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ROUNDTABLE ON THE IMPACT OF SUBSTITUTE SERVICE ON REGULATION

---Hungary---

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OECD COMP/WP2 ROUNDTABLE ON THE IMPACT OF SUBSTITUTE SERVICES ON REGULATION OF RAIL AND TELECOMMUNICATION SERVICES

1. The present submission consists of two parts. First, it provides general information concerning rail services. In its second part more detailed answers are submitted concerning the telecommunications services.

1. Rail services

II objectives defined for regulation of transport services by the Hungarian Transport Policy 2003-2015

2. The lately elaborated transport policy defines general regulatory objectives for transport services, and calls for the organic unity of the various transport infrastructure networks as a starting point. The major objectives pursued by the transport policy include the provision of public services and the requirement of efficient operation, together with environmental, quality and safety purposes.

3. For these reasons, in passenger transport mass transport should have priority over individual means, while in freight transport rail, water and combined transport modes are preferred and should be encouraged by regulation.

4. It should be mentioned at the outset that in Hungary – in both passenger and freight transport – rail services face significant competition mainly from road transport services, and other transport modes like water or air transport have less importance for regulators and market actors as well concerning competition and substitution. In fact, the geographical characteristics of Hungary (distances, landscape) and the lack of adequate infrastructure leaves minimized possibilities for inland air transport.

5. The role for regulation and thus the impact of substitute services is far different for passenger and freight transport. Passenger transport services are in principal regulated and the government directly influences the features of the services, while in freight transport regulation takes account of the competitive impact of substitute services indirectly.

1.2 Passenger transport services

6. Rail and road passenger transport services are operated on the basis of public service obligation and are both regulated in detail: tariffs, discounts, schedules, contracting terms and liability, quality and safety requirements etc. are all defined by the regulator.

7. In passenger transport, it is a strategic goal for regulation to divert passenger traffic from road to rail where it is economically more reasonable: having less social costs, rail transport is better placed to provide long-distance passenger transport between major cities (intercity rail links) and urban commuter trains in densely populated areas (especially Budapest), suffering from constant congestion of roads

(scarcity of road capacity). The goal is mainly achieved by price regulation, as regulator keeps the tariffs of rail passenger services lower and state – through the rail fare policy – provides wider discounts for rail passenger tickets and passes (consumer price subsidy). On the other hand, road passenger service providers are to ensure public transport where no rail service is available or economically viable. It means that – in transport policy and regulation – rail and road passenger transport are rather required to complete each other than to compete or substitute. It follows primarily from the requirement of efficient operation (no parallel rail and road transport operator for the same travelling relation). In practice, this theoretically well-founded ‘cooperation’ system does not work without difficulties and several factors seem to undermine the ideas of transport policy. Firstly, for the majority of passenger traffic, price regulation and traffic control measures do not seem to be sufficient incentives to switch from individual to public transport; secondly, the quality of railway infrastructure and the service itself often leaves much to be desired compared with road transport facilities; thirdly, timetables are yet not sufficiently harmonised; and finally, the Hungarian rail and road infrastructure both need completion and improvement, and the parallel construction and development of networks render the aims of regulation less clear for consumers and service providers.

8. The necessity for coordination between rail and road transport applies especially to urban commuter transport – a typical and long-lasting problem of the capital. The Budapest Transport Alliance is intended to introduce a new pass system enabling passengers to switch between operators and the standardization of tariffs and discounts.

9. Passenger traffic of inland waterways (especially the River Danube and Tisza, and Lake Balaton) mostly consists of tourists, but – for the lack of bridges – ferries crossing the mentioned rivers have turned out to be important substitutes of rail and road transport in certain travelling relations. These ferry services are priced by the operator freely, without any regulatory oversight or influence. On the other hand, state provides consumer price subsidy to support the operators and the (captured) consumers, as the ferry service constitutes a public service similar to rail and road passenger services. In practice, the subsidy itself – without price regulation and governmental supervision – does not seem to be effective, thus giving the floor to competition law enforcement.

1.2 Freight transport services

10. Contrary to passenger transport, rail and road freight transport services both operate on a commercial basis, and the regulator is restricted to the application of indirect regulatory measures (e.g. taxes, fees, licensing, control). In accordance with the goals defined by transport policy, regulation aims at promoting and providing incentives for environmentally friendly (non-road) transport modes. Rail transport is especially preferred for long-distance transportation, and has no reasonable substitute when carrying bulk goods. Rail and road transport companies often participate jointly in operating logistic service terminals.

