

## Draft joint ERG/EC approach on appropriate remedies in the new regulatory framework

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by

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### INTRODUCTION

I have been requested by the European Telecommunications Network Operators (ETNO) Group to comment on the ERG/ECC draft approach to remedies under the New Regulatory Framework (NRF) for communications. These brief comments are confined to the areas covered and recommendations in the Case Associates' study (Case Study) for ETNO already submitted to the ERG/ECC remedies consultation.<sup>1</sup>

### ERG/EC BASIC APPROACH

The draft ERG/ECC approach adds 4 'basic market constellations', generating '27 generic competition problems' to the EC Commission's 24 predefined markets, and 5 wholesale and several retail market obligations which can be imposed on a SMP operator.

The core of the ERG/ECC approach is behavioural, based on a taxonomy of potential abuses which are matched to one or more ex ante remedies.

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<sup>1</sup> *Remedies under the New EU regulation of the Communications Sector*, June 2002, an independent study for ETNO by Case Associates posted at <http://www.casecon.com/data/pdfs/ETNOfinalreport.pdf>.

## COMMENTS

### General

1. **Fails to address Core Concerns.** The document fails to adequately address many of the core concerns identified by the Case Study. The main recommendations of the Case Study are attached as an Annex for reconsideration by the ERG/ECC working group.
2. **Inadequate Guidance on Remedies.** The document proposes extensive micro-management of SMP operators based on a list of potential abuses drawn from the academic economic literature. It fails to provide practical criteria/guidance on how to determine the likelihood and severity of these potential abuses in practice, nor more importantly criteria for assessing regulatory effectiveness and costs. The danger of the draft's approach is that it may collapse into a 'box ticking' exercise by NRAs based hypothetical competition problems identified in the draft guidelines. For the most part the discussion adds little to the principles already stated in earlier EC directives/documents. **As the Case Study proposed, the remedies' guidelines should require a formal Regulatory Options Assessment (ROA) and contain guidance on how this is to be undertaken. It does not do this.**

### Specific

3. **Serious Gap I – between ex ante and ex post remedies.** No criteria are offered for the selection between *ex ante* and *ex post* remedies. It is claimed that the insufficiency of *ex post* remedies is determined at the market definition stage but the Recommendation does not discuss how this is to be done nor give criteria to determine the insufficiency of competition law relative to *ex ante* remedies.<sup>2</sup> It is also difficult to see how a comparative analysis of different regulatory options can be made at the market definition stage when the competitive abuses have yet to be determined. Even if the ERG/EC approach were accepted, it would indicate that the preferred regulatory approach (competition law) is illogically dismissed at the market definition stage while a subordinate regulatory response is dealt with after the seriousness of actual competitive abuses have (presumably) been fully

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<sup>2</sup> The draft guidelines mention several criteria for selecting *ex ante* regulation (where compliance requirements are extensive, frequent and timely intervention is indispensable, or creating legal certainty is a paramount concern (p. 110)) but these do not amount to an adequate 'test' of the insufficiency of competition law.

analysed.<sup>3</sup> **There is, in my view, a major gap at the heart of the NRF. At a minimum the approach should have set out general criteria to be applied to the selection of both ex ante and ex post remedies.**

4. **Serious Gap II – in systematic treatment of regulatory effectiveness and costs.** The draft contains ad hoc recognition of regulatory error arising from incomplete information, uncertainty about the future market developments, and/or the impact of proposed remedies on key variables – competition, consumer welfare, prices, investment.<sup>4</sup> The draft notes these and warns NRAs to be wary/take them into account. As stated above at point 1, **the draft provides no systematic treatment of these factors which would provide criteria for the selection of individual remedies.**
5. **Unacceptable low evidentiary standards.** Very weak evidentiary requirements are imposed on NRAs – they merely have to identify the theoretical ‘incentive’ to engage in one of the 27 generic competition problems. For example, an operator designated SMP in the provision of access would on my reading of the draft, has a theoretical incentive to engage in 21 of the 27 generic competition concerns. The justification for the ‘incentive to engage’ approach is weak. It is based, in part, on a distinction between Article 82 and the Framework Directive, and the claim that it is not necessary to show an abuse under the NRF. However, the correct comparison is with the EC Merger Regulation (ECMR). Under the CFI’s recent rulings, a forward-looking analysis of dominance (=SMP) must show that a) there is a very real likelihood of a competition problem; and b) spell out how the regulator sees the anticompetitive effect coming about in a realistic manner. The incentive to abuse is insufficient.<sup>5</sup> Also under the NRF, the assessment is not as entirely forward-looking and speculative as claimed in the draft. Ex ante remedies are to be imposed, and mostly continue those of the previous regulatory regime, on a pre-existing situation where there will be a history and evidence of the likelihood of the 27 market abuses. **The failure to set out a clear and defensible evidentiary standard as proposed in the Case Study violates the requirements of sound regulation.**
6. **Shifts focus of NRF from Market Power to Leveraging.** The draft gives an exceptionally high weighting to leveraging which goes well beyond the NRF

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<sup>3</sup> I also note parenthetically that the distinction between ex ante and ex post remedies is largely bogus and misleading. Competition law is an ex ante approach in that if effective it should deter market power abuses. It only enforces when there is an infringement that gives it an ex post character.

<sup>4</sup> It is suggested that in many areas where there is considerable doubt about the facts and the future, ex post remedies are optimal.

<sup>5</sup> Case T-342/99 *Airtours v Commission* (2002); Case T-310/01 *Schneider Electric v Commission* (2002); Case T-5/02 *Tetra Laval BV v Commission* (2002).

directives. It is too accepting of theoretical claims based on abstract economic models, and does not pay enough attention to the empirical analysis and controversy surrounding leveraging. For example, a price squeeze is easy to allege but hard to establish, and has often been rejected by NCAs, courts and NRAs.

