to the competition authority (Conseil de la concurrence)<sup>37</sup>.

37 - See below.

As part of the deal, Vivendi was required to agree to a number of commitments which were critical to securing approval for the takeover from the Minister of the Economy, Finance and Industry.

Among these commitments, Vivendi agreed to make seven of its channels, including TPS Star and Sport+, available to DSL providers. Meanwhile, the other channels operated by the new entity can continue to be distributed exclusively, notably high definition channels, even though they are crucial to the development of ultra-broadband offers.

Worth noting is that, once this merger has gone through, cable operators will be able to distribute virtually all of the channels operated by the new entity (apart from the different Canal+ channels), but DSL Internet service providers (ISPs) will not.

#### ARCEP opinion on the TPS/Canal+ merger

On 23 May 2006, the Authority issued an opinion<sup>38</sup> to the competition authority (Conseil de la concurrence) on the TPS/Canal+ merger. Its conclusions are as follows:

38 - ARCEP Opinion  
No 06-0528 of 23 May 2006.

The Authority considers that, in all probability, the Canal+ France entity formed by the merger enjoys significant power in the markets for “premium” rights acquisition, media production and distribution.

It is also possible that the position of Canal+ France in media markets would create unfair competition in fixed and mobile electronic communication markets, along with predatory behaviour in the linear services distribution market, thereby limiting consumer choices.

To limit these risks, Canal+ France could be required to agree to:

- ◆ not discriminate in the distribution of its packaged offers, or in providing access to channels and to content between the different platforms and the different operators and distributors, including those with which Canal+ France may have direct or indirect structural ties;
- ◆ formalise a channel access offer created by the group, including new channels and HD channels, which is subject to certain conditions;
- ◆ not acquire exclusive distribution rights to channels that it does not operate and, when necessary, to renegotiate existing exclusive rights periods which are clearly too long.

Given the Canal+ channel's special role in financing French and European films, the Authority expressed the view that the possible extension of commitments to the Canal+ channel falls under the responsibility of the audiovisual authority, CSA

(Conseil Supérieur de l'Audiovisuel) and of the competition authority, Conseil de la Concurrence.

Under the hypothesis whereby third-party distributors would have access to the Canal+ channel for the purpose of including it in their own pay-TV package, the financing base for the film industry would likely be extended to operators and distributors.

Moreover, it is possible that, when acquiring film rights for the distribution of linear services, the position of Canal+ France could lead to unfair competition in related and emerging markets for acquiring rights and broadcasting video on demand (VoD) services.

To limit these risks, Canal+ France could be required:

- ◆ not to acquire exclusive VoD rights, notably as part of general agreements with rights holders which cover both linear and time-shifted broadcasting services;
- ◆ to renounce or renegotiate its portfolio of exclusive VoD rights whose periods are clearly too long.

### 3. Narrowing the digital divide with naked DSL

In the summer of 2006, France Telecom launched a new wholesale bitstream offer referred to as "naked DSL" which allows alternative operators in non-unbundled zones to offer their customers the option of doing away with their telephone subscription thereby decreasing their monthly bill, in the same way that unbundling (LLU) allows in unbundled zones. In LLU zones, the naked DSL offer allows Orange to compete with offers based on full unbundling. The solution has been enjoying increasing popularity since its introduction.

All of the conditions are thus in place to allow the momentum that exists in unbundled zones to extend to non-unbundled ones, and for the tariffs in these zones to come into line with those on offer in LLU zones.

## B. Wholesale market regulation

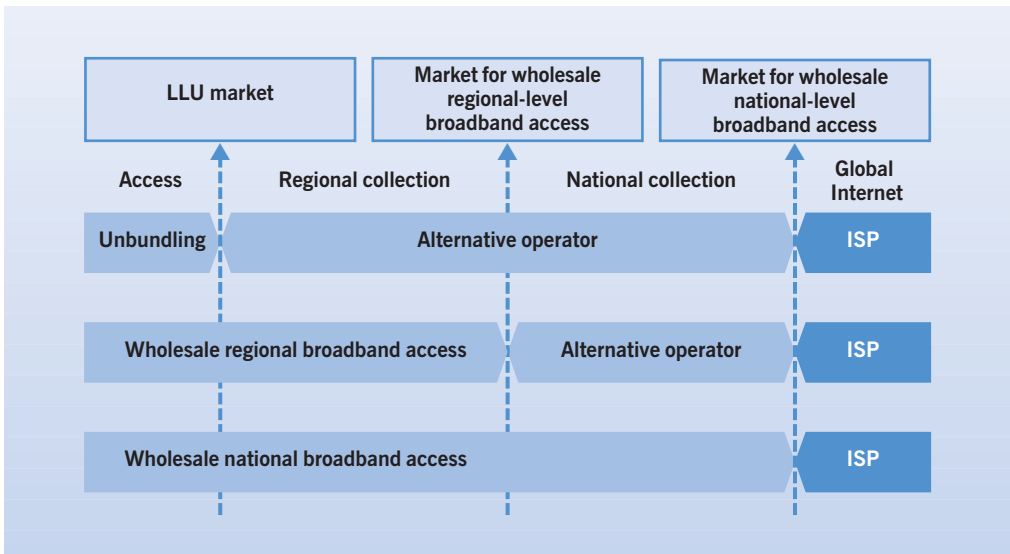
In France, broadband regulation concerns only wholesale markets, as the retail market is not regulated.

France Telecom offers alternative operators and ISPs several wholesale solutions based on xDSL technologies, which allow them to access the incumbent's network at different levels and to design their own offers.

Alternative operators can therefore:

- ◆ access the local loop directly via unbundling;
- ◆ subscribe to a bitstream offering;
- ◆ subscribe to a wholesale broadband access service at the national level, delivering broadband traffic to a single point nationwide.

Simplified diagram of the three wholesale broadband markets



An alternative operator can choose between several levels of wholesale offer. For a competing provider, the cost of deploying its own network will be that much higher as it is required to connect to the France Telecom network closest to subscribers. In the case of unbundling, even if it gives them more independence from France Telecom, alternative operators will still need to make sizeable investments. As a result, LLU can only be a profitable venture on the exchanges to which the largest number of potential customers is connected, and which offer the highest economies of scale. The geographical expansion of unbundling is thus limited by economics: an alternative solution is required for the rest of the country, where alternative operators generally prefer to opt for bitstream offers.

ARCEP holds the view that unbundling is the wholesale offer that enables the most lasting development of competition, and optimises client operators' technical and economic independence from France Telecom. Over time, the growing use of LLU leads to a lasting decrease in prices and an innovation dynamic that benefits consumers.

In terms of the obligations to which France Telecom is subject, this objective translates into greater regulation on the upper end of broadband market value chain (i.e. in the unbundling market) and lighter regulation as we move towards the retail market which is not regulated as such.

Tariff obligations incumbent on France Telecom, pursuant to bitstream market regulation, aim to provide a geographical complement to unbundling without competing with it directly. More specifically, regional tariffs must be:

- ◆ sufficiently low to guarantee dynamic competition in the retail market;
- ◆ but sufficiently high so that it is not economically appealing for an alternative operator to subscribe to a regional wholesale offer in a zone where unbundling is due to expand.

## C. Unbundling

### What is unbundling?

Unbundled access to the local loop consists of providing alternative operators with raw copper pairs for the purposes of installing their own transmission equipment on them. Naturally, client operators have to remunerate the incumbent carrier for use of its local network. The alternative operator must install its transmission gear at the extremity of the local loop to be able to connect these lines to its own network. It must house this equipment in the immediate vicinity of the incumbent carrier's distribution frame: as a corollary of unbundling, the incumbent must offer third-party operators the possibility of collocation in its exchange.

There are two types of unbundling:

Full unbundling, or fully unbundled access to the local loop, which involves making all of the copper pair frequencies available to third parties. The end user is thus no longer connected to the France Telecom network, but rather to the new entrant operator's.

Shared access, or partially unbundled access to the local loop, which consists of making the "high" frequency bands of the copper pair available to the alternative operator, on which the latter can then build an ADSL service, for instance. The low frequency band (the one used traditionally for telephony) continues to be managed by France Telecom, which continues to supply subscribers with its telephone services, without any effect on the service being caused by the unbundling.

### 1. Current situation

#### a. Full unbundling making strides

For over a year, full unbundling has accounted for the bulk of growth in wholesale offers purchased from France Telecom. There were four times more fully unbundled connections in 2006 than in 2005.

These results are due to a growing propensity among households to choose a single operator for all of their fixed services (including their phone subscription). Thanks to offers for the establishment of wholesale lines, this has now become possible for consumers as soon as they move into a new home. The introduction of a naked DSL wholesale bitstream offer also now increases customers' ability to do away with their telephone subscription in non-unbundled zones.

#### b. Issues involved in the geographical expansion of LLU

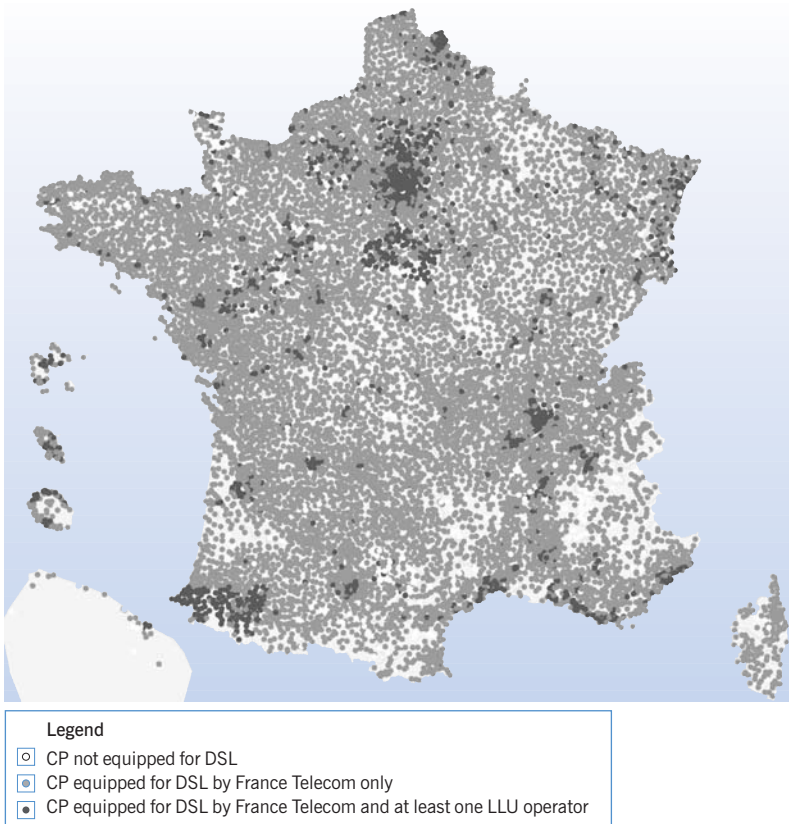
As of 31 December 2006, France Telecom had equipped 12,384 exchanges for DSL. Close to 99% of the country's phone lines are now connected to the incumbent carrier's broadband network. But some lines are still incompatible with DSL broadband services due to signal attenuation over a line that is too far from the central office. The actual coverage rate for France Telecom's broadband offers is thus likely to be closer to somewhere between 97% and 98%.

The incumbent carrier is being vigorously proactive in its expansion of DSL coverage. The first stage is to equip existing exchanges, of which the vast majority now deliver

broadband offers. France Telecom is also building new broadband subscriber connection points, referred to as NRA-HD (noeud de raccordement d'abonnés haut débit), which make it possible to deliver higher speeds, particularly in residential neighbourhoods and outlying business centres.

By the end of 2006, France Telecom had delivered 1,789 NRAs to alternative operators for the purposes of unbundling, allowing them to connect 59.6% of the population via LLU.

#### DSL coverage by France Telecom and LLU operators, as of 31 December 2006



Extending the geographical reach of unbundling is a major factor in spurring the development of competition. ARCEP devoted a great deal of its efforts to this issue in 2006, notably through its work with local authorities concerning France Telecom's fibre optic link offer, LFO (liaison fibre optique)<sup>39</sup>.