11. The road freight transport – as the major substitute and competitor for rail freight services – is fully privatised, operating as a competitive market with several thousand market actors. Privatisation and the competitive market conditions have contributed to the success of the sector and the changes in freight transport performance and thus the modal market positions: the performance figures of rail freight transport fell back with about 30% in ten years. The intention to arrest or even reverse this modal market situation and the catalysing process of EU accession required the railway regulator to open the rail transport market and establish intra-modal competition. By granting access to new railway undertakings, the whole rail sector is expected to be more efficient and the consumers benefit from the variety of rail services and service providers. The liberalisation gave rise to the need for a rail (market) regulatory body, besides the technical licensing and supervisory competences of the central transport authority.

12. Until now, the Hungarian Competition Authority have experienced no intention from the side of a substitute service provider to enter the rail freight market, or any merger attempt; competition law enforcement focuses on the problems of the rail market entrants.

2. Telecommunications

13. Can you provide a list of regulated services whose regulation has been or is being affected by substitute services? The list above might give you some ideas. But try not to limit yourselves to these examples. In each case, we invite you to answer the following questions:

- a What is the regulated service(s) and what are the substitute service(s)? Are the substitute services only a partial substitute? Or only a substitute for a certain class of end-users? Please explain.

14. In the filed of telecommunications and broadcasting, regulated services in Hungary are more or less the ones which emerge in the Framework Regulation of the European Union. The Act on Electronic Communications and its government decrees contains most of the provisions of the regulation, providing the framework for the law enforcement of the Regulatory Authority (the National Communications Authority, as national regulatory authority, hereinafter NRA) that designates the actual undertakings being concerned by regulation and formulates the actual obligations imposed on these undertakings having significant market power (SMP). Since the NRA also has the task to define relevant services and thus relevant markets that might be subject to regulation, the scale of the services actually regulated might also change as market conditions develop.

15. Beside the act mentioned above, the Act on Radio and Television Broadcasting also contains certain provisions, which regulate certain aspects of the broadcasting and program distribution markets.

16. Postal services are now regulated in a separate act.

17. With regard to the above background, the possible list¹ of regulated electronic communications, broadcasting and postal services is as follows:

Electronic communications services:

- Retail access to public telephone networks at fixed locations and calls² on those networks provided for residential customers;
- Retail access to public telephone networks at fixed locations and calls on those networks provided for business customers;
- Retail provision of leased lines;
- Wholesale call origination in the fixed public telephone networks;
- Wholesale call termination in the fixed public telephone networks;
- Wholesale transit services in the fixed public telephone networks;

¹ All services listed here are not necessarily subject to regulation at the same time, since it depends on the actual measures of the NRA.

² Retail access, the provision of national calls and the provision of international calls form three separate relevant services and thus three separate relevant markets under the regulatory regime.

- Wholesale access to the fixed public telephone networks (local loop unbundling);
- Wholesale access to and call origination in the public mobile telephone networks;
- Wholesale call termination in the public mobile telephone networks;
- International roaming services on public mobile telephone networks provided at the national level;
- Wholesale provision of leased line capacity (transit parts and termination parts);
- Wholesale access to broadband infrastructure;
- Wholesale broadcasting services.

18. Internet access as a separate set of rules.

2.Other broadcasting services

- Retail service of program distribution on cable networks

3.Postal services

19. Universal postal services:

- Postal services relating to the delivery of domestic and international postal consignments up to two kilograms in weight;
- postal services relating to the delivery of parcels within Hungary and from Hungary to abroad up to ten kilograms in weight and from abroad to Hungary up to twenty kilograms in weight;
- Postal services relating to the domestic and international delivery of consignments containing materials written in Braille for the blind, up to seven kilograms in weight;
- Postal money order service within Hungary;
- extra services: acknowledgement of receipt and insurance of value available along with the services specified in points a) to c), registered service in connection with the services specified in points a) to c) and acknowledgement of receipt in connection with the service specified in point d).