7. **High Level Principles Contentious.** The draft outlines five ‘high level principles’ allegedly set out in the NRF (section 3.2). The fifth principle is described as ‘incentive compatible remedies’ which is defined as regulation structured in a way that makes voluntary compliance outweigh the benefits of evasion. This is a new idea which warrants further justification and discussion. To the extent that criminal or civil penalties are proposed/endorsed by the draft, they greatly extend the NRF and would seem inappropriate in such guidelines. Notwithstanding this, it is a prime example of Gap I (noted in point 3 above) inherent in the NRF e.g. EC competition law is an incentive compatible regime because the parties can obtain compensatory damages for violation of exactly the same rules triggering ex ante remedies.
8. **Unacceptable Suggestions of Entry Assistance & Mandatory Access Regime.** The draft appears (at times) to suggest that the NRF sets out a mandatory access regime for SMP operators, and comes close at times to recommending entry assistance policies. Both interpretations are inconsistent with the NRF. They also do not sit well with best practice among NRAs. NRAs have frequently refused to mandate access when they believe they would encourage ‘business stealing’ without any appreciable consumer benefits, or have concerns that investment will be deterred.
9. **Confusion over SMP and FMA.** The suggestion that First Mover Advantages (FMA) is equivalent to SMP is rejected (p. 13).
10. **Loose Language needs to be dealt with.** Statements are sometimes made which appear incorrect, loose and/or controversial interpretations of the NRF e.g. that the ‘declared goal’ is to limit regulation to areas of essential facility/natural monopoly<sup>6</sup>; that predation requires evidence of entry deterrence and recoupment under EC law; that the Access Directive effectively mandates access where there is SMP.

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<sup>6</sup> e.g. ‘the declared goal of the NRF is to promote self-sustaining competition and to limit regulation to this parts of the market where the replication of the incumbent’s assets is infeasible or economically undesirable.’

## CONCLUSION

The ERG/ECC draft focus on potential competitive abuses and seeks to match remedies to these. It is short on practical guidelines which will assist NRAs to structure their analysis in a reasoned, proportionate and transparent way based on factual analysis. Indeed, it offers NRAs the possibility of adopting speculative grounds for specific ex ante regulation, while at the same time leaving ex post remedies and the private enforcement out of the calculus. What is most worrying is that in elaborating the potential ‘abuses’, it has shifted the NRF’s centre of gravity away from market power to leveraging, and in the direction of what appears to be a mandatory access regime.

## ANNEX

### Case Study recommendations:

#### General

1. require that regulatory costs and error costs be taken into account when imposing appropriate *ex ante* obligations;
2. modify the *SMP Guidelines* requirement that one or more obligations be imposed to reflect the *Framework Directive*'s requirement that only “*appropriate obligations*” be imposed. Specifically spell out and develop the concept of forbearance, which would allow NRAs not to impose *ex ante* obligations on SMP operators where they are likely either not to reduce social costs and to significantly increase social costs;<sup>7</sup>
3. require all proposals for *ex ante* obligations to be accompanied by a Regulatory Options Assessment (ROA);
4. set out criteria and tests to guide the choice between competition law and *ex ante* obligations; and
5. set out an evidentiary standard for NRAs equivalent to that applied under the EC Merger Regulation.

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<sup>7</sup> The *SMP Guidelines* (para. 114) state that at least one obligation must be applied whereas the directives refer to ‘appropriate obligations’ only. The Recommendation (para. 20) appears to state that *ex ante* obligations may not be necessary even in the markets it has pre-defined. EC Commission COMP officials have furthered muddied the waters; in a recent speech in Washington D.C. (20 May 2002) the following interpretation of para 114 of the *SMP Guidelines* was offered:

*A question is whether the NRA might merely designate an undertaking as having SMP on a given market, without imposing - for the time being - any compelling regulatory obligations. Can this be considered as an appropriate remedy in the sense of the Directive? The fact that the initial drafting - i.e. obliging NRAs to impose one or more obligations on operators with SMP was changed - appears to support the argument that it was the Council's and Parliament's intention that NRAs should have the discretion not to impose obligations on SMP designated undertakings where that would be appropriate. This interpretation finds support in recital 27 of the Framework Directive which envisages ex-ante measures only when competition law remedies are insufficient. Given that for example one of the ex-ante obligations listed in the access directive is non-discrimination (Article 10), one could indeed imagine that if an NRA would deem this remedy the appropriate one to tackle the absence of competition in the relevant market, they would decide not to duplicate the existing non-discrimination obligation under competition law.*

## Access

1. access obligations should only be imposed if it can be established that an operator's refusal to supply access is unreasonable and anticompetitive, or likely to prevent an equally or more efficient service provider from entering the relevant downstream market;
2. NRAs must provide evidence that mandating access or a specific *ex ante* obligation leads to: a) appreciable consumer benefits in the form of greater price competition and choice; and b) no offsetting costs in the form of reduced investment and innovation, both by the SMP operators and present and future alternative competitive facilities;
3. NRAs should provide a clear statement of the factors which must be considered when mandating access and, in particular, different forms of access, i.e. whether stimulating direct infrastructure competition, or competition via LLU, or wholesale bundled access; and
4. NRAs should offer clear guidance on the factors to be taken into account when selecting access price controls.

## Price Squeeze

1. set out clearly the conditions for an effective price squeeze;
2. set out the cost concepts to be taken into account in applying the imputation test;
3. establish a general presumption that price squeezes should be left to *ex post* competition law unless there is evidence that the practice is persistent.