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FILE NO. VI A 4 - 171015/1
DATE Bonn, 12 February 2007

SUBJECT Review under Section 1377 of the Omnibus Trade and Competitiveness Act

ENCL - 1 -

Dear Ms. Blue:

On behalf of the Government of the Federal Republic of Germany I hereby respond to the comments you received in connection with the annual review under Section 1377 of the Omnibus Trade and Competitiveness Act.

Before responding to the individual claims, the Federal Government would like to clarify that Germany's telecommunications policy and regulatory framework is fully compliant with the provisions of the World Trade Organization Basic Telecommunications Agreement and Reference Paper. Germany's telecommunications market remains one of the most liberalized markets in the world.

In addition, allow me to respond in greater detail to a number of fundamental claims and criticisms. The enclosed commentary, which makes extensive reference to these claims and criticisms, demonstrates that they relate largely to issues that are both irrelevant to the implementation of the WTO Basic Telecommunication Agreement and are otherwise refutable.

According to the Federal Government there are no grounds for complaint about Germany's regulatory practice where the telecommunications industry is concerned. Accordingly, the review under Section 1377 of the Omnibus Trade and Competitiveness Act should now be discontinued for good.

Page 2 / 2 In this context allow me to suggest that the existing positive bilateral relations between the United States and Germany in the telecommunications sector be extended, in order to facilitate the rapid clarification of any issues that may arise on either side.

To this end I propose holding a video conference, which has proven effective in recent years, with the attendance of experts in order to discuss issues of due importance in sufficient detail.

Sincerely yours

Enclosure

By order

A handwritten signature in black ink, appearing to read 'Reichle', written over the 'By order' text.

Reichle

Director General

for Information and Communication Technology, Media and Posts

Preliminary remarks

First of all reference is made to the document “Achte gemeinsame Marktanalyse zur Telekommunikation” (*Eighth joint telecommunications market analysis*), published in September 2006 by Dialog Consult and the Association of Telecommunications and Value-Added Service Providers „Association of the Providers of Telecommunications and Value-Added Services e.V.“ (VATM), Germany’s largest association of competitors, which provides a general overview of competitive issues in the German telecoms market. The Analysis documents the growth in competitors’ market shares, particularly in the broadband segment. The information provided here speaks for itself and fundamentally refutes COMPTTEL’s across-the-board criticism of the German Federal Government, the Federal Network Agency, and the situation in Germany.

1) Allegation of insufficient broadband regulation

A point to be made above all others is that competitors are already in a position to offer competitive DSL retail products using their own infrastructure, leased subscriber lines, line sharing, and resale. In particular where the leasing of subscriber lines is concerned, which is of crucial importance to infrastructural competition, Germany is a pioneering force in Europe and ahead of other major countries such as the UK and France. Competitors are now also in a position to offer their services via bitstream access.

As competitors have various ways to access broadband and DSL lines this has created very healthy competition in Germany. While competitors’ nationwide market share of switched DSL lines was at around 17% at the end of 2004, by mid 2006 that figure had risen to around 47%. Germany hence ranks third across Europe in terms of competitors’ market share in the DSL segment (cf. Cocom report, 1 July 2006).

More specifically, the following points must be mentioned:

a) Broadband access

The statement that DTAG’s wholesale access to its broadband network has been *de facto* exempt of regulation over the last four years is incorrect.

Further, the statement that there has to date been no access to DTAG's broadband network is also incorrect. Since 1998 there has been unbundled access to subscriber lines subject to cost-oriented rate approval, which competitors have used to provide more than 3.5 million broadband lines so far. In addition, the wholesale product DTAG offers under the name T-ZISP for broadband internet access via its concentrator network is subject to regulation. The main and initially disputed criteria for this access product were defined already in early 2003 during a regulatory order procedure. The rates for T-ZISP are currently subject to approval according to the (strict) criterion of cost of efficient service provision.

Moreover, in May 2006 the Federal Network Agency barred DTAG from billing DSL lines that it provided to ISPs to resell on the retail market according to the DSL NetRental model it had introduced in December 2005. The Agency had concluded that this was a discount-based model enabling major DSL providers to benefit from considerably higher margins when reselling DTAG DSL lines than smaller providers, with no objective reason. In addition, the model was incompatible with the Telecommunications Act's regulatory objective of safeguarding equitable competition nationwide.