39 - See below

#### c. Impact of unbundling on broadband development

In the account of the work performed by the public-initiative networks committee, CRIP (*Comité des réseaux d'initiative publique*)<sup>40</sup>, published on 19 March 2007, the Authority presented an analysis of the economic impact that unbundling has on

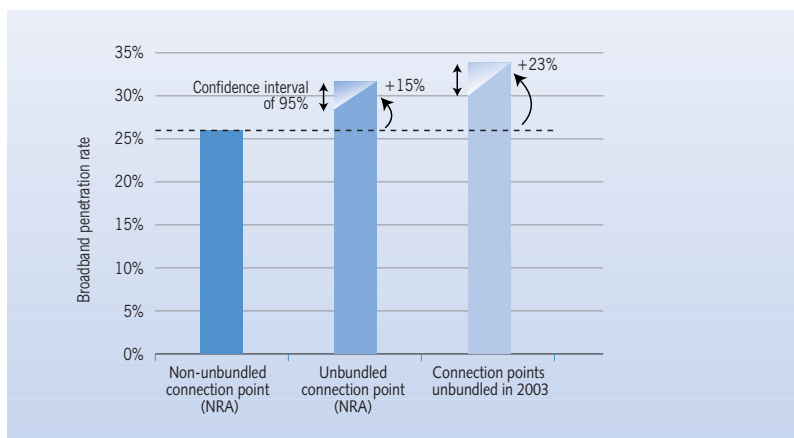
40 - The account of the work performed by CRIP, published on 19 March 2007, is available on ARCEP's website: <http://www.arcep.fr/uploads/txgspublication/compte-rendu-crip2007.pdf>.



broadband penetration. It consisted of measuring the correlation between LLU and the penetration rate in the zone in question, then of correcting the data based on a set of variables (e.g. average household income, the presence of waterways, etc.).

The following graph depicts the resulting causal effect.

### Impact of unbundling on broadband penetration rates, as of 1 January 2006



Connection points unbundled in 2003 led to a 23% increase in the broadband penetration rate by 1 January 2006. These figures underscore the impetus that competition provides for investment and market growth.

## 2. Operational and technical aspects of unbundling

### a. The “order-processing” group

At ARCEP’s initiative, a multilateral working group, called the order-processing group (*processus de commandes*), has met regularly since 2002, bringing together France Telecom and LLU operators to debate operational issues related to unbundling. Over the course of 2006, the group continued its work which focused chiefly on:

- ◆ lifting operational constraints on full unbundling, notably line establishment;
- ◆ adapting processes to address new challenges (e.g., installation of broadband subscriber connection points, saturated MDFs, the involvement of local authorities, etc.);
- ◆ adapting production techniques and control mechanisms to decrease the number of slamming incidences, and to increase the quality of service for final customers.

### b. Line creation

The principle of providing wholesale line creation offers is to allow alternative operators to market, as France Telecom does, services to customers who do not have a telephone line – because they have just moved into a new home, for instance. This can include any wholesale offer that involves the whole of the copper pair, full unbundling, naked DSL or wholesale line rental (VGAST).



In 2006, the order-processing group gradually put into place all of the necessary processes.

Trials are underway that seek to optimise the search for an inactive line already installed in a subscriber's new locale – the goal being to reduce, as much as possible, the number of service calls needed to fulfil orders for new connections.

A process for making appointments with customers on the operator's initiative has also been put into place, for cases where a France Telecom technician needs to make an on-site service call to establish a line. At the request of alternative operators, France Telecom has shortened service call waiting periods (the initial 12 calendar days reduced to seven).

### c. "Slamming"

The process of implementing unbundling can lead to certain problems for consumers, notably due to technical or human errors: "slamming" is one of those problems.

#### (a) Unbundling orders

When customers want to subscribe to a LLU subscription, they mandate their selected operator to order the unbundling of their line from France Telecom. Previously, France Telecom would check all mandates systematically beforehand, but it soon became apparent that this process was incompatible with a large volume of orders. It has thus switched to a principle of post-order verification, on a case by case basis.

#### (b) Designation number: a necessary ordering tool

When an alternative operator wants to order an unbundled line for one of its customers, it must get information from the customer that allows it to obtain the line designation number contained in the France Telecom database.

This information is the designation number (DN). Under the old public monopoly, France Telecom had the same designation for a copper pair (which existed because it satisfied a request for phone service) and the phone number of the telephone service it delivered (or had delivered). France Telecom still uses the same system as the work needed to dissociate line designations and numbers would have required a massive overhaul of the incumbent's information system.

Nevertheless, there are two processes which make it difficult for this system to operate properly in a competitive environment:

- ◆ geographic number retention: France Telecom subscribers can keep the same number when moving inside the same geographical zone;
- ◆ the arrival of copper pairs not used for any analogue phone service since they are fully unbundled.

#### (c) Overriding, regular operation of competition

When a customer who already subscribes to one or several fixed services (telephone, Internet access, etc.) subscribes to a new service provider, establishing this new service can, in some cases, override the service to which the customer already subscribes.

For instance, when residential customers sign up for a full unbundling offer with a service provider, they mandate their new provider to order the cancellation of all

existing services that had been delivered up until then via their telephone line, notably their telephone subscription and their broadband access: the implementation of full unbundling on their line will override these services, when applicable.

To guarantee efficient competition, the Authority has opted for a principle whereby any broadband connection can be overridden by an order for shared access, and where any access to the full pair can be overridden by a full unbundling order.

#### (d) Slamming

Slamming is the term used to refer to a situation when a customer's service is "slammed" (i.e. cut off) without the customer having subscribed to a new subscription with another service provider.

This can occur, for instance, when customers order a new ADSL connection and by mistake give their service provider a phone number which is not theirs, e.g. the number of the previous tenant who chose to retain his or her number when moving.

#### (e) Measures adopted to limit slamming

In early 2007, the Authority had occasion to remind the industry that, when it has been established that a customer has been the victim of slamming, electronic communications providers must re-establish the customer's services, free of charge and as quickly as possible, in accordance with their service agreements.

To better inform consumers on how to proceed when affected by slamming, ARCEP has enhanced the FAQ on its website with a section that details "what to do when you are a victim of slamming"<sup>41</sup>.

<sup>41</sup> - Cf. ARCEP's website:  
[http://www.ARCEP.fr/index.php?id=30&no\\_cache=1&tx\\_gsfaq\\_pi2\[categoryUid\]=62&tx\\_gsfaq\\_pi1\[categoryUid\]=62&chash=3a28629f60](http://www.ARCEP.fr/index.php?id=30&no_cache=1&tx_gsfaq_pi2[categoryUid]=62&tx_gsfaq_pi1[categoryUid]=62&chash=3a28629f60).

And, finally, the Authority has engaged in discussions with alternative operators and France Telecom to define the inter-operator mechanisms that will help minimise cases of slamming. The first step is to ensure greater accuracy of the information provided; an ad hoc procedure for swifter reconnection of slammed subscribers is also being examined.

#### d. Quality of service

In accordance with the obligations defined in the market analyses performed by the Authority in 2005, France Telecom has published a list of quality of service indicators (access delivery and after sales service) for wholesale and retail offers, each month for over a year.

At the end of 2005, the reported QoS levels proved insufficient, particularly customer support for business unbundling. France Telecom thus committed to several lines of action:

- ◆ decreasing post-production errors (SIGNA plan);
- ◆ improving the after-sales service process, from receipt of the complaint to issuing the summary report, and systematic use of diagnostic tools developed by the operators (IVS, line supervision from the DSLAM);
- ◆ implementation of a real service restoration time guarantee of four hours for business lines.

Since then, the quality of service in the residential segment has been relatively good: 95% of contractual lead time guarantees are met and 75% of after-sales service

guarantees. These are national figures, with no distinction made of regional disparities which may occur.

This work will continue on throughout 2007, notably on the integration by France Telecom of diagnostic tools developed by alternative operators. The results in the business segment should also improve and come more in line with the quality of service standards that France Telecom offers its end customers.

#### e. Work of the expert committee for the introduction of new technologies in the local loop

Parallel to the work being performed by the order-processing group, the work of the expert committee, chaired by Catherine Mancini, continued to focus in 2006 on its two guiding principles: non-discrimination in the introduction of new innovative technologies likely to be deployed on the local copper loop, and assuring that these techniques are compatible with the technologies which are already being employed.

In 2006, the committee devoted itself to the introduction of VDSL technologies.

A summary of the opinions issued by the expert committee is now available on ARCEP's website<sup>42</sup>. This document also maintains an up-to-date list of the local loop technologies authorised by France Telecom, at the distribution frame and MDF levels, along with the template for power spectral density.

42 - <http://www.arcep.fr/index.php?id=6988>.

### 3. "LFO" Fibre optic link offer for connecting distant exchange

#### a. Background

In its market analysis decision on unbundling<sup>43</sup>, ARCEP noted a stagnation in the coverage achieved by alternative operators using unbundling. The lack of collection networks allowing alternative operators to send back data streams from distant exchanges to their points of presence and their backbones<sup>44</sup> were identified as the main cause for this stagnation.

43 - ARCEP Decision No 05-0277 of 19 May 2005..

As a result, ARCEP felt it necessary that France Telecom offer all alternative operators a passive connection solution for distant exchanges to:

- ◆ allow alternative operators to deploy their own broadband equipment under technical and economic conditions similar to those that France Telecom enjoyed when installing its own equipment in its exchanges, with several years' head-start;
- ◆ encourage the geographical expansion of unbundling to limit disparities in regional competition dynamics, by instilling lasting broadband competition based on local loop unbundling and encouraging long-term investments by alternative operators.

44 - Backbone networks are very high-speed networks that make up the core of the Internet (essentially fibre optic cables installed undersea and on the continents).

The decision called on France Telecom and alternative operators to enter into good faith negotiations over the features of the offer, specifying that if resulting offer introduced by France Telecom was satisfactory it would not be necessary to regulate it. In the opposite case, the Authority reserved the right to order changes to the reference offer for unbundling.

45 - Cf. Part 2, Chapter 2, D During a meeting of the access and interconnection committee (*Comité de l'accès et de l'interconnexion*)<sup>45</sup> on 8 March 2006, France Telecom announced a commercial fibre optic link offer, LFO (*liaisons fibre optique*) – which was subsequently published on 24 April. Following a multilateral meeting on 11 July 2006, certain changes were made to the offer in September, chiefly concerning the prior supply of information.

#### b. Outcome of the public consultation on LFO

The Authority wanted to gather input from the players on this new offer, and so launched a public consultation on 5 October 2006 that sought to assess whether or not the fibre optic link (*LFO*) offer was satisfactory in terms of alternative operators' expectations, the restrictions to which France Telecom is subject, and the various regional development issues and goals involved in such an offer.

Five operators (France Telecom, Free, Neuf Cegetel, Mediaserv and Mobius), AFORS Telecom<sup>46</sup>, Avicca<sup>47</sup> and the city of Montpellier responded to the public consultation. This input (protected in part by commercial secrecy) and a summary of the consultation are available on the Authority's website ([www.arcep.fr](http://www.arcep.fr)).

Alternative operators using the offer felt that several of the features of the offer proposed by France Telecom fell short of expectations, notably:

- ◆ the lack of prior information (e.g. the list of sites covered by cable and fibre, and the list of sections on which fibre is available inside these cables) runs counter to standard market practices;
- ◆ the pace of the eligibility studies performed by France Telecom was deemed too slow, and thus likely to delay the equipment of alternative operator exchanges;
- ◆ the availability rate was deemed insufficient, and the lack of solutions such as WDM to increase capacity in saturated cables (in cases where no further fibre is available) was the source of considerable disappointment. Some players also had questions about the geographical disparities in the availability of the fibre optic link solution.

On 19 December 2006, the Authority concluded that the results of this public consultation did not allow it to identify objective reasons for France Telecom's failure to implement certain improvements requested by operators using the *LFO* offer.

As a result, ARCEP launched an administrative enquiry procedure aimed at assessing the organisational, IT and human means and resources put into place by France Telecom to plan its own rollout, and to respond to alternative operators' requests concerning the fibre optic link offer.