20. Regulated PSTN voice services (access to and calls in the public telephone networks at fixed location) are partially or entirely substitutable by several other services. Firstly, they face competition from mobile voice services, above all from prepaid mobile services in the case of residential subscribers to whom accessibility is essential but making calls is less necessary. Mobile voice services can be substitutes for traditional fixed line services in the business segment, as well, since mobile operators provide wireless office services or transfer fixed-to-mobile calls into mobile on-net calls via mobile adapters and supply them at a significantly lower tariff.

21. PSTN voice services face competition from cable telephony too but these latter services are only available in limited parts of the country. We suppose that voice services on CATV networks are a real alternative for residential and SOHO users mainly.

22. Presently, voice-over-IP services provided via the Internet (such as Skype or MSN Messenger) have only a marginal importance yet and in the near future we do not expect a fast expansion as the rate of households equipped with PCs in Hungary is not very high, and moreover, the use of these programs requires a certain talent for informatics.

23. However, other voice services transmitted (partly) over IP-networks are more common especially in the case of international calls such as calling cards (there are several companies providing such services) although we do not have proper information on the usage of these services. We only suppose that the target audience of these operators are residential customers and small and medium sized enterprises which are generating relatively high international voice traffic.

24. Wholesale call origination and termination in fixed telephone networks are only substitutable by another fixed connection such as an optical connection provided by an alternative operator or a cable connection by the CATV operator but the amount of these connections has not reached the critical point to affect the relatively heavy regulation imposed on incumbent telephone operators. Wholesale transit services are not regulated because of the intense competition experienced in this segment.

25. Wholesale mobile termination services are not substitutable due to technical features of the service. On the other hand, the wholesale access to and the origination in mobile networks are not regulated, since the NRA has found that fierce competition at the retail level makes wholesale regulation unnecessary. Though retail access to mobile networks is hardly substitutable by any other service, thus retail mobile telephone services are not regulated anymore. We do not have experience on international roaming service provided at national level, and the NRA has also not finished its market analysis.

26. ADSL services as wholesale broadband services are regulated, because the NRA found that there were no substitutes for them at this stage. At the wholesale level, CATV networks are not obliged to provide access to their infrastructure for Internet Service Providers (ISP), and it is probably justified in Hungary due to the different technical features of a large number of networks and due to scarce capacity, so CATV networks cannot serve as a real substitute. However, at retail level ADSL-Internet services face competition from broadband Internet services provided over CATV infrastructure and partially from broadband Internet services provided over microwave networks. In the case of large enterprises Internet services via leased lines can also function as substitutes for high speed ADSL (so called BDSL) services.

27. On the other hand, leased line services are also regulated as far as the retail level or the termination segment is concerned. In the absence of relevant experience of the Competition Office we could only cite the statements of the NRA. The NRA has not found any real substitutes for these services when carrying out its market analysis that should have established the broadening of the relevant market but it has also added that in the case of the retail segment IP VPN services and Gigabit Ethernet transmission services can serve as substitutes to some extent.

28. Retail Internet access services are not regulated. Wholesale services are regulated in different ways depending on the type of service. Since broadband wholesale services are elaborated above, here we only mention narrow band services. Legislation provides for an obligation on incumbent telephone operators to offer wholesale flat rate Internet access service in territories where broadband access has not yet been launched. In this case regulation clearly supposes that flat rate offers could lead to retail narrow band offers substituting broadband services, what is highly disputable (furthermore, this arrangement is practically not present in the market). Otherwise, certain aspects of the wholesale call origination for

Internet access are regulated, since this origination service can hardly be substituted by other means (though narrow band Internet access provided on fixed public telephone networks at the retail level might be limitedly substituted by mobile Internet services, ISPs cannot provide their services on mobile networks, and microwave services – also a limited substitute – are much more expensive and technically less feasible).

29. Wholesale analogue terrestrial radio and television broadcasting are also regulated services. The NRA's draft measure found that distribution on CATV networks and satellite broadcasting cannot substitute this service for content providers.

30. Other broadcasting-type services include program distribution provided on CATV services, which are regulated by the Act on Radio and Television Broadcasting due to the high penetration of cable in Hungary. This regulation is however focusing on content related concerns, such as the "must carry" obligation to deliver the Hungarian public broadcasters.

