

Ringling the changes – The New Approach to Telecommunications Regulation

¹ See, primarily, “Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services” and “Commission Guidelines on market analysis and assessment of significant market power under the Community regulatory framework for electronic communications networks and services”

² See the “Commission Notice on the definition of the relevant market for the purposes of Community competition law”, 1997, (OJ C372)” and “Commission Guidelines on market analysis and assessment of significant market power under the Community regulatory framework for electronic communications networks and services”.

³ There are three main problems. First in a sector in which profound technological changes are continuing there is a danger that any market definition used by the regulators will have been overtaken by events before it can be embedded into the regulatory framework. Second, pre-existing market power can distort market evidence so as to overstate the extent of substitution between products, leading to the identification of overly broad markets (the so-called Cellophane fallacy). Third, historic regulation may have created the impression of a broad market and these regulations might thus cease to be applied in the new regime, and as a result the competition created by the regulation may disappear.

In July of this year a new European regime for the regulation of electronic communications will come into force.¹ It will harmonise the framework to be used for telecommunications regulation throughout the EC, whilst leaving national regulatory authorities (NRAs) free to deal with the different domestic circumstances each faces.

Harmonisation is to be achieved by requiring each NRA to assess the competitiveness of the communications markets for which it is responsible within a framework based on the principles used in general competition law. The perceived advantage of this approach is that it forces each NRA to evaluate systematically the necessity of existing regulation, within an established and common framework. This should reduce the risk that regulation is unnecessarily maintained when its underlying economic rationale no longer exists and also help to ensure that consistent regulatory standards are applied throughout the European Union. However, local discretion will continue to be required due to differences that exist in the extent of existing infrastructures across Member States and in the effectiveness of competition.

This approach appears an attractive one for several reasons. First, competition and regulation both seek to prevent firms with market power from behaving in ways that will impede the emergence of more effective competition in the future, either through their actions (e.g. bundling) or their wilful inaction (e.g. refusal to grant access). Indeed it might be argued that the only substantive difference between regulation and competition law is in the timing of the intervention; regulation anticipates competition problems that are likely to arise (ex ante intervention), whilst competition law responds to problems as they occur (ex post intervention). Second, the NRAs will be able to benefit from a tried and tested analytical framework, already in use within the European Commission, and widely used by many domestic competition authorities. Third, by providing an apparently tightly specified set of analytical rules, the adoption of competition law principles would appear to give NRAs the discretion they need to respond to differences in local circumstances, whilst ensuring consistent treatment of similar situations across jurisdictions.

This Brief considers the new regime, and discusses the issues and factors that NRAs and regulated firms will need to consider in shaping how the discretion of the NRAs is to be used within the new framework.

The New Regime

The process of imposing ex ante regulation begins by defining relevant markets using standard methods of market definition.² This initial step is fraught with problems since the techniques used to define markets in general competition law are most readily applied in the competitive assessment of mergers. Applying these techniques to a technologically fast-moving industry, in which firms are believed already to enjoy significant market power, and in which historic performance has been heavily influenced by the existence of regulation, raises significant conceptual and practical difficulties.³ Fortunately for the NRAs, whilst it is far from clear that the Commission has resolved the profound problems raised by these issues, it has at least issued a set of product market definitions that the NRAs will be able to use as the starting point for their own analysis, so saving them from having to grapple with the most problematic of these issues.⁴ Of course, where the pre-

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The product market definitions to be used by the NRAs are set out in the “Commission Recommendation On Relevant Product and Service Markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services.” C(2003)497. The primary market definition task for the NRAs will therefore be to define the relevant geographic market for the product and service markets identified by the Commission.

defined market definitions presented to the NRAs by the Commission have failed adequately to deal with these issues the market definitions used by the NRAs may be wrong and their analysis is likely to be flawed as a result.

Once the market definition stage of the analysis has been completed the substantive approach under the new regime begins explicitly to differ from the standard competition law approach to abuse of dominance. First, although NRAs will be required to identify a firm with significant market power (SMP) before they are able to impose any ex ante regulation, NRAs will be able to find SMP at significantly lower levels of market share (above 25%) than have traditionally been required to justify a finding of dominance under general competition law.