## 4. Tariff aspects of unbundling

### a. Non-recurring tariffs

To achieve consistency in the tariff schedules for its different wholesale and retail offerings and thereby avoid circumvention of the reference unbundling offer, France Telecom now proposes a single service access fee for full unbundling: €50. This applies to both taking over an existing line and line establishment with section abutment. It includes capacity increases in saturated copper pairs for single-pair connections.

46 - Association Française des Opérateurs de Réseaux et de Services de Télécommunications (French association of network and telecommunications service operators)

47 - Association des villes et collectivités pour les communications électroniques et l'audiovisuel (Association of towns and local authorities for electronic communications and media)

Service access fees for full unbundling have therefore come in line with those charged for wholesale line rental (VGAST) and for the “Bitstream DSL only” offer. Coming into effect on 1 September 2006, this new service access fee has since allowed residential market operators to offer full unbundling offers with line establishment.

#### b. Related tariffs

The Authority has continued to devote itself to achieving maximum clarity of the various tariffs related to unbundling. This work has focused in particular on the tariff structure and cost sharing of MDF capacity upgrades.

## D. Broadband access offers delivered at the regional and national levels

Bitstream can be delivered in IP or ATM mode, and allows alternative operators to collect Internet traffic at various regional points on the France Telecom network (21 IP points and 40 to 95 ATM points) and then use their own complementary transport infrastructure.

Alternative operators can use regional offerings to serve subscribers on any France Telecom exchange equipped for DSL. In practice, this means that the population covered by regional offerings is identical to the population covered by France Telecom’s retail DSL offerings, which was close to 98% at the end of 2006.

Even though other alternative operators market offers based on unbundled access that compete with France Telecom’s wholesale bitstream offerings, only France Telecom is subject to regulation in this market as it enjoys SMP.

From a regulatory standpoint, two ARCEP decisions<sup>48</sup> increased the Authority’s powers to govern this market – which is now regulated in a similar fashion as the market for unbundled access – particularly as concerns the obligation for France Telecom to publish a reference offer.

**48 - ARCEP Decisions**  
No 05-0278 and No 05-0280  
of 19 May 2005.

Following the publication of the first France Telecom reference offer for DSL access and collection on 27 July 2005, and its subsequent updates, the regional offers now marketed by the incumbent carrier are segmented as follows:

- ◆ *DSL Access*, an access offering for the residential market, which allows users with a PSTN subscription to be connected to a France Telecom DSLAM by means of DSL technologies;
- ◆ *DSL Access Only*, also a residential market access offering that allows users who do not have a PSTN subscription to connect to a France Telecom DSLAM by means of DSL technologies (this offer has been available in the wholesale market since 17 July 2006);
- ◆ *DSL Collect ATM*, a collection offering for the residential market which allows the client operator to take delivery of ATM broadband streams at the regional level and *DSL Collect IP*, a residential market collection offering which allows the client operator to take delivery of IP broadband streams at the regional level;

- ◆ *DSL Entreprises*, an access and collection offering for the business market, which allows delivery of ATM broadband streams to be taken at the regional level. This offering is used by operators to serve the business market and, thanks to SDSL technology, allows them to offer their customers guaranteed and symmetrical bitrates.

## 1. ARCEP actions in the bitstream offers market

The Authority intervened in the bitstream market in 2006, notably by holding multi-lateral meetings with France Telecom and alternative operators.

ARCEP also continued to develop cost models for unbundled access and collection, which made it possible to perform price squeeze tests between the different regional offers and unbundling.

Lastly, as part of a multilateral working group<sup>49</sup>, the Authority was also involved in more far-reaching discussions on the allocation of civil engineering costs between narrow-band and broadband.

### a. Improving quality of service through the multilateral bitstream group

As has been the case for the unbundling market since 2001, periodic multilateral meetings have been set up with all of the players involved in the bitstream offer market.

The bitstream group was established before the first reference offer was published, and has been an ongoing concern since 2005. The scope of the work performed by the group covers operational and technical implementation issues, new features in the reference offer and tariff aspects.

The goal of this group is to provide a forum where the parties can share information and discuss issues encountered by alternative operators, and thereby arrive at consensual solutions. It also constitutes a forum for France Telecom announcements about developments and changes in the reference offer for DSL access and collection (*Accès et collecte DSL*).

The topics addressed at the multilateral meetings held in 2006 included:

- ◆ the operational implementation of the reference offer: improving the order process for *DSL Entreprises*, addressing problems encountered with fault clearing in the *DSL Access* offer (implementation of a new version of the online customer service application, webSAV, resolution of incompatibilities between certain modems and certain DSLAMs, etc.), trials for alleviating saturation issues in the *DSL Entreprises* offer, etc.;
- ◆ the launch of France Telecom's naked DSL offer, called *DSL Access Only*: trials, operational launch, implementation of portability and order processes, extension to ADSL2+;
- ◆ increasing the uniformity of the France Telecom reference offers for "DSL access and collection" and unbundling.

The changes achieved through these meetings over the course of 2006 helped improve the quality of service of France Telecom's wholesale broadband offers delivered at regional level.

<sup>49</sup> - The "Bureau" group, named after its Chairman, Dominique Bureau (Director of Economic and International Affairs for the French Ministry of Transport).

## b. Publication of a regulatory cost model for broadband collection networks, and update of the cost models for unbundled access and Internet service providers

### Reference models

The Authority relies on models when implementing regulation, notably for supervising the incumbent carrier's wholesale tariffs. In a more general fashion, when deemed appropriate, the various competition authorities may also use these models. Their publication helps elucidate players on the tools and procedures used by the Authority thereby clarifying any decisions it might make.

These models are generally devised multilaterally, drawing on input from operators, then submitted to public consultation. Once they are published, the players can at any time inform the regulator of any changes which are likely to alter the models' parameters, which are updated by ARCEP in a regular basis.

On 30 January 2007, the Authority submitted to public consultation a regulatory cost model for collection networks. These are the networks that lie between broadband access networks (the subject of a regulatory cost model for unbundled access) and service provision (the subject of a regulatory cost model for Internet service providers).

At the same time, the Authority invited players that wished to do so to comment on these two other models during a public consultation.

In 2004, the Authority, in cooperation with France Telecom and LLU operators, developed a cost model for unbundled access. The model allows the monthly cost of unbundled access to be evaluated, for an efficient alternative operator, according to the size of the exchange involved. It thereby provides an overall view of the principal services that make up the France Telecom reference offer for unbundled access.

This model was published for the first time in November 2004 and has been updated three times since then: in March, July and November 2005. These changes have made it possible to take account, first, of changes made to tariffs in the reference offer for unbundling (service access fees, monthly tariff for full unbundling, related service tariffs) and, second, the changes in the state of the market – since the DSL penetration rate in France is one of the model's parameters.

Regulatory cost models for broadband collection networks and unbundled access provide a means for estimating the economic leeway available to operators between unbundled access and other France Telecom wholesale offerings, notably regional DSL Access. This means that, in accordance with France Telecom tariff obligations with respect to its regional offers, ARCEP can verify whether the tariffs create a price squeeze on unbundled access.

### c. Work on a model for collection and the “Bureau” working group

The largest cost item when constructing a network is civil engineering – the fundamental stage of installing the infrastructure which will house the equipment that provides voice call and data services, such as broadband Internet.

In an environment where IP telephony is gradually gaining ground on switched voice, and where Internet traffic is occupying an ever-increasing place on the networks, the issue of how civil engineering costs are allocated to each of these services becomes critical. As a result, in 2005 the Authority appointed Dominique Bureau to chair a working group devoted to this issue. The group continued its work in 2006.

The group met three times this past year, and on one occasion heard from Mr. Jean Tirole, the Scientific Director of IDEI (Industrial Economic Institute), on the issue of fixed cost allocation. In addition, France Telecom and AFORST (French association of telecommunications network and service operators) presented different simulations illustrating certain scenarios of change

### d. Monitoring quality of service indicators published each month by France Telecom

In accordance with broadband market analysis decisions, France Telecom has published QoS indicators for its wholesale and retail DSL access and PSTN service offers every month since July 2005. These indicators concern two issues: delivery and after-sales service for each of the offers, in both residential and business markets.

The indicators make it possible to measure the evolution of the quality of service and, because they are publicly available, to encourage France Telecom to implement the technical and operational solutions required to improve their performance. In 2006, they made it possible to ensure that there was no discrimination between France Telecom retail offers and the wholesale offers marketed to alternative operators.

### e. Changes made to the France Telecom reference offer

Each of these elements led France Telecom to amend its reference offer on several occasions over the course of 2006.



## Principal changes made

| Date of modification to the reference offer | Principal changes made  |
|---|---|
| 13/04/2006                                  | <ul style="list-style-type: none"> <li>• Introduction of the <i>DSL Access Only</i> offer: a naked DSL offer that became available on 17 July 2006;</li> <li>• decrease in service access fees for the <i>DSL Access</i> offer, from €53 to €49 starting on 1 September 2006.</li> </ul>  |
| 21/06/2007                                  | <ul style="list-style-type: none"> <li>• Decrease in IP collection tariffs, from €247-€313/month/Mbps to €210-€265/month/Mbps;</li> <li>• decrease in the recurring tariff of <i>DSL Access</i> from €14.20 to €13.30;</li> <li>• decrease in the recurring tariff of <i>DSL Access Only</i> from €22.26 to €21.50;</li> <li>• homogenisation of ADSL and ADSL2+ access tariffs;</li> <li>• decrease in the recurring tariff of STM4 ports to €750/month;</li> <li>• introduction of a maximum period of three months for making IP Collect broadband DSL connections available.</li> </ul> |
| 07/02/2007                                  | <ul style="list-style-type: none"> <li>• Addition of symmetrical links operating at 8 Mbps in the <i>DSL Entreprises</i> offer, on 1 March 2007;</li> <li>• introduction of an “S1” guaranteed repair time (within 4 hours, 24/7) in the overseas <i>départements</i>, as of April 2007.</li> </ul>   |

## 2. Lifting regulation of broadband access offers delivered at the national level

### Background

The market for broadband access offerings delivered at the national level was not one of pre-identified markets contained in the European Commission Recommendation of 11 February 2003, concerning the relevant markets for electronic communication products and services.

The regulatory framework for this market was set by the Authority in July 2005, in its Market Analysis Decision<sup>50</sup> which imposed obligations on France Telecom, namely the prohibition of predatory pricing, the requirement to act in non-discriminatory manner and perform accounting separation, in addition to setting the technical terms and internal transfer pricing for residential broadband offerings.

The regulation included in this framework thus aimed to discourage any future anti-competitive behaviour on the part of the incumbent carrier. This constituted a lighter mechanism than the regulatory restrictions imposed on France Telecom under the old framework, and was enacted for a transitional period of one year.

In accordance with the remarks made by the European Commission in 2005, it was the Authority's responsibility to re-examine its analysis, whose provisions expired in autumn 2006.

50 - ARCEP Decision  
No 05-0281 of 28 July 2005.

ARCEP held the view that the wholesale market for broadband access delivered at the national level had evolved considerably since summer 2005, particularly with respect to:

- ◆ the deployment of alternative operators' networks at the regional level, and the increase in network capillarity;

- ◆ the development of wholesale markets for LLU access and for bitstream offers;
- ◆ the consolidation of the Internet market, as a result of a series of mergers and acquisitions between operators competing with France Telecom;
- ◆ increased competition, as revealed by the existence of wholesale broadband access offers delivered at the national level in addition to those marketed by France Telecom.

The Authority thus concluded that the three cumulative criteria defined by the European Commission to determine whether a market is relevant (i.e. existence of high and permanent entry barriers, lack of prospects for a shift towards effective competition and the inability of competition law to remedy market failures single-handedly) were not being met.

51 - ARCEP Decision  
No 2007-0089  
of 30 January 2007.

As a result, ARCEP lifted<sup>51</sup> the *ex ante* regulatory provision that it had defined for this market one year earlier. This was done upon completion of a process that involved consultation with the sector's economic players, the competition authority (*Conseil de la concurrence*), the European Commission and other NRAs from European Union Member States.