31. Digital broadcasting is not yet regulated, since the launch of the terrestrial service is still under preparation, and so is the regulation, but it is to see that it becomes a substitute for several existing services and this fact will affect the content of regulation.

32. The universal postal services mainly between private persons may be partially substituted by other text communications services (SMS, email), but most of the postal items is business-to-consumer letters. These partial substitutes have not affected regulation in any ways.

b What is the purpose or the objectives of the regulation on the regulated services? (For example, is the regulation designed to promote high quality, efficient production, reasonable prices? to ensure a plurality of voices in the media? or to prevent excessive risk-taking by banks?)

33. The objectives and basic principles of the Act C of 2003 on electronic communications are the following:

34. "a) establishment of a reliable and transparent regulatory framework that facilitates the development of the electronic communications infrastructure of the information society and the promotion of services and new technologies related to it, enhancing competition regardless of the technology applied;

35. b) Protection of consumers' interests in their relationship with all players of the electronic communications market, ensuring, in particular, that

36. ba) All communications services be available to consumers required for them to have access to all information and content provided by content providers accessible through means of electronic communications, subject to authorisations;

37. bb) Consumers be able to have a free choice of electronic communications networks, electronic communications service providers (hereinafter: service providers) and services, and be able to decide which network, service provider or service to use;

38. bc) Consumers be able to communicate with other consumers by way of electronic communications irrespective of the fact whether such consumers have a contractual relationship with the same, or other service providers;

39. bd) Consumers be able to choose freely between the service providers and services used, irrespective of the service providers;

40. be) Consumers be able to use electronic communications services under publicly available, defined and equitable terms and conditions disclosed to the public, for the lowest price and at the highest quality;
41. bf) Consumers be able to receive reliable, transparent and up-to-date information concerning the features of electronic communications services and the conditions concerning their use;
42. bg) Consumers be able to have access to high quality protection in their disputes with service providers in order to settle such disputes simply and quickly;
43. c) Provision of universal access to high quality and efficient electronic communications services defined in accordance with the interests of the entire society;
44. d) Greater consideration of the needs of certain social groups, in particular the disabled and low-income users;
45. e) Elimination of factors that distort or restrict competition in the unifying electronic communications market, and enhancement of the further development of efficient competition;
46. f) creation of a legal and economic environment to ensure the freedom, rights, obligations, equal opportunities for and the enforcement of the interests of market players, and granting access to the markets for new market players, as well as counterbalancing – in a differentiated manner – the influence of those with significant market power to the extent necessary for the evolution and maintenance of efficient market competition so that market actors pursue their activities in compliance with the norms of fair play, giving due respect to their competitors' interests;
47. g) Safeguarding the undisturbed and successful operation of the electronic communications market and the interests of those pursuing electronic communications activities and of the user, and maintenance of fair and efficient competition;
48. h) Provision of procedures and services enforcing the principle of equal treatment in the unifying electronic communications markets by supervising the behaviour of organizations and persons pursuing electronic communications activity;
49. i) Facilitating and implementing data protection measures in connection with electronic communications;
50. j) Enforcement of environmental protection measures in respect of electronic communications;
51. k) promoting transfer of cultural, scientific and societal values by appropriate regulation of broadcasting as electronic communications service, in particular to ensure access to the public service radio and television programs, and to specify the basic public-service tasks in connection with the quality and continuity of these services;
52. l) Maintenance of the integrity and safety of the public electronic communications networks;
53. m) Efficient management of radio-frequencies and identifiers;
54. n) Facilitating the use of radio-frequencies free of harmful interference;

55. o) Ensuring free trade of electronic communications services in accordance with the international treaties of the Republic of Hungary and the fulfilment of the international commitments of the Republic of Hungary, including the provision of cross-border services at the lowest possible price;

56. p) integration of the Hungarian electronic communications markets into the unifying electronic communications market of the European Community, with special regard to the establishment and development of trans-European networks, and the promotion of the interoperability of pan-European services and establishing end-to-end connectivity;

57. q) Specifying the basic rules and regulations regarding the duties of the state with respect to electronic communications, with special regard to the safety of, and the dangers jeopardising electronic communications and the order for making preparations for state of emergency, martial law or period of jeopardy (hereinafter jointly referred to as qualified period)."