In another case the Federal Network Agency reviewed the rates for DSL lines offered by DTAG to ISPs for the purpose of reselling them on the retail market. The case was discontinued without a final decision after DTAG began offering new rates for DSL resale as of 1 June 2006. These involve an increase in the discount on DSL retail prices from 11.5 to 20 percent.

b) Bitstream

IP bitstream:

On balance it must be stated that besides subscriber lines DTAG offers regulated and voluntary broadband backhaul services via which ISPs can and do link up to DTAG's broadband networks. Also, DTAG's DSL resale products were regulated ex post. All of these wholesale products have helped to raise the competitors' share in the German market for retail broadband lines to around 50 percent meanwhile.

On 13 September 2006 the Federal Network Agency issued a regulatory administrative order obliging DTAG to offer competitors, on request, unbundled broadband access

based on internet protocol - also referred to as IP bitstream access. Accordingly, DTAG must grant IP bitstream access in all standard xDSL variants in such a way that competitors are able to establish high-speed connections with individual quality parameters to their end customers. This also applies to bitstream access services based on VDSL technology provided they can be seen as substitutes for existing bitstream access products in these markets. Further, DTAG must offer IP bitstream access on non-discriminatory terms and gain prior approval from the Federal Network Agency for this type of service in accordance with the cost of efficient service provision principle. The EU Commission, to which the decision had been submitted prior to approval, welcomed the measures taken by the Agency. DTAG filed a complaint about the decision of 13 September 2006 with the Administrative Court in Cologne and simultaneously applied for the decision to be suspended (so they would initially not have to comply with the decision). However, as of 9 January 2007 the court had not issued a decision.

On 13 December 2006 DTAG published its standard terms and conditions for IP bitstream access on its extranet and supplied them to the Federal Network Agency. This had been an additional requirement. The Agency subsequently initiated a review of these terms and conditions, in particular to verify whether they complied with the statutory provisions of the Telecommunications Act and the requirements of the regulatory administrative order of 13 September 2006.

ATM bitstream

The regulatory administrative order for ATM bitstream access will be issued shortly. The Federal Network Agency had submitted the draft decision on 12 January 2007 to the EU Commission and the NRAs of the EU Member States. Unlike in the draft consultation the order now assigns the responsibility for granting ATM bitstream access to DTAG.

2) VDSL

The allegation that the Federal Network Agency had defined access to the fiber optic network, which DTAG uses for its VDSL2 product, as part of an ex-ante regulated market is incorrect. Rather, it is as yet undecided whether VDSL is part of Market 12. The market analysis states that bitstream access products based on VDSL infrastructure are

considered part of the market if they can be substituted by existing bitstream access products.

Further, COMPTTEL's allegations concerning the definition of the new market are unfounded. The legal definition of the new market is based on the criteria commonly applied in German competition law, ones that have been developed and confirmed in the course of jurisdiction. In defining the market, the relevant market concept is used without restriction. The allegation that the new market is being defined without respecting the standard criteria is hence unfounded. The crucial factor is and remains the issue of substitutability from a user perspective. Whether or not substitution is possible is determined in each case by the Federal Network Agency. Political aspects do not play a role in any way.

Moreover, the definition is worded neutrally and is just as applicable to investing competitors as it is to DTAG. The quality features such as "reach" and "availability" mentioned in the definition are only examples, not an exhaustive set of characteristics to define the "quality" of a product. The criteria of the relevant market concept may not be applied mechanically; rather, whether or not they are fulfilled must be determined on a case-by-case basis. Whether and if so, to what extent individual or a cluster of features are relevant to substitutability must be assessed in each case by the Federal Network Agency (cf. also the statement of Deutscher Bundestag re. Section 3 No. 12b, BT publication 16/3635, p. 45). There is no indication that DTAG is given preferential treatment.

The amendments to the Telecommunications Act with regard to new markets are worded in close correspondence with the instructions of the EU Commission (cf. Recital 15 of the Commission Recommendation of 11 February 2003 on Relevant Product and Service Markets within the electronic communications sector).

The provisions are intended to ensure that incentives to open up new markets remain in place, from which the economy will benefit accordingly. They do not grant a general "temporary exemption" from regulation to DTAG.