## E. Ultra-broadband (fibre)

### 1. Ultra-broadband for businesses

After a relative freeze on local fibre optic loop deployments after the Internet bubble burst in 2000, it now seems likely that, in the coming years, operators will be reviving their plans to provide businesses with ultra-broadband connections. The Authority's work on this subject has focused particularly on operator access to passive infrastructures in business parks.

The work performed by the committee for public-initiative networks, CRIP (Comité des réseaux d'initiative publique) led to the publication of guidelines for local authorities in March 2006, followed by a guide for regional developers in October 2006, devoted to the modalities for equipping business parks with broadband and ultra-broadband<sup>52</sup>.

52 - All CRIP publications  
are available  
on ARCEP's website:  
<http://www.ARCEP.fr/index.php?id=2097>.

As an extension to this work, on 15 March 2006 France Telecom announced the introduction of an access offer for its ducts located in certain business parks referred to as "LGC ZAC" (civil engineering links in a designated development zone). These are zones where the manner in which urban development has taken place has led to telecommunications infrastructures being financed directly or indirectly by the State or by a local authority. This offer is geared to enabling quicker and less costly network rollouts for alternative operators. After a trial phase during the summer of 2006, the offer has been fully operational since the start of 2007.

The Minister-delegate of Industry wants to encourage the equipment of business parks with ultra-broadband by creating an "ultra-broadband business park" label. With this in mind, the Minister mandated CRIP to define the eligibility criteria for this designation. CRIP completed its work in the first quarter of 2007, and the first labels could be awarded in the coming months.



## 2. Residential ultra-broadband

The existing local copper loop will have reached its limitations in terms of capacity within the next few years, due to the ongoing trend of offering users ever-higher bitrates<sup>53</sup>. It therefore appears inevitable that a new fibre optic local loop network that runs to the subscriber's premises will be deployed in the medium term.

53 - Cf. Part 11, Chapter 1.

Fully aware that this transition from broadband to ultra-broadband is more than a simple step forward, ARCEP sent the Minister-delegate of Industry a memorandum on public authority accompaniment of ultra-broadband in July 2006, following up on the conclusions reached in a report produced by IDATE<sup>54</sup>.

54 - Institut de l'Audiovisuel et des Télécommunications en Europe: <http://www.idate.fr>.

In light of the initial trends that are taking shape, and to give greater visibility to the investments being made in fibre optic networks, ARCEP presented its work programme for the coming months to the press on 10 November 2006. The Authority's action will seek to encourage passive infrastructure sharing (civil engineering, terminal portion of the fibre network) and will focus on several key areas of concern.

### ◆ Role of local authorities

Local authorities have clear forms of leverage at their disposal to spur the development of electronic communications infrastructure in their region. As the manager of the public domain, they can encourage civil engineering sharing and act in a more direct fashion, either by allowing operators to rent the ducts installed during roadwork projects, or through public-initiative networks. These forms of intervention will be the subject of much debate in 2007 inside the committee for public-initiative networks, CRIP (Comité des réseaux d'initiative publique) and, by the end of the year, ARCEP will publish guidelines for local authority involvement in promoting ultra-broadband.

### ◆ Whether to regulate France Telecom ducts

It seems likely that France Telecom has a significant capacity of reserve civil engineering ducts left over from the old public monopoly. Given the importance of civil engineering in the fibre rollout equation, this resource could go a long way to reducing the cost to the incumbent of delivering fibre to the home (FTTH), which is why, over the course of 2007, the Authority will conduct an enquiry into the relevance and feasibility of regulating France Telecom's ducts.

### ◆ Sharing fibre access networks

The process of deploying fibre access networks to homes and the common areas of residential buildings gives rise to certain practical issues for operators, but also questions for property-owners and building managers, particularly in apartment complexes. In 2007, ARCEP will perform the work needed to allow competition to develop, without having to duplicate the terminal portion of fibre access networks.



# Mobiles

## A. Mobile interconnection

### 1. Voice call termination

#### a. Market analysis cycle

Voice call termination is an interconnection service offered by each mobile operator to all other operators, fixed and mobile. It is the bottleneck through which every call for a mobile customer must pass, whether the call is fixed-to-mobile or mobile-to-mobile.

In accordance with the European Commission's Recommendation of 11 February 2003, the Authority has qualified as relevant the wholesale market for voice call termination (Market 16) on each individual mobile operator's network. In these markets, which are segmented geographically by licence area (Metropolitan France, Antilles-Guyana, Mayotte, Reunion, and Saint Pierre and Miquelon), the Authority has also declared that each mobile operator enjoys significant power in the market for call termination on its own network, for a period of three years (2005-2007).

#### (a) In Metropolitan France

In Metropolitan France, the Authority has imposed the following obligations on the three mobile operators<sup>55</sup>:

- ◆ the obligation to grant all reasonable requests for access and interconnection services relating to voice call termination;
- ◆ the obligation to provide voice call termination services under non-discriminatory conditions;
- ◆ the obligation to provide voice call termination services under transparent conditions;
- ◆ the obligation to apply a rate structure to these voice call services reflective of the service rendered (the structure cannot contain an indivisible time period);

**55 - ARCEP Decisions**  
No 04-937, 04-938 and 04-939 of 9 December 2004 concerning the significant power of Orange France, SFR France and Bouygues Telecom in the wholesale market for voice call termination on their respective networks, and concerning the obligations imposed for this reason.

- ◆ the obligation to publish a reference offer for voice call termination;
- ◆ the obligation to maintain accounting separation and perform cost accounting.

In addition, ARCEP has imposed a tariff control obligation on operators in Metropolitan France, requiring their tariffs to reflect the cost of providing the mobile call termination service.

In 2006, the Authority set the tariff ceiling to be applied in 2007<sup>56</sup>.

**Tariff ceiling set by the Authority (€ cents/min, excl. VAT)**

|                  | 2005* | 2006* | 2007 |
|------------------|-------|-------|------|
| Orange/SFR       | 12.50 | 9.50  | 7.50 |
| Bouygues Telecom | 14.79 | 11.24 | 9.24 |

Source: ARCEP.

\* Tariff ceiling set by the Authority in December 2004.

The Authority has maintained a gap between Bouygues Telecom call termination tariffs and those imposed on Orange France and SFR – holding the view that allowing Bouygues Telecom to charge higher tariffs will enable the company to correct the pernicious effects of voice call termination tariffs which are high compared to costs, and of its late arrival in the market.

**(b) Overseas**

The Authority has imposed the following obligations on operators in the overseas territories and *départements*<sup>57</sup>:

- ◆ the obligation to grant all reasonable requests for access and interconnection services relating to voice call termination;
- ◆ the obligation to provide voice call termination services under non-discriminatory conditions;
- ◆ the obligation to provide voice call termination services under transparent conditions;
- ◆ the obligation to apply a rate structure to these voice call services reflective of the service rendered (the structure cannot contain an indivisible time period).

Furthermore, ARCEP has required that Orange Caraïbe and SRR charge cost-oriented mobile call termination tariffs. The tariff ceilings set by the Authority in 2005 apply up to 2007 and correspond to an annual 20% decrease over three years.

**Ceiling tariffs set by the Authority (€ cents/min, excl. VAT)**

|                | April to December 2005 | 2006  | 2007  |
|----------------|------------------------|-------|-------|
| Orange Caraïbe | 20.56                  | 16.44 | 13.16 |
| SRR            | 19.65                  | 15.72 | 12.57 |

Source: ARCEP.

56 - ARCEP Decision No 06-0779 of 14 September 2006, concerning the supervision of "direct" voice call termination tariffs for 2007 for Orange France, la Société Française de Radiotéléphone and Bouygues Telecom, as a result of them having been designated as enjoying SMP in the wholesale market for voice call termination on their respective networks.

57 - ART Decision No 05-0111 of 1 February 2005 concerning the determination of relevant markets for voice call termination on mobile networks in the overseas territories and départements. ART Decisions No 05-0112, 05-0113, 05-0114, 05-0115, 05-0116, 05-0117, and 05-0118 of 1 February 2005 concerning the SMP of Orange Caraïbe, SRR, Orange Reunion, Bouygues Telecom Caraïbe, Saint-Martin Mobile, Dauphin Telecom, and SPM Telecom in the wholesale market for voice call termination on their respective networks, and concerning the obligations imposed for this reason.

The other smaller operators (Digicel – ex Bouygues Telecom Caraïbe – Dauphin Telecom, Saint-Martin Mobile in the Antilles-Guyana region; Orange Réunion in Reunion, and SPM Telecom in Saint Pierre and Miquelon) are subject to an obligation not to charge excessive prices.

## b. Implementing obligations

### (a) Reference offers

In accordance with their obligations<sup>58</sup>, the operators have published reference offers for voice call termination interconnection and access on their respective websites, which include all of the changes that have come into effect in 2007. It should nevertheless be remembered that the publication of a reference offer does not necessarily mean that ARCEP's approval has been obtained.

**58 - ART Decisions**  
No 04-937, 04-938  
and 04-939  
of 9 December 2004.

### (b) Accounting obligations

#### ◆ Regulatory framework for cost accounting

In 2006, the Authority implemented a decision<sup>59</sup> concerning accounts submitted for regulatory purposes for fiscal years 2004 and 2005 for operators in Metropolitan France. This decision specifies the methods for applying the obligation to perform accounting separation and cost accounting, and requires that the operators concerned submit two separate accounts:

**59 - ARCEP Decision**  
No 05-0960  
of 8 December 2005.

- a specific account for voice services, comprising the historic cost of voice services, including the cost of mobile voice call termination;
- a specific account called *compte de bouclage*, comprising the historic cost of services other than voice, which enables ARCEP to evaluate the completeness of the costs.

The decision will be amended in 2007 in order to clarify or amend certain points that have already been specified, and to specify the methods for applying the obligations of accounting separation and cost accounting for text messaging (SMS) services, imposed on mobile operators in Metropolitan France.

#### ◆ 2004 and 2005 account audits

Following the regulator account audits for fiscal years 2004 and 2005, which were performed in 2006, the Authority published attestations of conformity for the statements of accounts and revenues from each of the three mobile operators in Metropolitan France, delivered by the accounting firm appointed by ARCEP<sup>60</sup>. These goal of these audits is to obtain reliable accounting information which is consistent across the three operators, so that it may be taken into account when setting call termination tariffs.

**60 - ARCEP Decisions**  
No 06-1083, No 06-1084  
and No 06-1085 for fiscal  
year 2004 and Decisions  
No 06-1086, No 06-1087  
and No 06-1088 for fiscal  
year 2005, for Orange  
France, SFR and Bouygues  
Telecom, respectively.

#### ◆ Timetable

On 1 July 2007, Orange France, SFR, Bouygues Telecom, Orange Caraïbe and SRR will submit to the Authority their non-audited statements of cost and revenue for fiscal year 2006<sup>61</sup>. They will be audited in view of delivering, when applicable, a certificate of conformity (with the audit report) by 30 September 2007.

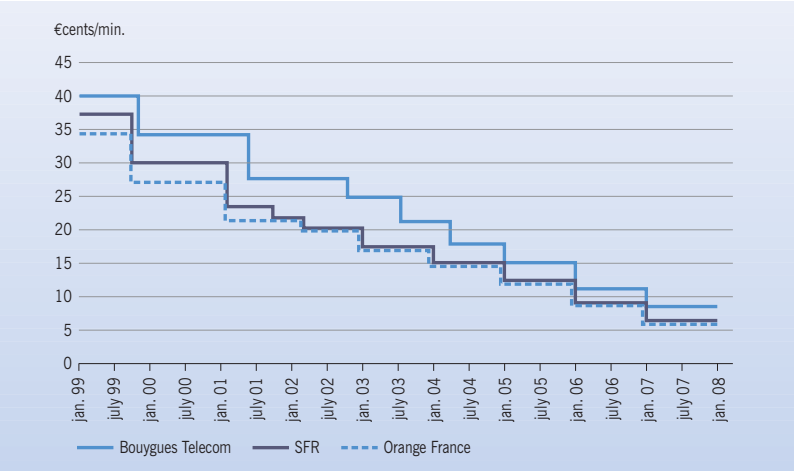
**61 - ARCEP Decision**  
No 05-0960  
of 8 December 2005.

