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Identifying and Remedying Market Power in Telecommunications

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December 10 2007

The logic behind the process

- Telecommunications markets may require *ex ante* regulation
- This should be confined to markets satisfying particular conditions
- Other markets should not be regulated, except by competition law

Criteria for *ex ante* regulation (1)

For inclusion in the candidate list of markets:

- Persistent barriers to entry and the development of competition
- No prospect of their disappearance
- Competition law cannot deal with it

Criteria for *ex ante* regulation (2)

For applying regulation:

- If a market on the candidate list is to be regulated, significant market power (SMP) must be found; SMP is the same as dominance
- If it is found, a remedy can be imposed

As a result, the system

- Relies on anti-trust concepts for market definition and definition of SMP/dominance.
- Tries to minimize the scope of regulation
- Defaults to competition law as each market becomes effectively competitive

The procedure in detail:

- Market definition: ‘relevant’ markets identified, using anti-trust principles, as candidates for *ex ante* regulation.
- Market analysis: is there (single, joint or vertically leveraged) dominance/SMP in the relevant markets.
- Remedies: if there is SMP, a remedy is selected.

Why not rely entirely on competition law from the start?

- Telecommunications networks exhibit economies of scale and scope which create persistent barriers to entry.
- Competition law does not adequately address the resulting market failures because they require continuous regulatory intervention and monitoring, specialized knowledge and frequent and/or timely intervention.

Defining Markets

Because the process relies on (and defaults to) competition law , markets are defined in accordance with competition law principles in two dimensions:

1. Product /service market, which identifies products regarded as substitutable by user given by
   - Characteristics
   - Price
   - Intended use
2. Geographic market - the area in which competitive conditions are sufficiently similar and different from conditions in neighboring areas

Product/Service Market

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- Two main competitive constraints in product market:
  - Demand Substitution (consumers switching)
  - Supply Substitution (new supply coming on stream)
- The ideal approach is the Hypothetical Monopolist or SSNIP test.

- Second best solution:
  - consumer questionnaires
  - observed behavior
  - etc....

Geographic Market

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- Physical area where the conditions of competition are sufficiently similar
- Options are:
    - National markets
    - Sub-national markets
    - Transnational Markets
- Geographic markets are determined by licensing policy, by regulation and by firm behavior

Finding significant market power (dominance)

The European Legal Standard of Dominance

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

- **Case 27/76, *United Brands v. Commission (1978)***

Dominance can be exercised by a single firm or jointly by two or more firms

Legal Standards of Dominance

Criteria of dominance emerging from case-law and administrative practice:

- Control of infrastructure not easily duplicated
- Technological advantages or superiority
- Absence or low countervailing buying power
- Easy access to capital markets
- Services diversification (e.g. bundled services)
- Economies of scale
- Economies of scope
- Vertical integration
- Highly developed distribution and sales network
- Absence of potential competition
- Barriers to expansion

Source: European Commission Guidelines

What is joint dominance?

- A group of firms is able to adopt a common policy on the market and act to a considerable extent independently of their competitors and customers. This is done through implicit or tacit collusion.
- This is different from explicit agreements made by firms, for example to fix prices or to share markets
- Because the agreement is tacit, there is no communication by speech or writing between the participants. Instead, they signal to one another by their behavior

What are the essential elements of joint dominance ?

•Transparency of behavior (this enables participants to detect departures from the tacit agreement)

•Retaliation (this enables participants to punish departures from the tacit agreement)

•Absence of competition from firms which are not part of the tacit agreement

Leveraged dominance

- Dominance may be present in one market but abused in another related market.
- Vertical leveraging involves using market power in one part of the production process to gain advantage in a downstream market
- An example: An operator may be dominant in the local loop market but be subject to price controls in that market; it can use its dominance to exclude competitors from the retailing activity and make excessive profits there; the dominance in the local loop is leveraged into retailing

Remedies (Countermeasures to SMP)

- These should only be applied in the absence of effective competition
- They should be proportionate and justified by the objectives of regime as a whole
- They should be the minimum necessary to correct the problem and avoid overregulation.
- If possible, they should be applied to wholesale markets
- However, intervention in retail markets may sometimes be necessary

Examples of remedies in wholesale markets based on European experience (1)

1. Transparency
   - May require mandatory public offer for access and interconnection.
2. Non-discrimination
   - This prevents discrimination in favor of particular competitors
   - It can also prevent a firm discriminating in terms of quality and price in favor of it own affiliated businesses and against their competitors

Examples of remedies in wholesale markets based on European experience (2)

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3. Accounting separation
   - This provides profit and loss and balance sheet information about a dominant firm´s separate businesses
   - Helps to prevent cost shifting between monopoly and competitive businesses
   - Can also be used to identify leveraged dominance.

Examples of remedies in wholesale markets based on European experience (3)

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4. Mandatory access
   - This requires the dominant firm to make its facilities available to competitors.
   - There are some parallels with the ´Essential facilities´ doctrine but the application is wider
   - Access will be granted at prices set by the regulator. These can be based on cost, or based on some other principles.

Examples of remedies in **retail** markets based on European experience

Retail price controls

- These may be necessary on competition grounds if competition in wholesale markets is not strong enough
- They may take the form of price caps
- Retail price controls also have social objectives (For example Standard of living classification in Colombia: ESTRATOS)

How to conduct market analyses to minimize regulation

1. Examine each retail market. In the absence of regulation, would there be a competition problem?
2. If no, there is no reason to regulate.
3. If yes, analyze the value chain,
4. Examine the market in the value chain where the assets are hardest to duplicate.
5. If SMP is found in that market, devise a remedy.
6. Is there still a competition problem after the remedy is implemented?
7. If no, there is no reason to regulate further
8. If yes, apply a remedy to another market in the chain
9. Stop when competition problems are resolved

Value chains under examination

Fixed voice

- Termination
- Local loop
- Origination
- Transit
- Retail

Broadband

- Local loop
- Bitstream
- WWW access
- Retail

Mobile

- Termination
- Network Access and Origination
- Retail

How this system has operated in Europe

- 27 countries in Europe are operating this system
- It came in to effect in 2003
- It has recently been reviewed and has been declared a success
- It has encouraged a great deal of competition especially at the retail level
- As a result, regulation is increasingly being focused on bottlenecks
- This is reflected in a fall in the number of markets subject to ex ante regulation from 18 to 7

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