Should there be any danger of a permanent monopoly situation, where competitors were not in the position to enter the “new” market under economically reasonable conditions, the market will have to be opened with immediate effect by means of ex-ante measures. The development of monopolistic structures that bar access to competitors in the long term will not be tolerated, not even for a short while (see also statement by Deutscher Bundestag re. Section 9a, BT publication 16/3635, p. 45).

3) Excessive fixed-to-mobile termination rates and anti-competitive pricing

The allegations raised by COMPTTEL regarding supposed lack of cost orientation, stability, and procedural transparency are unfounded.

Last year the Federal Network Agency brought about a significant drop in mobile termination rates. The rates, approved by the Federal Network Agency in November 2006, of 8.78 euro-cents for D networks and 9.94 euro-cents for E networks, demonstrate that mobile termination rates in Germany are far below the EU25 average of 12.96 euro-cents that was published in the EU Commission’s 11th Implementation Report in 2006. The drop in rates has remedied the competitive distortion between the mobile and fixed line market while creating legal and planning security for all involved parties. In this context the Agency drew on the figures of comparable, efficient European mobile operators. It is this carefully compiled comparison that ensures German fixed line users do not have to pay more than users in low-cost EU states. In addition, it encourages continued healthy competition between mobile operators, with necessary adjustments made in line with comparable cost-oriented regulated “glideslopes”.

The mobile termination rates, which became subject to approval for the first time in 2006, were hence subject to a procedure that represented a continuation of the comparison method already used successfully in previous years in other areas.

Finally, the allegation of intransparency is also unfounded. The rates approval proceedings were accompanied by an active dialogue with market participants, one that began upon publication of the rate approval applications on 13 and 27 September 2006 in the Federal Network Agency’s Official Gazette and on its website. Each proceeding was accompanied by over 20 persons or groups of persons, among them two interest

groups comprising 40 and 50 members, respectively. In each case more than 10 of the persons or groups took the opportunity to make an own statement during the proceeding. The public debates on 27 September and 19 October 2006 were attended by more than 15 representatives. During the proceedings the involved parties were informed in full and continuously about the documentation received from the other parties (with the exception of confidential business documents). Upon conclusion of the proceedings, all involved parties received a copy of the resolutions, excluding any reference to confidential business information.

4) Failure to provide access to local leased lines on reasonable terms and conditions

As part of procedure concerning the preliminary obligation to grant access to leased lines, the Federal Network Agency refrained in May 2005 from imposing such an obligation. This was basically made possible by a voluntary commitment on the part of DTAG to make leased lines available at present conditions until the final regulatory order on leased lines is issued. The concern that there was a lack of legal security is unfounded. On the one hand, a legally unclear situation cannot arise since the present voluntary commitment will be replaced without interruption by the regulatory order. On the other hand, the Agency, by virtue of its official powers, will be able to open new proceedings at any time should the voluntary commitment be violated.

COMPTEL complains that the process of the market analysis is too long on the part of the Federal Network Agency. This, however, is also due mainly to the market players' failure to actively cooperate in providing the relevant data. Reaching a timely and justifiable result in a market analysis decision is only possible if reliable data is promptly delivered by market players. The leased lines markets are an especially good example of this:

The Federal Network Agency has to define separate markets for trunk and terminating segments. However, the vast majority of providers of leased lines stated that they do not offer trunk and terminating segments separately. The other operators stated that while they differentiated between trunk segments and terminating segments, most of them found it difficult to disambiguate the relevant data accordingly. As the answers of the

providers were generally incomplete, the Agency had to ask several times for the data to be completed and disambiguated. In this process, it turned out that the answers given were sometimes also incorrect, as companies gave different versions of the same data. Some companies were not able to provide the necessary data or even a robust estimation even at the end of the process.

The findings of the Federal Network Agency were correct on the basis of the data provided by the market players. As the Commission requested more information during phase II of the consolidation process to examine the Agency's decision further, another questionnaire was sent out to the market players. The relevant questions were extremely complex. Moreover, it turned out that some of the data provided by the market players was incorrect or incomplete (e.g. some products were not included). Against this background, the Agency decided to review its draft and re-analyze the market. Given the short timeframe of phase II, the Agency decided to withdraw the notification and is currently working on a new market analysis which will be notified to the Commission and other NRAs as soon as possible.