(c) Supervising wholesale tariffs

Wholesale call termination tariffs are an important component of a call's retail tariff since they represent two-thirds of the price of a fixed-to-mobile call in Metropolitan France. The decrease in the wholesale tariff should thus lead to a corresponding decrease in the retail price of fixed-to-mobile calls, which will benefit fixed customers.

For the past ten years, ARCEP has been undertaking actions that have enabled a substantial decrease in call termination tariffs: fixed-to-mobile call termination tariffs in Metropolitan France have gone down by more than 75% since 1999.

Average price of a mobile call termination minute



Source: ARCEP.

The wholesale tariffs charged by operators which are subject to a price cap comply with the ceiling tariff set by the Authority, as indicated in the following table.

|                  |                      | Tariff in € per minute<br>in 2006 | Tariff in € per minute<br>in 2007 |
|------------------|----------------------|-----------------------------------|-----------------------------------|
| Orange France    | Intra-ZA tariff      | 0.0950                            | 0.0750                            |
|                  | Extra-ZA tariff      | 0.0986                            | 0.0786                            |
| SFR              | Intra-ZA tariff      | 0.0950                            | 0.0750                            |
|                  | Extra-ZA tariff (T2) | 0.0990                            | 0.0786                            |
|                  | Extra-ZA tariff (T3) | 0.1035                            | 0.0827                            |
| Bouygues Telecom | Intra-ZA tariff      | 0.1124                            | 0.0924                            |
|                  | Extra-ZA tariff      | 0.1163                            | 0.0963                            |
| Orange Caraïbe   | -                    | 0.1644                            | 0.1316                            |
| SRR              | -                    | 0.1572                            | 0.1257                            |

Source :ARCEP.



#### (d) Outlook

For operators in Metropolitan France, 2007 will mark the start of a new market analysis cycle for mobile call termination, which will cover the period 2008 to 2010. In this market analysis cycle, the Authority will need to:

- ◆ confirm relevant market definitions and SMP operator designations for each of the mobile voice call termination markets, after having received the opinion of the competition authority (*Conseil de la concurrence*);
- ◆ once again impose, amend or, if applicable, lift the obligations incumbent on these operators.

Also in 2007, ARCEP will adopt a bottom-up technical-economic cost model for an efficient mobile operator, as announced in its decision<sup>62</sup> setting voice call termination tariffs for 2007. Established in collaboration with mobile operators in Metropolitan France, this model will serve as an additional tool for understanding the costs shouldered by mobile operators when providing voice call and text messaging termination services. It will help shed additional light on the cost levels observed in the accounts submitted for regulatory purposes.

**62 - ARCEP Decision**  
No 06-0779  
of 14 September 2006.

As concerns the overseas territories, operator Outremer Telecom had not yet launched its mobile services commercially when the first market analysis on wholesale voice call termination was performed in 2004 and was therefore not concerned by the regulation implemented at that time. Following commercial launch in late 2004 in Guyana, and in late 2005 in Martinique and Guadeloupe, the Authority performed a market analysis in 2006 which sought to designate Outremer Telecom as having SMP in the wholesale market for voice call termination on its own network in the Antilles-Guyana region. After having received a favourable opinion from the European Commission, the procedure for implementing call termination regulation for Outremer Telecom was concluded in March 2007<sup>63</sup>.

**63 - ARCEP Decisions**  
No 07-0277  
and No 07-0278  
of 28 March 2007.

## 2. SMS call termination

### a. How the market operates

#### Text messaging: technical aspects

As its name implies, a text message (also referred to as SMS: short message service) is a typed message composed of a maximum 160 characters, each with seven-bit encoding. This service is available on all mobile handsets currently in circulation, and is compatible with all types of network (GSM, GPRS, UMTS). In compliance with the GSM standard, text messages use dedicated signalling capacity and are transmitted via signalling system No 7 (SS7).

In addition to end-to-end SMS, the GSM standard distinguishes MO-SMS (*Mobile Originated*) and MT-SMS (*Mobile Terminated*). An MO-SMS designates a text message sent from a mobile to the SMSC (SMS Centre), whereas an MT-SMS designates a text message sent from the SMSC to a mobile phone.

From a technical standpoint, a text messaging service requires one or several dedicated servers to be installed in the network. The SMS server (SMSC) ensures the storage of the text messages in databases, their distribution to destination

mobile handsets (when these are active in the GSM network they belong to), and the processing of the message validity period. The MSC (*Mobile Services Switching Centre*), which is a mobile network switching component shared by all other categories of traffic, is the network transmitter of MO-SMS and the network recipient of MT-SMS.

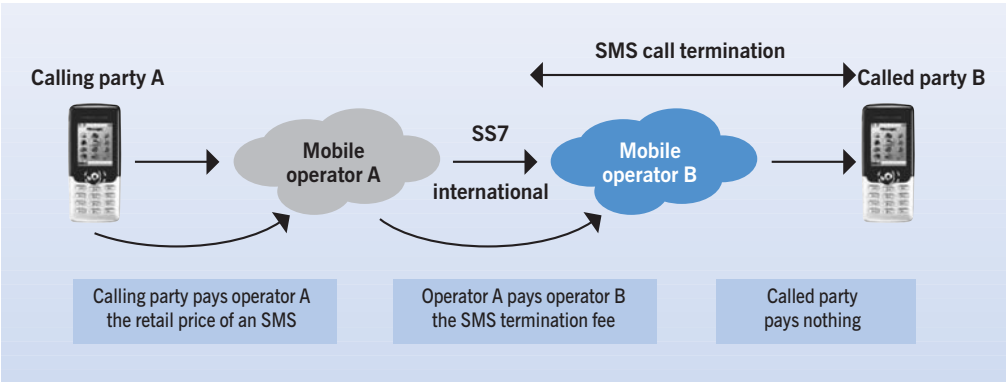
(a) Person-to-person text messaging

The process of sending a person-to-person text message from a French or foreign mobile operator to a third-party mobile operator’s network is governed by an SMS interoperability agreement, which is generally reciprocal. When a text message from operator A is terminated on operator B’s network, the latter is responsible for routing the SMS to its mobile subscriber in the form of an MT-SMS.

Because this involves retail billing mode, the calling-party-pays mechanism prevails: customers are billed only for sending a text message; i.e. they are not charged for receiving it. On the wholesale side of things, mobile operators pay the price of terminating a text message call for messages terminated on third-party networks. Here, the price of terminating an SMS call is the only part of the fee that the calling party’s operator pays to the called party’s operator. On 31 December 2005, this fee was 4.3 eurocents but, since 27 July 2006 – the date of the ARCEP decision regulating this wholesale market<sup>64</sup> – the tariff has been brought down to 3 eurocents for Orange France and SFR and 3.5 eurocents for Bouygues Telecom.

64 - ARCEP Decision  
No 06-0593  
of 27 July 2006.

The process of sending an SMS from an operator to another



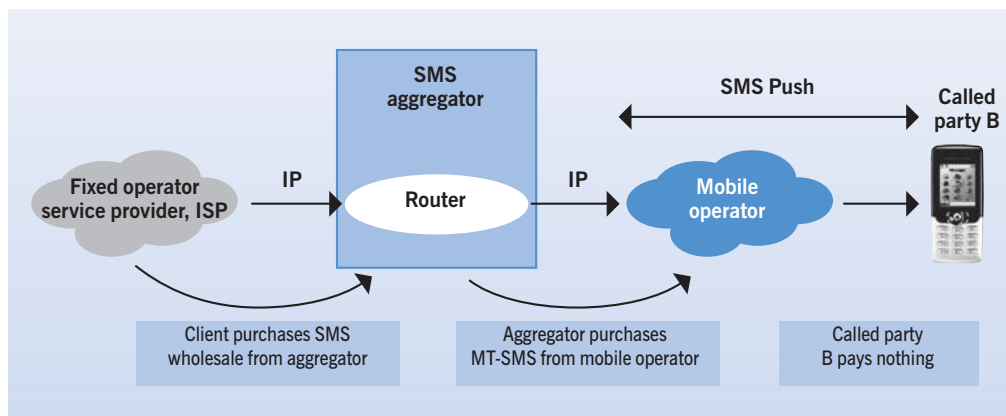
Source: ARCEP.

(b) Aggregators

Aside from mobile operators, other players – notably ISPs and service providers – can use a recipient operator’s MT-SMS services. In this case, an MT-SMS is sent off-line, referred to as “SMS Push”. Although the network architectures differ somewhat, the nature of the exchange is the same as the one described above.

Rather than go through several interfaces (one per destination operator) which have different properties and would thus require certain technical upgrades, these non-mobile players generally call on an aggregator (equivalent to a transit operator for voice calls), which takes care of routing the text messages.

#### The process of sending an SMS via an aggregator



Source: ARCEP.

#### (c) Key figures: context and economic issues

In 2006, there were ten times more text messages exchanged than in the year 2000. Although the rate of increase has gradually diminished over the past three years, as text messaging services reach maturity, the number of exchanged SMS nevertheless rose once again in 2006: this time by 13.4%, to reach a total 14.4 billion.

In 2006, data transport (SMS, MMS, Internet access and multimedia services) accounted for roughly 13% of mobile operators' total revenues (of which SMS/MMS represented two-thirds).

#### Number of person-to-person SMS sent between 2000 and 2006

| Million units                       | 2000  | 2001  | 2002  | 2003  | 2004   | 2005   | 2006   |
|-------------------------------------|-------|-------|-------|-------|--------|--------|--------|
| Number of person-to-person SMS sent | 1,471 | 3,508 | 5,523 | 8,188 | 10,335 | 12,597 | 15,023 |

Source: ARCEP.

In 2006, each mobile phone user sent an average 25 text messages each month<sup>65</sup>. 65 - Source: ARCEP.

#### Number of SMS sent per week

| In millions | 12-17 year olds | 18-24 year olds | 25-39 year olds | 40-59 year olds | 60-69 year olds | > 70 year olds |
|-------------|-----------------|-----------------|-----------------|-----------------|-----------------|----------------|
| 2003        | 19              | 13              | 9               | 5               | 2               | 4              |
| 2004        | 17              | 19              | 9               | 6               | 4               | 2              |
| 2005        | 28              | 20              | 11              | 7               | 4               | 2              |
| 2006        | 31              | 23              | 10              | 6               | 3               | 2              |

Source : "La diffusion des technologies de l'information dans la société française", CREDOC, 2006.

b. ARCEP analysis

(a) Lack of significant price change

66 - ARCEP Decision  
No 06-0593  
of 27 July 2006.

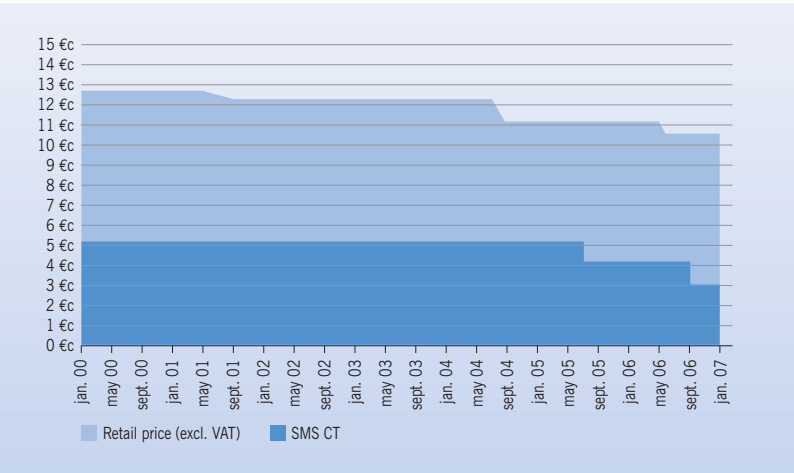
In 2006, the Authority defined the wholesale market for SMS call termination on mobile networks as a relevant market, in the same way as the market for wholesale voice call termination on mobile networks<sup>66</sup>. Among the competition issues identified, ARCEP stressed, in particular, the lack of a significant change in prices.

