Market power and market definition
in electronic communications

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CERRE Expert Workshop
21 June 2011
Four steps to impose economic regulation in electronic communication

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<tr>
<th>Step</th>
<th>Description</th>
<th>Criteria</th>
<th>Decision</th>
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<tbody>
<tr>
<td>1. EU screening</td>
<td>3 criteria test SSNIP test</td>
<td>Commission Recommendation</td>
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<td>1bis. National Screening</td>
<td>3 criteria test SSNIP test</td>
<td>Pos. Commission veto</td>
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<td>+ Emerging market</td>
<td>No inappropriate selection</td>
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<td>2. Market analysis</td>
<td>No effective competition = SMP = Dominance</td>
<td>Pos. Commission veto</td>
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<td>3. Remedies</td>
<td>At least one Mainly behavioural Proportionate</td>
<td>Pos. Commission comments Recommendation or Decision</td>
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Three issues to be discussed

- Market definition: principles, practice, difficulties
- SMP assessment: principles, practice, difficulties
- Alignment of sector regulation with competition policy principle
OUTLINE

A. Relevant markets
   - Selection of markets susceptible to ex-ante regulation
   - Product market definition
   - Geographic market definition

B. Significant Market Power assessment
   - Single SMP
   - Collective SMP

C. The risks of alignment

D. Conclusion
1. Market selection

• Article 15(1) of the Framework Directive 2002/21 states that:
  *The [Commission] Recommendation shall identify (...) those product and service markets within the electronic communications sector, the characteristics of which may be such as to justify the imposition of regulatory obligations set out in the Specific Directives*

• Recital 27 of the Framework Directive is a bit more explicit by stating in a generic way that:
  *It is essential that ex ante regulatory obligations should only be imposed where (...) national and Community competition law remedies are not sufficient to address the (competitive) problem*

• Article 2 of the Commission Recommendation 2007/879 on relevant markets: 3 criteria test
1. Market selection

1. Static - Barriers to entry that are high and non-transitory
   - Structural barriers: Absolute cost advantages, substantial economy of scale and/or scope, capacity constraints, high sunk costs, control of infrastructure that is difficult to duplicate
   - Legal or regulatory barriers: Limit access to spectrum, price control which affect entry and positioning on the market

2. Dynamic - Market structure which does not tend towards effective competition within the relevant time horizon
   - Technological developments and convergence
   - Sufficient number of undertakings with diverging cost-structure and facing price elastic demand
   - Excess capacity or no expansion barriers

3. Insufficiency of competition law alone to adequately address the market failure(s) concerned
   - Extensive compliance requirement (monitoring of costs or technical parameters)
   - Frequent and/or timely intervention is indispensable
2. Product market definition: Principles and practice

• A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.

• Two main types of markets
  – First, services to end users (retail)
  – Then, services supplied to undertakings so as to provide retail services (wholesale)

• Five platforms
  – Fixed narrowband
  – Fixed broadband
  – Fixed leased lines
  – Mobile
  – Broadcasting
## 2. Product market definition: Principles and practice

|            | (3/2003) Services local/national for residential  
|            | (4/2003) Services international for residential  
|            | (5/2003) Services local/national for non-residential  
|            | (6/2003) Services international for non-residential  |
| Fixed dedicated lines | (7/2003) Minimum set of leased lines |
## 2. Product market definition: Principles and practice

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<tr>
<th>Category</th>
<th>Market Definition</th>
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<td>Fixed narrowband</td>
<td>- Call origination (all networks) (2/2007)</td>
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<td>- Call termination (each network) (3/2007)</td>
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<td>- Transit (10/2003)</td>
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<td>Fixed broadband</td>
<td>- Unbundled access (4/2007)</td>
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<td>- Wholesale broadband access (5/2007)</td>
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<tr>
<td>Fixed dedicated lines</td>
<td>- Terminating segments of leased lines (6/2007)</td>
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<td>- Trunk segments of leased lines (14/2003)</td>
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<td>Mobile voice</td>
<td>- Access and call origination (all networks) (15/2003)</td>
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<td>- Voice call termination (each network) (7/2007)</td>
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<td>- International roaming (17/2003)</td>
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<td>Broadcasting</td>
<td>- Broadcasting transmission services (18/2003)</td>
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2. Product market definition: Principles and practice

Main criteria used by the Commission in competition cases

- Demand-side substitution (cf. segmentation fixed/mobile)
- Price differentials between products (cf. segmentation fixed/mobile)
- Different payment structures (cf. segmentation cable/satellite television)
- Different product characteristics (cf. segmentation pay-TV and free TV)
- Existence of specific customer groups (cf. segmentation enhanced telecommunications for international corporations)
2. Product market definition: Main difficulties

• Notional wholesale market
  – May be defined when wholesale service is indispensable and there is a demand (Case C-418/01 IMS Health)

• Self-supply
  – For incumbent: should be taken into account
  – For new entrant: may be taken into account unless capacity constrain, limited coverage, difficulty to enter the merchant market (Case T-221/95 Endemol, and Case T-310/03 Schneider Electric)
2. Product market definition: Main difficulties