5) Lack of independent regulator and transparency

The allegation that Germany's regulatory authority is insufficiently independent is incorrect. Several detailed explanations refuting that claim have been made over the years, to which reference is hereby made.

The fact that the Federal Government continues to hold a stake in DTAG has historical reasons and has no influence on the work of the regulatory authority. The Federal Government continues to make efforts to scale back its stake in DTAG to ultimately zero. At the beginning of last year it reduced its stake yet again; at the end of 2006 it was at 14.8 percent (KfW stake: 16.9 percent).

Further, Section 117 of the Telecommunications Act requires that any instructions from the Federal Ministry of Economics (BMWi) have to be published in the Federal Gazette. No such instructions have been issued by BMWi to the Federal Network Agency so far.

The claim that the activities of the Federal Network Agency are insufficiently transparent is also unfounded. Various reporting and information obligations exist both under the old and the new Telecommunications Act. For instance, since its inception the Agency has been required to publish an Activity Report every two years. Since the new Telecommunications Act came into force the Agency has also been obliged to publish an annual Strategic Plan “listing matters of legal and economic policy to be addressed by the Regulatory Authority in the current year” (cf. Section 122 (2) of the Telecommunications Act; the Plan for 2006 was published in the Gazette in late December and was also put up on the Agency's website). Moreover, the market is informed in advance of any impending relevant issues and is encouraged to play an active role in the regulatory proceedings by submitting statements concerning the Strategic Plan.

Further the Agency's market analysis and market definition procedures on which the Agency's regulatory decisions are based are published in the draft version and interested parties are invited to comment.

Considering the obligation to publish extensively and the fact that the market is invited to voice its opinions, COMPTEL's claim that the Federal Network Agency's activities are intransparent is unfounded.

6) USCIB: Lack of independent regulator / Lack of transparency

As explained using the example of mobile termination rates, the Federal Network Agency creates very extensive transparency with regard to regulatory order, rates approval, and misuse proceedings for all market players. The obligation of the Agency to inform and consult interested parties prior to the issue of a regulatory order is set forth in sections 12 and 13 of the Telecommunications Act.

According to these provisions the Federal Network Agency is obliged to give interested parties an opportunity to make representations, within a reasonable amount of time, on the proposed measures. The consultation procedure and its results are published by the Agency in its Official Gazette and on its website. In addition, public oral proceedings are held that may be attended by all interested parties. For this purpose the Agency set up a Single Information Point that lists all current proceedings (see

www.bundesnetzagentur.de). In terms of coordination at European level, too, there is extensive transparency (see

<http://forum.europa.eu.int/Public/irc/infso/ecctf/home>).

Non-compliance with deadlines in formally initiated misuse proceedings, one of USCIB's complaints, has not been an issue so far. It is hence not clear what exactly USCIB is referring to.

USCIB further complains that the Federal Network Agency publishes only non-confidential versions of its decisions and only partially. However, all non-confidential versions of the relevant market analyses and remedies decisions have been published in full length. Where the non-confidential versions are concerned, the undisclosed parts are solely to protect the companies' business secrets. In response to the Agency's questionnaires for the market analyses, most companies state that the answer must be considered confidential and therefore may not be disclosed. If the companies believe that Agency should publish more of the relevant data in its market analyses, it is up to them to give their answers as non-classified data.

The claim that it was virtually impossible for DTAG's competitors to attend the court proceedings while DTAG was always present and could hence influence the decisions taken by the court is factually incorrect. Moreover, the allegation represents an implicit criticism of decisions taken by independent judicial bodies and in turn, appears to put into question the rule of law in Germany. It is hence unconditionally and severely refuted.

With regard to being called into court, the general provisions of the German Code of Administrative Court Procedure apply. German administrative law naturally provides for the involvement of third parties (here: competitors) in the proceedings. The only requirement is that the decision of the court may touch upon the competitors' legal interests. Under these judicial principles competitors are not always called in to court; but the same goes, of course, also for DTAG. In a court case DTAG does not enjoy any more extensive rights than its competitors and is just as unable to influence court decisions as all other parties.