Back in October 2005, ARCEP became one of the first regulatory authorities in Europe to propose regulation of wholesale SMS call termination prices, in a bid to stimulate competition in the retail market for text messaging.

Between 2000 and 2005, wholesale prices levelled off to a certain degree, as did retail prices. If the volume of SMS being sent has increased sharply over the past few years, the reduction in retail tariffs which began in summer 2004 was slow in coming, limited in scope and confined essentially to SMS flat rates for large volumes.

During 2006, the drop in the average per-unit price of text messages in peak calling times, which began in July 2004, continued, parallel to actions undertaken by the Authority in the market for wholesale SMS call termination.

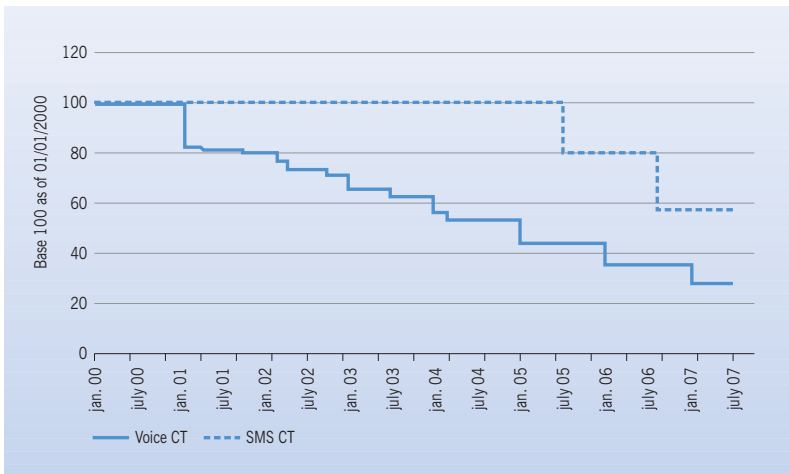
Per-unit price of SMS in peak hours



Source: ARCEP, 2007.

67 - The price dropped from 5.3 eurocents in 1999 to 4.3 eurocents in November 2005, with retroactive application back to 1 July 2005, pursuant to ARCEP Decisions No 05-0929 and 05-0930 concerning two requests for dispute settlement against Orange France and SFR that Bouygues Telecom filed with the Authority.

## Evolution of SMS and voice call termination tariffs



Source: ARCEP, 2006.

### (b) Proposed remedies

To resolve the various competition issues identified in the SMS call termination market, the Authority imposed several obligations on Metropolitan France's three mobile operators<sup>68</sup>:

- ◆ grant all reasonable requests for access and interconnection services relating to SMS call termination;
- ◆ provide SMS call termination services under non-discriminatory conditions;
- ◆ provide SMS call termination services under transparent conditions;
- ◆ perform accounting separation and cost accounting;
- ◆ submit to tariff supervision measures in the form of cost-oriented pricing.

**68 - ARCEP Decision**  
No 06-0593  
of 27 July 2006.

As concerns the last remedy, ARCEP has set the maximum tariff for SMS call termination in Metropolitan France:

- ◆ at 3 € cents per SMS for Orange France and SFR;
- ◆ at 3.5 € cents per SMS for Bouygues Telecom.

Given current uncertainties over subadjacent cost structures, the proposed tariff schedule represents a temporary ceiling.

These obligations will be completed by a cost accounting methodology for SMS CT, which is in the adoption process and which will serve as the basis for establishing regulatory accounts, amending the mobile cost accounting decision which is currently in effect<sup>69</sup>.

**69 - ARCEP Decision**  
No 05-0960  
of 8 December 2005.

Worth noting is the fact that ARCEP has set two years as the maximum length of the validity period for the tariff schedules defined in the decision. At the end of this period, and based on the initial audited cost elements that will be available by autumn 2007 at the latest, the Authority will re-examine the ceiling tariffs, particularly with respect to the difference in call termination tariffs that Bouygues Telecom can charge, and the ceilings set for SFR and Orange France – a temporary advantage given to

Bouygues Telecom – and will specify the terms for the shift of SMS call termination towards a symmetrical price cap.

The repercussions of these decreases in the retail price of SMS will depend, among other things, on the state of competition in the wholesale markets for access and call origination – a market that supplies MVNOs – and so, ultimately, of the intensity of competition in the retail market. As requested by the competition authority (*Conseil de la concurrence*) and the European Commission, ARCEP will be keeping a close eye on the impact that SMS CT tariff decreases have on these two markets.

### c. Situation in Europe

#### (a) European Commission proposal

The wholesale market for SMS call termination on mobile networks is not included in the relevant markets listed by the European Commission in its Recommendation of 11 February 2003.

In accordance with the guidelines of 11 July 2002 on market analysis and SMP assessment, the Authority has thus applied the three criteria used initially by the Commission to establish this list.

Worth noting is that, as part of the review of the EU Regulatory Framework launched on 29 June 2006, the European Commission has proposed that SMS CT be included in the list of markets that could be subject to *ex ante* regulation.

#### (b) Other NRAs

In light of this possible change to the regulatory framework, on 13 September 2006 the British regulator, Ofcom, announced that it had launched a review process for the wholesale market for SMS call termination, which will be conducted over the course of 2007-2008.

Moreover, following work undertaken by the Authority in 2005 and 2006, the Independent Regulators Group (IRG) in 2006 elected to begin monitoring the SMS call termination market on a regular basis. Creating a benchmark for text message call termination and tracking the volume of SMS being sent around Europe have now been formally incorporated into the IRG programme, and are being monitored on a regular basis in the same manner as voice call termination.

Finally, an analysis of the first benchmark elements collected by ARCEP as part of its market analysis has made it possible to reach the following conclusions:

- ◆ SMS call termination appears definitely to be a component of SMS retail pricing and, more specifically, a retail SMS provision cost;
- ◆ the longer the delay in establishing termination rates, the lower they are set. This is particularly the case in some countries that were still practicing bill-and-keep for SMS in 2002 and even in 2003.

## B. The market for access and call origination on mobile networks and mobile virtual network operators

### 1. Retail market trends

With a penetration rate that totalled 81.4% on 31 December 2006, the French mobile market has virtually reached maturity. Aside from the protracted underlying trend of developing unmetered offers, 2006 was marked by the growing prominence of mobile virtual network operators (MVNOs).

Unlike mobile network operators (in Metropolitan France: Orange France, SFR, Bouygues Telecom), MVNOs have no spectrum resources of their own. To provide end customers with a mobile service, they use the radio network owned by a mobile network operator (MNO), referred to as the “host” operator.

Over the course of 2006, six new MVNOs<sup>70</sup> began operating in the mobile market:

- ◆ A-mobile (on the SFR network);
- ◆ Carrefour mobile (on the Orange France network);
- ◆ Coriolis Télécom (on the SFR network);
- ◆ MobiSud (on the SFR network);
- ◆ Ten (on the Orange France network);
- ◆ Virgin Mobile (on the Orange France network)

*70 - As of 1 January 2006, there were six MVNOs (Breizh Mobile, Debitel, Neuf Mobile, NRJ Mobile, Tele2 Mobile, Transatel).*

### 2. State of competition

#### a. Monitoring the market

##### Background

On 14 April 2005, the Authority notified the European Commission and other European regulators (NRAs) of its analysis of the wholesale market for mobile access and mobile call origination (Market 15 of the Commission's Relevant Markets Recommendation – a market in which the service providers are MNOs and the clients are MVNOs). In this document, ARCEP emphasised that the MVNO agreements might not be sufficient to improve the unsatisfactory situation in the retail market. In effect, it seemed that the agreements neither offered MVNOs sufficient and sustainable economic leeway nor allowed them to differentiate themselves except by price. Because the agreements had only recently been implemented and because they could change, the Authority concluded that the competitive situation in the mobile market was too unclear to judge with certainty, especially with respect to the future. As a result, the Authority suspended its analysis of Market 15. It nevertheless continues to monitor the market to be able to assess the true impact of MVNO agreements on the retail market, and committed to notifying a new analysis to the Commission by the end of 2006.

**(a) Monitoring mobile market indicators (SIM)**

To better appreciate how the competitive situation in the market was evolving, particularly in terms of pricing and market share, ARCEP began collecting statistical data by means of a quarterly questionnaire addressed to mobile operators (network operators and MVNOs in Metropolitan France): the *Suivi des Indicateurs Mobiles (SIM)*, which is published on the Authority's website. It includes indicators which make it possible to measure the vitality of market competition. In addition to close monitoring of the respective performance of network operators and virtual operators, the *SIM* aim to quantify a certain number of market characteristics, notably with respect to its fluidity, in other words the propensity of demand to be able to express itself as freely as possible, particularly through the ability to switch operators without being bound by excessive contract periods.

**(b) Measuring market fluidity**

The mobile market indicators measure the portion of customers who are no longer contractually bound to their operator, and thus in a position to switch operators without penalty. As of 31 December 2006, this situation applied to only 24.9% of mobile customers.

Tracking gross sales, both prepaid and post-paid, combined with the monitoring of quarterly cancellation levels, makes it possible to evaluate the vitality of competition in the retail market more precisely than with net sales – as a low level of net sales could indicate either a stagnant market or a healthy market with a high rate of cancellations. Furthermore, monitoring gross market share makes it possible to determine the share of customers subscribing to MVNOs. As of 31 December 2006, the quarterly rate of cancellation for post-paid subscribers totalled 3.8%, compared to 9.4% for prepaid customers.

As concerns MVNOs' customer acquisition performance, in other words their gross sales, the Authority's figures indicate that, as of 31 December, they had a 10.2% share of the post-paid segment, and a 13.6% share of the prepaid segment – which means that close to one in ten mobile subscribers chooses an MVNO offer.

**(c) Scorecard for the European Commission**

In addition, since May 2005 ARCEP has established a scorecard for the mobile market in Metropolitan France, which it transmits every six months to the European Commission. The first scorecard, for the second half of 2005, tracked the changes in the retail market for mobile access and call origination, and provided an analysis of the wholesale terms offered to virtual operators that had joined the market since the suspension of the analysis of Market 15. The second scorecard, which covers the entire first half of 2006, continues to monitor the market and includes an analysis of the wholesale conditions which are shaping the state of competition in this market.

**(d) Market share**

As of 31 December 2006, the market share for the three mobile network operators in Metropolitan France was: 45.11% for Orange France, 34.59% for SFR and 17.51% for Bouygues Telecom. At that time, MVNOs were sharing a customer base of close to 1,400,000 lines, which represents 2.79% of the total national base – up from 1.99% or 953,900 lines on 31 September 2006.



### Mobile operator market share in Metropolitan France as of 31 December 2006

| Metropolitan France | Total market    |              | Prepaid base |              | Post-paid base |              |
|---------------------|-----------------|--------------|--------------|--------------|----------------|--------------|
|                     | Total customers | Market share | Customers    | Market share | Customers      | Market share |
| Orange France       | 22,467,305      | 45.11        | 8,188,190    | 47.74        | 14,279,115     | 43.73        |
| SFR                 | 17,227,540      | 34.59        | 5,864,557    | 34.19        | 11,362,983     | 34.80        |
| Bouygues Telecom    | 8,721,561       | 17.51        | 2,473,745    | 14.42        | 6,247,816      | 19.13        |
| Total MVNO base     | 1,392,093       | 2.79         | 625,730      | 3.65         | 766 363        | 2.35         |
| Total               | 49,808,499      | 100.00       | 17,152,222   | 100.00       | 32,656,277     | 100.00       |

### Growth of MVNO market share in Metropolitan France in 2006

|                                       | Déc. 2005      | Mars 2006      | Juin 2006      | Sept. 2006     | Déc. 2006        |
|---------------------------------------|----------------|----------------|----------------|----------------|------------------|
| <b>MVNO subscriber base</b>           | <b>279,800</b> | <b>425,300</b> | <b>693,800</b> | <b>953,900</b> | <b>1,392,100</b> |
| Net quarterly growth                  | 171,800        | 145,500        | 268,500        | 260,100        | 438,200          |
| Net quarterly growth (%)              | 159.1%         | 52.0%          | 63.1%          | 37.5%          | 45.9%            |
| <b>MVNOs' market share</b>            | <b>0.60%</b>   | <b>0.91%</b>   | <b>1.46%</b>   | <b>1.99%</b>   | <b>2.79%</b>     |
| MVNOs' share of post-paid gross sales | 5.0%           | 5.5%           | 10.8%          | 11.6%          | 10.2%            |
| MVNOs' share of prepaid gross sales   | 3.2%           | 5.0%           | 7.2%           | 6.8%           | 13.6%            |

Source: ARCEP.