This immediately begs the question as to why the implicit threshold for intervention is lower for regulators than for competition authorities. If market power sufficient to exploit consumers and distort competition to a significant degree can arise at this level, then this lower level should be adopted by general competition law. Conversely, if significant exploitation and distortion of competition can only occur at the higher level of market power used in general competition law then why is intervention permitted under the new framework at a lower level? If regulation and competition are seeking to secure the same objectives the threshold for intervention should be the same. On the other hand, if regulatory objectives differ significantly from those found in competition policy – so justifying different thresholds for intervention – maybe the entire attempt at unifying the language and analytical approach of the two is misconceived.

Secondly, under general competition law the mere identification of a dominant position is insufficient grounds for intervention. Intervention is justified only when the behaviour of a firm is shown to constitute an abuse.

“Appropriate” and “Proportionate” Measures

There is no stage within the new regulatory regime that corresponds explicitly to the identification of an on-going abuse under general competition law. Under the new regime a finding that a firm has SMP will be sufficient justification for the imposition of regulatory measures. In the absence of an on-going abuse, the challenge for the NRAs will therefore be to identify remedies that are “appropriate and proportionate in relation to the nature of the problem identified”.⁵ However, what is an “appropriate and proportionate” remedy in the absence of an identified on-going abuse?

Even though the NRAs cannot have as an objective the ending of an existing abuse (since no abuse will yet have been committed), NRAs might justify a remedy as “appropriate and proportionate” in two ways. The first of these may be to try to anticipate and impose remedies designed to prevent those abuses that might be committed by the firm were it to be freed from regulation. The second may be to impose remedies that pro-actively encourage the emergence of effective competition in the market in which SMP is held, or in a related market. This second objective goes beyond that of addressing abuses as they are traditionally defined in general competition law, since competition law remedies under Article 82 are generally directed at preventing abuse, not at directly undermining the dominance of the firm involved.

Anticipating Abuse

If the policy objective is to prevent abuse then the NRAs must initially form an expectation of what abuses might occur in the absence of ex ante regulation and shape remedies to address them. For example, in the case of access to fixed telephony networks, an

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Consideration 15 in “Directive 2002/19/EC of 7 March 2002” – OJ L 108/7, 24 April 2002.

obvious potential abuse is the refusal to grant network access to rivals in the supply of fixed telephony services or the granting of access on terms that nevertheless prevent the emergence of competitive outcomes.

In general, a dominant position in a market is likely to confer the ability to abuse in a wide variety of ways. Even where an NRA believes that it has formed a reasonable view of what might be expected in the absence of intervention, it must find a set of measures that can be expected to address adequately the potential abuse, in all of its possible manifestations, whilst ensuring that its intervention remains “proportionate” to the harm that those abuses might cause. For example, the guidelines on access suggest a number of instruments that might be suitable for dealing with possible access-related abuses. These include obligations to grant access, enhanced transparency of terms, non-discrimination obligations, accounting separation, as well as various forms of price regulation. The imposition of remedies designed to deal with every conceivable abuse would lead to such an extensive and prescriptive list of regulatory measures that regulated firms would lose almost all commercial discretion over the running of their businesses.⁶ In this light, it might be sensible to impose ex ante obligations to address the most obvious abuses, or those whose effects may be difficult to remedy ex post, whilst leaving the remedying of the more speculative abuses to ex post intervention. Such an approach would leave firms with SMP with at least some commercial discretion and the freedom to embark on initiatives that may ultimately prove to be pro-competitive in effect.

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It seems likely that the initial starting point for the NRAs will be their existing portfolio of regulations, although if the new regime is to have beneficial effects clearly some NRAs will end up moving from their current position.

Encouraging Effective Competition

Even without a clear expectation of which abuses might occur without intervention, the NRAs could choose to impose measures to encourage or speed up effective competition and so erode the identified position of SMP.