58. However, the direct purpose of the regulatory intervention in the individual markets is in fact more tangible. The regulation of retail PSTN services aims at ensuring fixed line telephone services in a nation-wide uniform quality and at an affordable price (universal service). The objective of regulating retail leased line services is providing a minimum set of leased lines. The objective of regulation at the wholesale level is to promote entry and – through applying proper costing models – efficient production. Internet access regulation of different levels and of different approaches tries to aim beside reasonable prices also a higher penetration of broadband access to promote the socio-political aim of knowledge-based economy and society. Regulation limiting the maximum of households to be reached by the same CATV operator was originally designed to secure the plurality of opinions in media.

59. The general objectives of Act of CI 2003 on the Post are similar to those of the Act on electronic communications:

- Ensuring the provision of universal access to high quality and efficient postal services;
- The protection of consumers;
- Safeguarding the efficient operation and the development of the postal market,
- Ensuring the integration of the Hungarian postal market with the postal market of the EU.

(i) Which of the objectives of the regulation (if any) are enhanced or promoted by the presence of substitute services? (For example, where regulation is designed to promote high quality, efficient production, or reasonable prices, the presence of competition from substitute services enhances the objectives of the regulation).

60. The degree of fix-mobile substitution contributes to the effectuation of the regulatory objective to promote reasonable prices while the effects of competition from cable TV operators appear in the incumbents' purpose of providing triple play or at least bundled (telephone and broadband Internet) services.

(ii) *Conversely, which of the objectives of the regulation (if any) are undermined by the presence of substitute services? (For example, where regulation imposes an obligation on the regulated incumbent – such as the obligation to fund a non-commercial service – the presence of substitute services which are not subject to the same obligation will undermine the objective of the regulation).*

61. One example might be the strict regulation of universal PSTN services. Since the services provided by the incumbent telephone operator seems to be at least partly substitutable by several other

services (in this regard primarily by mobile operators which could also provide universal services though Hungarian regulation does not allow it, but also by CATV and VoIP operators), the regulatory obligations imposed on it may be too burdensome thus leading to unjustified competitive disadvantage (mainly inefficiencies).

62. Another example might be the overwhelming expansion of the wholesale ADSL access resale arrangement offered by the two largest incumbent telephone operators, which provide a perfect substitute for ISPs to bundle the access product with their own Internet product. This kind of arrangement makes it economically irrational to buy access to the unbundled local loop and so to offer a genuine Internet access product by the ISP. In this way the incumbents can secure their quasi monopoly position at the wholesale market of access to broadband infrastructure.

(c) Has the regulatory regime been modified in some way (or are there calls for future changes to the regulatory regime) to take account of competition from substitute services? What was the nature of these changes in the regulatory regime? For example, were there policy actions to:

(i) Enhance or promote competition from the substitute services? (For example, were steps taken to ensure access to essential facilities, to relax licensing requirements, or to reduce switching costs?)

63. In the first several years after mobile services had been appeared in Hungary prices of both retail and wholesale mobile services were regulated. Later on, these obligations were lifted as competition between mobile operators had reached a certain level, however regulation of fixed line services stayed in force and even got stricter. This kind of asymmetric regulation gave mobile operators greater latitude and hence they could provide new and better services and increase penetration.

(ii) *Prevent competition from substitute services? (For example, were licensing requirements tightened up, were new obligations imposed on the substitute services, or were these services prohibited entirely?)*

No.

(iii) *Ensure a "level playing field" between the regulated services and the substitute services? For example, were regulatory obligations on the regulated services extended to the substitute services? Or were existing regulatory obligations on the regulated services lifted?*

64. We can mention only one example from the past when in order to ensure the introduction of VoIP services and to encourage market entry the NRA defined its technical standards in order to differentiate it from the PSTN voice service so that international calls could have been completed using this technology despite the fact that the incumbent had exclusive rights over the provision of telephone calls using PSTN infrastructure.

65. As far as possible future changes are concerned it might be a future issue whether it is justifiable for the NRA to consider the regulation of CATV network operators capable of providing broadband services at wholesale level and imposing obligations similar to those on fixed telephone network operators providing wholesale broadband access. The reconsideration of substitutability of fix and mobile calls might result at the lifting of the existing price regulation of certain retail telephone services provided at fixed location.