#### b. Changes in wholesale agreements signed by MVNOs

In its market analysis, ARCEP expressed the view that the arrival of new entrants could translate into a positive and significant change in the state of market competition, provided that MVNOs, through their access contract (including its daily application) enjoy sufficient leeway to establish a dynamic and autonomous commercial policy over the long term.

This leeway depends a great deal on the initial terms that wholesale operators offer their virtual counterparts. The market analysis performed by ARCEP in 2003, coupled with its examination of subsequent changes made to wholesale agreements, have made it possible to assess the viability of MVNOs in the retail market. In the same vein, the Authority performs a "static" assessment of the terms offered to MVNOs, in other words their ultimate capacity to appeal to consumers in the retail market.

This approach needs to be completed by a dynamic analysis of wholesale agreements. Should they gain more weight in the retail market, MVNOs could eventually enjoy greater negotiating power in the wholesale market for mobile access and call origination. This negotiating power, which equates to the acquisition of countervailing buyer power, would give MVNOs access to better wholesale terms, and so increase their appeal in the retail market.

Qualifying the extent to which the wholesale market is open to competition therefore requires that the initial terms offered by MNOs be assessed using a dynamic analysis to determine their potential for opening up the market. This dynamic reading of the situation becomes all the more necessary given that access contracts are agreements which are qualified as “incomplete” from an economic standpoint, as the terms of their execution depend a great deal on information which is non-existent or undisclosed when the decision was made.

Here, a wholesale market is “open” when mobile virtual network operators are able to express in the wholesale market the weight they have acquired in the retail market. This therefore implies:

- ◆ changing the existing wholesale agreement with the provider, to take into account the weight acquired in the retail market since the wholesale contract was executed;
- ◆ periodic calls for tender, to secure better terms with another wholesale supplier, whether for all purchases or only a fraction of them.

On the other hand, a wholesale market is said to be “closed” when the performances achieved by MVNOs in the retail market have no influence over upstream conditions and all the more so when wholesale market conditions compromise this expression of the weight acquired in the retail market. In other words, the MVNO’s negotiating power is not affected by their performance in the retail market, and remains more or less at the same level as when they signed the initial access agreement.

Here, then, a wholesale market is said to be closed when virtual operators are unable to exercise countervailing buyer power acquired through their retail market performance, either:

- ◆ because they cannot re-negotiate their initial agreements;
- ◆ or because they cannot launch a call for tenders with the goal of securing better terms from other suppliers.

### **c. Postponement of the analysis of the market for access and call origination on mobile networks**

In May 2005, the Authority placed the market for mobile access and call origination (Market 15) under surveillance for a period of 12 to 18 months, and committed to notifying a new draft decision by the end of 2006.

This deadline was postponed, however, due to the interest expressed by several players in obtaining the fourth 3G licence following a public consultation launched on 5 October 2006. The arrival of a new player in the market could go a long way in stimulating competition in the mobile communications market and, in any event, would considerably alter the future legal and economic qualification of the wholesale market. ARCEP therefore proposed to the Commission that notification of this analysis be postponed, while awaiting the results of a call for candidates for the fourth 3G licence. In the meantime, wholesale and retail markets for mobile access and call origination will continued to be monitored.

## C. International roaming

In 2006, the market for wholesale international roaming accounted for a significant portion of the work performed by national regulatory authorities (NRAs) and by ARCEP in particular.

### 1. Current state of affairs

A common position on market definitions and analysis was drafted for the wholesale international roaming market. This document provides European regulators with guidelines for their analysis of Market 17.

#### a. Wholesale market: description and operation

This wholesale service, which NRAs were directed to analyse by the European Commission's Recommendation of 11 February 2003 (Market 17), comprises all electronic communication services (access and call origination for voice, SMS and data) offered by network operators in Member States to operators in other Member States so that customers of the latter group might enjoy continuity of service when travelling abroad. For example, a Spanish operator wishing to allow its customers to make calls while in France (i.e. from a French mobile network) must purchase wholesale international roaming minutes from that French network.

This market has a *de facto* international dimension: wholesale prices in one country necessarily affect retail prices in other countries. The roaming market is thus the result of international interdependence, which provided the impetus for NRAs in the European Economic Area (EEA) to undertake simultaneous data-gathering, and for the preliminary analysis of the European Regulators Group (ERG). Above all, any intervention in this market must be coordinated at the European level, justifying a high level of involvement from the European Commission.

#### b. Retail market: description and operation

Providing international roaming services to end customers consists of providing them with continuity of service while travelling abroad.

The term “roaming out” (referring to “external” or “foreign” roaming) is used to denote these services which are more often than not available to the customer either automatically or by simple activation of the option by sending a request to the home operator. These services are billed as one of the component services in a mobile communication offering (consisting of a package of services). On the whole, however, they are not billed at the same rates as calls placed and received within national boundaries. In particular, post-paid customers pay for their use of roaming-out services in addition to the charge for their flat-rate plans.

Unlike national tariff agreements, under which only the calling party pays for the call, including its termination, it is the roaming customer who pays for the incoming call (over and above the price paid by the calling party) in the case of international roaming. This retail tariff for call reception covers the cost of international transit plus the possible surcharge covering the difference between the cost of national call termination and the cost of terminating the call on the foreign operator's network. Thus, whatever

the called party's location, the cost of their outbound call never exceeds the price of a call to someone in his or her usual geographic area (the same applies to forwarded calls).

## 2. ARCEP actions

ARCEP has completed its analysis of the wholesale market for international roaming, and has proposed remedies. This market analysis was submitted to public consultation that ended on 21 January 2006.

### a. Competition report

The Authority believes that retail prices for roaming are high (more than €1 per minute, incl. VAT) and that this is due to the level of underlying wholesale prices which are very similar to, or even higher than, those seen in the wholesale market in 1999. At that time, traffic was divided among operators in a virtually random fashion. As there was no possibility of price competition, each operator was in a position to employ monopoly pricing. As a result, wholesale tariffs in 1999 were monopoly tariffs that exploited a low user-sensitivity to price. The information available to the Authority indicates that wholesale prices (net of discounts) are more than three to four times higher than their underlying production costs.

### b. ARCEP proposals

In its draft market analysis, ARCEP proposed three courses of action.

71 - Cf. <http://www.arcep.fr/fileadmin/reprise/publications/cpublique/consult-roaming-151205.pdf>.

The first consists of defining remedies in the context of a market analysis<sup>71</sup>. The observed situation of an oligopoly without competition can be qualified as a situation of joint market dominance. In terms of the Community framework, however, this is a new situation since it arises from the widespread practice of maintaining prices that were set before there was a structure for competition, and despite the fact that it has since become possible to direct traffic.

In addition, it has been noted that the GSM Association has shaped the wholesale market to a large degree, a market from which MVNOs in particular are excluded. Moreover, according to the Authority, the establishment of exclusive cross-purchasing rights within alliances or groups of operators contributes to parallel behaviour at the pan-European level, and in any event induces the compartmentalisation of services in each national market. Because of this, such practices could be considered collusive under Community competition law.

Finally, in the absence of any prospect of sector-specific regulation or the application of competition law to this market, the Authority believes that direct regulation by the Community legislature will be necessary – similar to that undertaken for unbundling and cross-border banking services.

### c. Commission's draft regulation

The European Commissioner for Information Society and Media, Ms. Viviane Reding, announced at the ERG (European Regulators Group) meeting in 2006 that a European regulation would be proposed to bring down the price of international roaming calls. During the draft stage, this regulation was submitted to two public consultations; its final draft version was published on 12 July 2006.

The Authority contributed a great deal to the discussions on the Community draft regulation that took place between NRAs within the ERG. Once the Commission proposal was made public, ARCEP was able to lend its expertise to the Ministry of the Economy to help define the French position on the text.

The draft regulation proposed by the European Commission in July 2006<sup>72</sup> seeks to set a ceiling for wholesale and retail international roaming prices. Worth noting is that the Commission has adopted a European Home *Market Approach*: its draft regulation proposes the implementation of wholesale market regulation, but also aims to regulate the prices that are charged to end customers using their mobile phone when travelling abroad.

The European Commission's proposed regulation is due to be debated by the European Parliament and the Council of Ministers in late May/early June 2007. If the text is adopted on the first reading, as predicted, it could come into effect by the second half of 2007.

*72 - Proposal for a European Parliament and Council regulation on roaming on public mobile networks within the Community, and amending Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services, COM(2006) 382 final.*



# Other market analyses completed in 2006

## A. Leased lines

### Definition

Leased lines, also referred to as capacity services, involve an operator providing telecommunications capacity between several network points to a business, a corporation or another operator. There are two types of leased line: “conventional” leased lines based on ETSI (analogue and digital) standards, and capacity services that use alternative interfaces (Ethernet, ATM, etc.).

## 1. The new framework

### a. Market analysis

In October 2006 ARCEP adopted a market analysis decision concerning capacity services<sup>73</sup>, whose provisions include:

- ◆ the publication by France Telecom of a reference offer describing the products sold in the intermediate terminal segment market, the trunk circuit market and the market for undersea cables between the overseas *départements* and Metropolitan France;
- ◆ the implementation of a framework that provides incentives for the incumbent carrier and alternative operators to invest in ultra-broadband networks (fibre to the premises);
- ◆ easing the retail market regulation for leased lines, with removal of the tariff approval mechanism;
- ◆ modalities for supervising the fairness of wholesale and retail market operators' competition practices, particularly in terms of the ability to replicate offers.

This regulatory framework will be reviewed by autumn 2009 at the latest, but could be re-examined sooner should a major change in the market require it.

**73 - ARCEP Decision**  
No 06-0592  
of 26 September 2006.

## b. Implementation

As concerns wholesale markets, on 14 November 2006 France Telecom published the first reference offer for capacity services<sup>74</sup>.

<sup>74</sup> - Cf. <http://www.francetelecom.com/fr/groupe/initiatives/savoirplus/documentation/interconnexion/#N10D1D>.

The Authority has also formed an operator working group devoted to capacity services, along the lines of groups previously set up for the unbundling and bitstream markets. The first multilateral meeting held within this new framework took place on 25 October 2006 – providing an opportunity to discuss a number of operational issues, notably those connected with following France Telecom offers: wholesale Ethernet (CE2O) and transfix links (LA/LPT).

As concerns retail markets, ARCEP called on alternative operators to inform them of any France Telecom offers being marketed to business customers that may cause replication issues from a pricing or technical perspective. The Authority has not yet been required to make any statements on such offers.

## B. Wholesale market for audiovisual broadcasting services

### 1. Market analysis decisions

On 6 April 2006, the Authority completed its analysis of the wholesale market for audiovisual broadcasting services (Market 18)<sup>75</sup>, after having gone through the process of consulting the sector, the audiovisual authority, CSA (*Conseil supérieur de l'audiovisuel*), the competition authority (*Conseil de la concurrence*), the European Commission and NRAs from the other European Union Member States.

<sup>75</sup> - ARCEP Decision No 06-0160 of 6 April 2006 concerning the definition of the relevant wholesale market for terrestrial broadcasting of television programmes, and the designation of the SMP operator in this market; and ARCEP Decision No 06-0161 of 6 April 2006 concerning obligations imposed on TDF due to its designation as the SMP operator in the relevant wholesale market for terrestrial broadcasting of television programmes.

Based on the outcome of its analysis<sup>76</sup>, the Authority deemed it necessary to implement a provision of *ex ante* regulation for the upstream wholesale market that supplies terrestrial broadcasting services, both analogue and digital. All of the suppliers and customers in this market are broadcasters (TDF, Towercast, OneCast, and multiplex operator, CNH, which performs some of its own broadcasting).