In seeking to impose measures designed to introduce competition, the NRAs will face a crucial trade-off. Measures designed to encourage the emergence of competition at one point in the supply chain may, paradoxically, slow the emergence of competition elsewhere in the chain. For example, in seeking to introduce competition into the supply of fixed line telephony, NRAs must decide whether their priority is to encourage competition at the retail level or in the provision of fixed telephony infrastructure. If access to existing infrastructure is made too easy for entrants, competition in the provision of fixed retail services may flourish, but the possibility of a rival ever creating its own infrastructure is dramatically reduced. Conversely, if access is made too hard there will be stronger incentives to build competing infrastructure, but the pace of service competition will be dictated by whether infrastructural competition materialises and the speed with which it emerges.⁷

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Similar issues arise within infrastructure. If access to a part of the infrastructure is made easy entry to other parts of it will be encouraged, but the prospect of full infrastructure competition will be diminished.

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In order to minimise the risk of different NRAs applying different remedies in similar circumstances the NRAs are required to discuss and co-ordinate their actions through the European Regulators Group for Electronic Communications Networks and Services.

A trade-off between the promotion of competition at different points in the supply chain is inevitable in any intervention of this type. Yet it is preferable that such a trade-off is made explicit and that the choice of strategy for the encouragement of competition is clearly made. Without such an explicit choice it will be impossible to assess which measures are appropriate and proportionate to the meeting of the NRAs specific objectives. It is in making this trade-off that the approach of different NRAs could diverge, leading to more intrusive and onerous measures implemented in some cases (e.g. to promote service competition as a priority) and lesser measures elsewhere (e.g. where the maintenance of incentives to invest is key).⁸

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See UK Monopolies and Mergers Commission, *The Supply of Classified Directory Advertising Services*.

Moreover, clear guidance on this trade-off is unlikely to be found in past competition cases. In some cases competition authorities have signalled that they see no realistic prospect of effective competition emerging at any level in the supply chain and have chosen directly to regulate consumer prices.⁹ In other cases, the authorities have tried

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See *B&I Line plc v Sealink Harbours Ltd and Sealink Stena Ltd (Case IV/34.174) [1992] 5 C.M.L.R. 255*.

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See *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG, CFI, (Case C-7/97)*.

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The liberalisation of the water industry in the UK is a good example of where the introduction of competition into a very limited range of activities at best can generate benefits that are dwarfed by the value-added in the remainder of the supply chain. In the case of water infrastructure this may be inevitable. It is less clear that infrastructural competition in telecommunications is not feasible.

to promote competition in services by requiring infrastructure operators to provide favourable access to downstream competitors.¹⁰ In yet other cases, potential entrants have been denied access to a facility with the express intention of forcing them to compete in the provision of infrastructure as well as services.¹¹

Ultimately, the scope of regulation in the longer term can only be materially reduced if competition is encouraged throughout the greatest possible part of the supply chain. In addition, the gains from the encouragement of competition will be slight if vigorous competition is encouraged in areas in which relatively little value is added, but no incentives are in place for the introduction of competition into those areas in which the bulk of the economic value is created.¹² An approach which is too disrespectful of the property rights of those firms found to have SMP risks leaving too few incentives for investment in the maintenance and improvement of existing infrastructure, too few incentives for investment in competing infrastructure and very little prospect of a long term reduction in regulation.

Conclusions

The idea that regulation should make more use of concepts common in general competition law has some merit. It should force NRAs to evaluate systematically the continued necessity for existing regulation, reducing the risk that redundant regulation is maintained. However, the use of general competition law analysis is much more difficult and speculative when applied in an ex ante setting, and there is a danger that the use of a common analytical framework will create more confusion than consistency if the underlying policy objectives differ as between competition and regulation.

The NRAs will need to anticipate the potential abuses that may be practised by a firm with SMP and impose remedies in contemplation of these abuses. However the scope of potential abuse is likely to be wide and the imposition of ex ante obligations designed to pre-empt all of these could amount to the regulator running the regulated firm's business for it. It may also prevent the regulated firm from engaging in pro-competitive initiatives.

If the ultimate aim is for a reduction in the scope of regulation in communications markets, NRAs will need to make some tough choices to ensure that a significant proportion of the value-added in the supply chain will be subject to effective competition. They must avoid the situation where their interventions result in lower prices for consumers today and a proliferation of downstream competition, but a long term legacy of on-going regulation, with no realistic prospect for the emergence of competition between communication infrastructures. In the interests of promoting long term competition to the greatest extent possible, it may be better in some situations for NRAs and competition authorities to use targeted ex post intervention rather than to err on the side of overly intrusive ex ante regulation.