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<tr>
<th>Demand-side substitution: ISP changes wholesale providers</th>
<th>Direct constraint</th>
<th>Indirect constraint</th>
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<td>Actual (merchant market)</td>
<td>There is a wholesale cable offer</td>
<td>There is no wholesale cable offer</td>
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<td>Potential (notional market)</td>
<td>And the marginal access seeker will switch to that offer</td>
<td>But the marginal access seeker demands such offer</td>
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<td>May include self-supply</td>
<td>Retail DSL price increase such that a sufficient number of retail customers switch to retail cable</td>
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<th>Supply-side substitution: Infrastructure-based operators offer wholesale access to ISP</th>
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<td>Cable will start offering wholesale access in short to medium term</td>
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2. Product market definition: Main difficulties

• Bundled product (e.g. triple or quadruple play offer)
  – Bundle is a market if the individual demand does not constrain the price of the bundle (Case T-201/04 Microsoft)

• Each network may be a market
  – In case of externalities: Calling Party Principle

• Product market may be geographically bound
  – Market by route
  – Market by network or cluster of products
  – Market by type of customers (having different requirements)

• Two-sided markets
  – Both sides should be analysed together
2. Product market definition: Main difficulties

• Basis price to run the SSNIP test (and alleviate the cellophane fallacy)
  – The regulated price is assumed to be the competitive price

• Modified green-field approach
  – Regulation on the analysed market should not be taken into account to alleviate vicious circle,
  – but regulation outside the analysed market should be taken into account
3. Geographic market definition

- The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.

- Main criteria:
  - Area covered by a network
  - Existence of legal and other regulatory instruments that could prevent the cross-border provision of services or networks
  - Characteristics of the viewers and the homogeneity of linguistic areas that cross national borders
3. Geographic market definition

• Most of the markets remain national because
  – Physical characteristics or capacity of a network *(i.e. the area covered by the network)*: no tradable goods
  – Regulatory reasons *(i.e. the area in which operators are authorised to operate or to use share facilities such as spectrum)*
  – National or regional restrictions on the cross-border provision of services at least as far as the control of editorial content is concerned

• However some markets are broader than national
  – E.g. equipment, business services?
  – No transnational market as provided in Art. 15(4) of the Framework Directive
3. Geographic market definition

• Other markets are sub-national
  – Traditional cases: different adjacent historic incumbents
    • UK (2), HU (5), FI (26)
  – New cases with the uneven development of competition within Member State
    • Wholesale broadband access in UK, PT, FI
    • Terminating segment of leased lines in UK and AT
  – BEREC
    • Start with national market (small or national coverage of the entrant, uniform prices, no geo difference)
    • If not, go for geographic segmentation
  – Commission
    • Strict control on regional differentiation

– Less applied in antitrust than in regulation
– Cf. also State aids Guidelines: black, grey and white zones
OUTLINE

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D. Conclusion
1. Single dominant position: Notion

- Dominance is a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers.

- Three type of constraints
  - by actual competitors
  - by expansion of actual competitors and potential entrants
  - by customers
1. Single dominant position: Notion

1. Market position of the dominant undertaking and its competitors
   • Market share (>40%) and stability over time

2. Barriers to entry and expansion
   – Legal (i.e. imposed by the State)
     • Tariff or quotas
   – Structural (i.e. resulting from the market structure)
     • Economies of scale and scope, privileged access to essential inputs or natural resources, important technologies or an established distribution and sales network, network effects
   – Behavioural (i.e. manufactured by the dominant firms)
     • Make significant investments which competitors would have to match, conclude long term contracts with its customers that have appreciable foreclosing effects

3. Countervailing buyer power
   – Customers’ size or their commercial significance for the dominant undertaking, ability to switch quickly to competing suppliers, to promote new entry, or to vertically integrate
1. Single dominant position: Notion

• Main criterion: market share
  – > 60 % : presumption of SMP, save exceptional circumstances
  – < 40 % : presumption of no SMP

• Direct counteracting criteria
  – Sufficient alternative infrastructure (no control of infrastructure no easily duplicated)
  – Low switching cost (alternative provider or self-provision)
  – Sufficiency of wholesale remedies to remove entry barriers

• Corroborating counteracting criteria
  – Falling price and/or prices below the EU average
  – Overall size of operators

• Not very important criteria
  – Vertical integration, potential competition, technological advantage or superiority, privileged access to financial resources
2. Collective dominance: Notion

- A collective dominant position amounts to the case where two or several firms, which remain independent, adapt a common policy and behave as if they were a single entity.