The Authority has also designated TDF, the enterprise that owns virtually all of the terrestrial broadcasting infrastructures, as the SMP operator in this market.

In the entire relevant wholesale market, TDF is thus subject to cost accounting and separate accounting obligations, as well as several obligations concerning the market segment of wholesale digital terrestrial broadcasting offers<sup>77</sup>:

<sup>76</sup> - ARCEP Decision No 06-0160 of 6 April 2006.

<sup>77</sup> - ARCEP Decision No 06-0161 of 6 April 2006.

- ◆ the obligation to grant reasonable requests for access;
- ◆ the obligation to provide access under non-discriminatory conditions;
- ◆ the obligation for transparency (publication of a reference offer);
- ◆ the obligation to comply with tariff controls (proscription against excessive and predatory pricing);
- ◆ the obligation to formalise, in the form of agreements, the terms and tariffs applicable to internal TDF services, while awaiting the application of accounting separation obligations.

These market analysis decisions will be in effect up to 1 April 2009. To monitor the state of competition in the market, ARCEP has elected to publish a scorecard for DTT



broadcasting<sup>78</sup> on a regular basis, one of the goals being to measure the impact of regulation on the development of competition in the upstream wholesale market, as well as the impact of upstream wholesale market regulation on the state of competition in the wholesale market that supplies broadcasting offers to multiplexes.

**78** - Cf. ARCEP's website:  
<http://www.arcep.fr/index.php?id=9214&L=0>.

#### Broadcasting market competition (Situation as of 23 March 2007)

| DTT rollout phases | % of alternative sites kept by multiplexes | Alternative broadcasters' market share, in number of broadcast frequencies |
|--------------------|--|--|
| Phase 1            | 5.9  | 15.3   |
| Phase 2            | 6.7  | 21.3   |
| Phase 3            | 5.3  | 16.8   |
| Phase 4            | 6.7  | 19.2   |
| Phases 1 to 4      | 6.1  | 18.0   |

Source: ARCEP.

TDF therefore boasts an 82% share of the DTT broadcasting market.

## 2. Specification of cost accounting and accounting separation obligations imposed on TDF

In its market analysis, ARCEP noted that the possible anti-competitive practices that TDF could engage in could be monitored thanks to cost accounting and accounting separation obligations. The chief goal of these obligations is to make it possible to check that accounting and non-discrimination obligations are being satisfied, and to ensure the lack of abusive cross-subsidies.

The Authority has set itself the task of specifying these obligations and setting the scope of application in a draft decision that is expected to be adopted in 2007.



# Specification of cost accounting and accounting separation obligations

On completion of the analyses of relevant markets performed by the Authority, France Telecom was designated as the SMP operator in several wholesale and retail markets. As a result, certain obligations (notably accounting) were imposed on the incumbent. ARCEP specified a common set of obligations in December 2006<sup>79</sup>, for all of the markets concerned – replacing the accounting obligations imposed under the previous regulatory framework.

*79 - ARCEP Decision  
No 06-1007  
of 7 December 2006.*

This decision was adopted following a series of exchanges with the sector players:

- ◆ working groups comprised of operators and consultants;
- ◆ draft of a document describing the objectives being pursued, and interaction with the sector;
- ◆ draft decision submitted twice to public consultation.

The accounting obligations are broken down into a cost accounting obligation and an accounting separation obligation – when imposed on markets related to access and interconnection, and wholesale markets – and an obligation to maintain accounts for retail market activities and services.

## A. Goal of accounting obligations

One particular feature of the cost accounting and accounting separation obligations is that they underpin or enable verification of other obligations imposed on the SMP operator. The regulatory framework in fact explicitly provides for a link between accounting obligations, price control, transparency, non-discrimination and the prevention of abusive cross-subsidies. They are thus a crucial and structurally fundamental tool for allowing ARCEP to achieve its regulatory objectives.

Cost accounting is particularly critical for enforcing price control obligations. It involves the implementation of a system of accounting and for allocating all of the per service/product costs and revenues, as well as the capital employed by these products and services. As a result, they make it possible to ensure the correlation of the operator's tariffs and expenditures, and so to ensure that the obligation of cost-oriented prices is being met.

Accounting separation, which is based on cost and revenue elements produced by the cost accounting system, consists of isolating certain operator activities – from an accounting standpoint – to be able to check compliance with the non-discrimination obligation imposed during the market analyses, and the absence of abusive cross-subsidies between business areas.

In a more general fashion, accounting obligations contribute to achieving the goal of transparency to the extent that they incorporate (albeit protected to a degree by commercial secrecy) the requirement to publish a set of accounts and related notes.

## B. Obtaining cost-related information

To be able to implement an efficient cost control mechanism, the Authority needs to have access to information on the costs incurred by France Telecom. To achieve this, the decision upholds the incumbent carrier's obligation to maintain a system of cost accounting, and provides for the extraction of more or less targeted reporting statements in three broad areas:

- ◆ To clarify the source of the costs it has incurred, France Telecom must:
  - describe the transition from France Telecom SA social accounting to the cost assessment basis used in its cost accounting system;
  - justify the allocation of its set of costs and specify the methodologies used to determine the way that the costs have been distributed. This last measurement makes it possible to obtain several degrees of cost precision, from the primary service (support or sales, network element, etc.) to the commercial offer or activity.
- ◆ France Telecom must guarantee the overall consistency of cost allocations and provide a structured view of the economics of its business: the enterprise is required to provide the Authority with a global view of cost components, by taking several horizontal approaches (e.g. there is a reporting statement planned which shows transmission cost allocations, according to the technology used: switched network, broadband, leased lines). This type of reporting statement is particularly important to tracking market developments, whether technological

(introduction and development of NGN) or competitive (uneven development of competition depending on network hierarchy).

- ◆ France Telecom must submit targeted elements according to its tariff obligations concerning specific markets or offers (e. g. costs relating to local loop access or interconnection offers).

From a more general perspective, when required to do so by an ARCEP decision, France Telecom must submit its cost statements by taking into account methods for evaluating regulatory costs (e.g. data relating to the cost of the local copper loop must be calculated using “current economic costs”<sup>80</sup>).

**80 - ARCEP Decision**  
No 05-0834  
of 15 December 2005.

## C. Ensuring compliance with the obligation to act in a non-discriminatory fashion in the wholesale market

Accounting separation consists of disregarding the integrated nature of France Telecom by separating the operator’s different business areas from an accounting standpoint, and by requiring that its retail operations make use of the offers produced by its wholesale operations under the same terms as those offered to alternative operators positioned in retail markets<sup>81</sup>.

**81 - See below (accounting mechanism diagram).**

The segmentation of France Telecom activities defined in the ARCEP decision consists, first, of isolating from an accounting standpoint all of the relevant wholesale markets where accounting separation and non-discrimination obligations apply. Also isolated, when applicable, are the accounts for regulated wholesale offers which are subject to an accounting obligation as the result of a market analysis (such is the case for VGAST wholesale line rental<sup>82</sup>). The accounts for relevant retail markets where ARCEP has designated France Telecom as the SMP operator are also isolated, as are the accounts for retail markets where the incumbent does not enjoy significant power but which are based on the supply of wholesale offers which are subject to obligations.

**82 - See above.**

Transactions between accounts, in other words between wholesale and retail activities, are formalised in internal sales protocols which specify which wholesale offers are used to create which France Telecom retail offers. As a result, the protocols contain information on tariff (internal sales prices or transfer prices) and technical (corresponding to offers marketed to third parties) conditions which are applied internally, and which make it possible to verify compliance with the obligation to act in a non-discriminatory fashion in wholesale markets.

## D. Improving transparency with third-parties

The decision provides for an expansion of the range of accounting data that France Telecom provides the sector. The Authority has thus proposed the publication of the elements needed to understand how the incumbent sets its costs, and to ensure that it is meeting its obligations. While respecting commercial secrecy, this involves the publication of:

- ◆ a description of the cost accounting system and the methodologies used for allocating these costs;
- ◆ elements of reconciliation between social accounting and regulatory accounting;

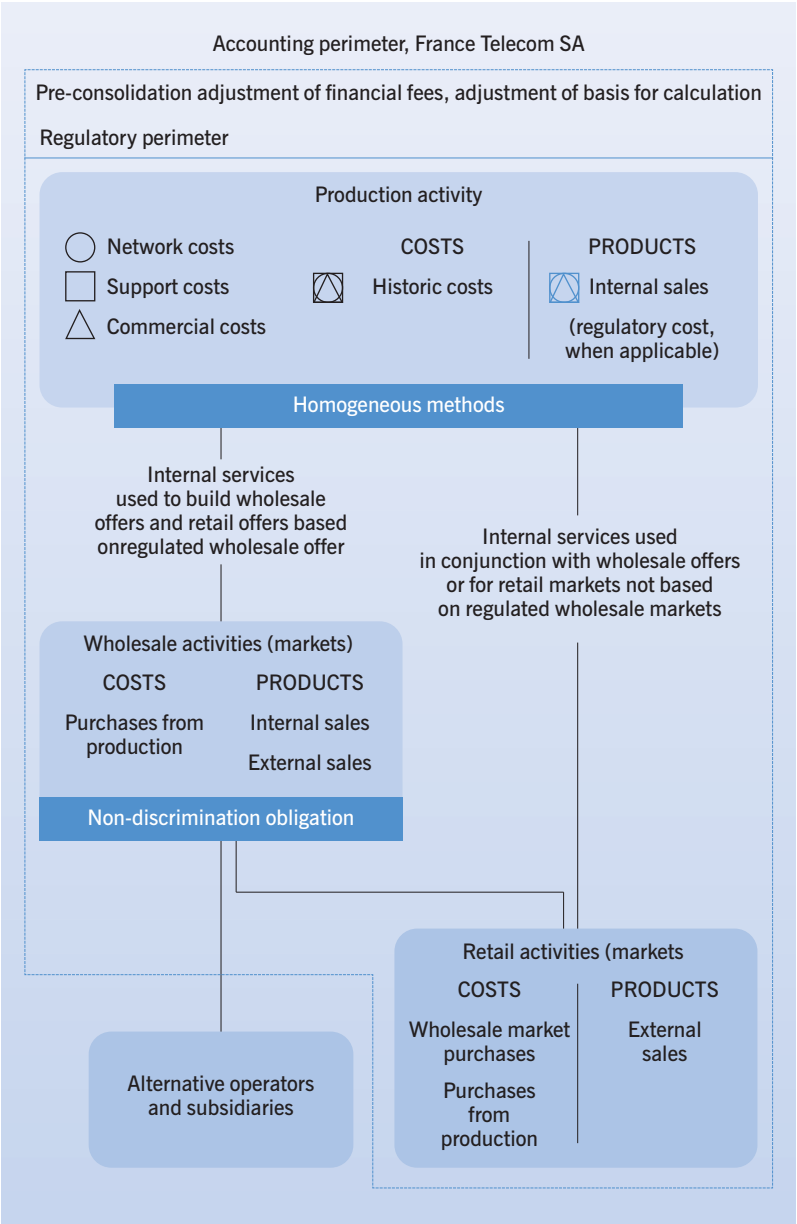
- ◆ a list of the wholesale offers on which retail offers are based (taken from the protocols) and of transfer prices;
- ◆ the results of the separated wholesale market accounts and regulated retail market accounts.

In accordance with the legal provisions, the cost accounting system and the accounting separation mechanism are audited, and the evidence of conformity of the accounts, along with a summary of the results of the audit, are published.

## E. Preparing for lightened retail market regulation

By guaranteeing that France Telecom is complying with its obligations with respect to access and interconnection, and particularly the use of its own wholesale offers in a non-discriminatory fashion, these accounting obligations help create the conditions that will allow the Authority to lift control mechanisms in retail markets. In accordance with the logic instilled by the regulatory framework, effective and efficient regulation of upstream markets should make it possible to resolve competition issues in downstream markets, and to limit the regulator's intervention in these markets.

Diagram of the accounting separation mechanism



Source : ARCEP.