(iv) *Has the presence of substitutes affected specific aspects of the way services are regulated – for example, has the presence of substitutes affected the way that the regulated services are priced (For example, the presence of un-timed voice-over-IP calls might affect the ability to charge a timed rate for PSTN calls; the tariffs for electricity transmission services might affect the way that gas transmission should be regulated and vice versa).*

66. We are not aware of any such effect in regulation. However, it might be worthwhile to mention that no changes were made even if substitution grew more significant. The NRA has now upheld the retail price regulation (practically a price cap regulation) on PSTN access services though growing substitution from the part of mobile services and CATV voice services avoid fixed operators raising the price of access.

(d) Has the presence of substitute services led to a move to reorganise or consolidate regulatory frameworks or regulatory institutions? (For example, the ability to provide “broadcasting” services over a range of different infrastructures has encouraged a movement towards “technology neutral” broadcasting regulation and, at the same time, has led to the consolidation of different regulatory bodies which, historically, had responsibility for different infrastructures).

67. The Hungarian regulation of electronic communication networks and services is based on the common regulatory framework of the European Union for electronic communications networks and services which entered into force in 2002. This new regulatory framework responded to the convergence of the media, telecommunications and information technology. This phenomenon gave ground for a more horizontal approach to regulation of communications infrastructure, because the former separate regulatory frameworks, which had a major impact on the liberalisation of all telecommunications services and networks were likely to be inconsistent with these market developments.

68. The former regulatory framework was not technologically neutral since different rules applied to services provided over different networks, for example mobile and fix networks. The new regulatory framework as far as possible aims not to differentiate between technologies over which communications services are delivered. In this sense technological neutrality means that the legislation defines the objectives to be achieved, and neither imposes nor discriminates in favour of the use of a particular type of technology to achieve these objectives. In order to ensure technological independence the specification of relevant markets on which the existence of SMP had been presumed was removed and the competition law concept of dominant position was introduced as a more appropriate trigger for certain ex ante regulations.

69. As far as postal regulation is concerned, it came into force in 2004 (The Act of CI 2003 on the Post and its executive decrees) and it is compatible with EU regulations (Directive 97/67/EC and 2002/39/EC) and contains provisions on accounting separation, on transparent, non-discriminatory, uniform pricing and discount system of universal service providers, and obligation of access to the network of incumbent service provider. Universal postal services may be provided by the designated universal postal service provider, and by licensed providers, but only the designated one can maintain the exclusive right to provide the reserved services (delivery of postal items up to 100 grams). Services outside the scope of universal services may be provided without individual licence after a general authorisation. So the postal regulation tries to help the entry of other postal operators into postal service market, but the competition from other text communications technologies (fax, email, SMS) does not influence the postal regulation.

(e) Has the presence of substitute services raised issues and concerns for competition law enforcement? Have you sought to prevent mergers between the regulated and the substitute services? (For example, have you sought to prevent mergers between say, electricity and gas transmission or distribution, or between an ADSL provider and a cable television infrastructure provider, or between, say, a rail service provider and a bus company?)

70. The Hungarian Competition Authority has sought to prevent two planned mergers between an incumbent fixed telephone network operator providing among others ADSL services two CATV service providers operating networks parallel with the networks of the fixed telephone network operator. In our analysis we found that CATV infrastructure becomes a real alternative of fixed telephone networks considering either broadband Internet services or voice services. The proposed concentrations could have impeded the development of this competition between infrastructures, so the Competition Council in the

SO expressed its intention not to authorize the merger, in consequence of which the parties withdrew their requests.

71. Has the provider of the regulated services sought to use its position in order to restrict the entry of substitute services (For example, has the regulated incumbent sought to deny access to essential facilities, or to use below-cost pricing to drive out competitors in the substitute services?)

72. We had competition cases on similar matters in the fixed telephony market if we regard carrier pre-selection (CPS) that is insured by regulation as a substitute service. The Hungarian Competition Authority investigated the conduct of an incumbent telephone operator in both the market of retail telephony services provided for business customers and in the market of retail telephony services provided for residential customers. In these cases the investigation found evidence that the incumbent created retail service-packages in such a way that competitors were not able to offer similarly attractive tariffs regarding the price of the wholesale interconnection fee they had to pay for the incumbent for being able to provide their own CPS services (a margin squeeze situation).