- This parallel behaviour may be due to:
  - structural links between the firms such as agreements,
  - market structure such that firms align their behaviours without any link (pure tacit collusion).
2. Collective dominance: Conditions

Three conditions to prove a collective dominant position

1. Ability and incentive to get to a coordinated outcome (the focal point)

2. Ability and incentive to sustain this coordinated outcome, which implies the possibility:
   - to detect any deviation
   - and to retaliate to such deviation
   *(The incentive constrain)*

3. Absence of actual or potential market constraints that may be exercised by
   - fringe competitors or potential entrants,
   - and countervailing buying power.
# 2. Collective dominance: Criteria

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<td>1. High concentration*</td>
<td>Important</td>
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<td>2. Similar market shares</td>
<td>Important</td>
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<td>3. Low elasticity of demand (market)</td>
<td>Additional, but ambiguous to some extend</td>
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<td>4. High legal or economic barriers to entry and Lack of potential competition</td>
<td>Necessary</td>
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<td>5. Lack of countervailing buyer power</td>
<td>Additional</td>
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<td>6. Vertical integration with collective refusal to supply</td>
<td>Consequence of other factors (focal point)</td>
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**Framework Directive 2002**

<table>
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<tr>
<th>7. Transparency*</th>
<th>Additional</th>
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<tr>
<td>8. Mature market, Lack of technical innovation, mature technology</td>
<td>Necessary</td>
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<td>9. Homogeneous product*</td>
<td>Additional</td>
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<td>10. Various kinds of informal or other links between the undertakings concerned</td>
<td>Important and additional</td>
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<td>11. Similar cost structures</td>
<td>Important</td>
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<td>12. Absence of excess capacity</td>
<td>Ambiguous</td>
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<td>13. Stagnant or moderate growth on the demand side</td>
<td>Additional, but deserves collusion</td>
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<td>14. Retaliatory mechanisms</td>
<td>Consequence of other factors</td>
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<td>15. Lack or reduced scope of price competition</td>
<td>Consequence of other factors additional</td>
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2. Collective dominance: Practice

- 4 cases accepted by the Commission
  - Market 15/2003 IE, but withdrawn in national appeal
    • Refusal wholesale access to MVNO although pen-up demand,
    • retaliation with lower retail price and granting wholesale access,
    • insufficient market constraint by new MNOs
  - Market 15/2003 ES
    • Deficiencies at the retail level: stable and high prices, high profit, parallel strategies
    • Refusal wholesale access to MVNO although pen-up demand,
    • retaliation with lower retail price and granting wholesale access,
    • insufficient market constraint by new MNOs
  - Market 15/2003 MT
  - Market 18/2003 IT

- Two cases withdrawn after the opening of Phase II
  - Market 15/2003 SI (single dominance in the new analysis)
    • No retail rents to be protected
    • One mobile operator was already regulated and the other was not giving access (because of capacity constrains)
  - Market 12/2003 MT (effective competition in the new analysis)
    • No retail rents to be protected
    • No focal point, and countervailing buying power from Broadband Wireless Access
Practice so far

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Practice so far

“One of our concerns with current regulatory reforms is that, beyond the liberalization and free-market rhetoric, one may be creating an environment that will lead to heavy-handed regulatory intervention”
J.J. Laffont and J. Tirole (2000, p. 141)

“In what was ostensibly introduced as a system for organizing the transition from sector regulation to competition policy wherever possible, we have mainly seen the imposition of additional sector specific regulation”
OUTLINE

A. Relevant markets
   - Selection of markets susceptible to ex-ante regulation
   - Product market definition
   - Geographic market definition

B. Significant Market Power assessment
   - Single SMP
   - Collective SMP

C. The risks of alignment

D. Conclusion
# 1. Comparison between legal instruments

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2. Pro and cons of alignment

• Alignment is good as it will make sector regulation would be:
  – More harmonised because antitrust is strongly Europeanised
  – More flexible because antitrust is based on economic principles
  – More legally certain because antitrust is based on more than fifty years of case-law
  – Make easier the transition towards the sole application of competition law

• However competition policy principles are more than a rigorous economic way of looking at the market, they are intrinsically linked to the objectives and the procedures of antitrust law
Therefore, they can not be equally be used for sector regulation without creating distortions
Surely, it can not hide the conflic of objectives behind any industrial policy
2. Pro and cons of alignment

• Thus, alignment has several drawbacks
  – Competition policy methodology is not always applied
    • Comp. Ofcom market 5/2005 analysis (with geographic segmentation) and Carphone Warehouse/Tiscali UK (without geographic segmentation)
  – Competition policy methodology should not always be applied
    • Sector regulation should have a broader and longer term view
    • Can industrial policy be built on specific market analysis review?
  – Spillovers (or fears of) spill-overs between instruments
    • Very high burden of proof for collective SMP maybe explained by a fear of using collective dominance in Art. 102 cases
  – Confusion may lead to distortion in the use of competition policy methodology and creates regulatory uncertainty
2. Pro and cons of alignment

• Alignment is surely not a first-best option

• But what else: bottleneck?
  – The selection criteria should focus on market structure that are not satisfactory from a welfare point of view and that will not self-correct
    Hence, should focus on the cause of market power and on its level
    Should NOT focus on the type a abuses that may be done and the way that have to be remedied
    Should NOT focus on institutional elements
OUTLINE

A. Relevant markets
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Main messages

• The application of competition methodologies in electronic communications raise some particular issues due to the characteristics of the sector
  – Wholesale/retail, self-supply, bundling, two-sided market

• The application of competition methodologies for regulation leads to several difficulties because such methodologies are linked to the objectives and procedure of competition law

• But is there a better alternative?
Thank you

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