



EE&MC COMMENTS¹

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

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General remarks:

- One of the main characteristics of the new regulatory package is that it is in accordance with the principles in competition law.² It is rare that this approach is not applied in the ERG/EC document. Most of the economic aspects discussed have been elaborated in the case law of the European Communities already. The ERG/EC document would benefit from an

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2 Article 15(1) Framework Directive states that the guidelines for market analysis and the assessment of significant market power shall be in accordance with the principles of competition law. See Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108 , 24.4.2002. This approach is confirmed by the SMP Guidelines in Paragraph 24 which states that under the regulatory framework, markets will be defined and SMP will be assessed using the same methodologies as competition law. Paragraph 70 of the SMP guidelines adds that, in applying the new definition of SMP, NRAs will have to ensure that their decisions are in accordance with the Commission's practice and the relevant jurisprudence of the Court of Justice and the Court of First Instance on dominance. This is in particular true for the finding of dominance in the case of leveraging of market power to neighbouring markets.

illustration of the appropriate legal concepts e.g. on predatory pricing, cross-subsidisation, etc.

- The ERG/EC document is on some points confusing. The main critique in this context is the extensive discussion of vertical and horizontal leveraging and in particular the conclusions derived from this discussion. It should be noted that leverage is a concept related to dominance and is dealt within the market analyses section.

Discussion on remedies with no link to competition law principles

The approach to take into account competition law principles has been applied by the Commission both in its market definition exercise as well as in the assessment of SMP by means of a market analysis. There is a clear commitment that the methodology on market definition has been applied in accordance with the principles of competition law as explained in the Commission's Notice on Market Definition.³ Regarding market analysis, the SMP guidelines refer explicitly to the competition law concept of dominance. "The new framework has aligned the definition of SMP with the Courts definition of dominance within the meaning of Article 82 of the Treaty."⁴ In addition, the SMP guidelines discuss in a very comprehensive way most recent EC competition law developments. That is why it is quite astonishing that the ERG/EC document is not applying this approach. To recall some of the objectives agreed in the new regulatory package we elaborate in the following some of the guiding principles.

Guiding principle: Remedies in SMP markets only

Recital 27 of the Framework Directive confirms that ex ante regulatory obligations (with respect to electronic communications networks and services) should only be imposed where there is not effective competition, i.e. in markets where there are one or more undertakings with significant market power, within the meaning of Article 14 of that Directive, and where national and Community competition law remedies are not sufficient to address the problem. The notion of

³ Commission Recommendation, point 3.1

⁴ Paragraph 70, SMP guidelines

effective competition means that there is no undertaking with dominance on the relevant market.⁵ If a NRA finds that a relevant market is subject to effective competition it is not allowed to impose obligations on any operator on that relevant market under Article 16.⁶ Therefore, the ERG/EC document should focus on the imposition, maintenance, amendment or withdrawal, as appropriate, of specific regulatory obligations on undertakings designated as having SMP. For the completeness it should be noted that the SMP guidelines also describe the circumstances in which similar obligations than those that can be imposed on SMP operators may, exceptionally, be imposed on undertakings who have not been designated as having SMP. Those cases are clearly identified and are listed in Article 8(3) of the Access Directive.⁷ Therefore, we do not see the need to

⁵ Paragraph 112, SMP guidelines

⁶ Paragraphs 2 to 4 Article 16 Framework Directive reads as follows:

2. Where a national regulatory authority is required under Articles 16, 17, 18 or 19 of Directive 2002/22/EC (Universal Service Directive), or Articles 7 or 8 of Directive 2002/19/EC (Access Directive) to determine whether to impose, maintain, amend or withdraw obligations on undertakings, it shall determine on the basis of its market analysis referred to in paragraph 1 of this Article whether a relevant market is effectively competitive.

3. Where a national regulatory authority concludes that the market is effectively competitive, it shall not impose or maintain any of the specific regulatory obligations referred to in paragraph 2 of this Article. In cases where sector specific regulatory obligations already exist, it shall withdraw such obligations placed on undertakings in that relevant market. An appropriate period of notice shall be given to parties affected by such a withdrawal of obligations.

4. Where a national regulatory authority determines that a relevant market is not effectively competitive, it shall identify undertakings with significant market power on that market in accordance with Article 14 and the national regulatory authority shall on such undertakings impose appropriate specific regulatory obligations referred to in paragraph 2 of this Article or maintain or amend such obligations where they already exist.

⁷ These are – obligations covering *inter alia* access to conditional access systems, obligations to interconnect to ensure end-to-end interoperability, and access to

elaborate in an extensive way the conduct a SMP company might/may have in a Non-SMP market.

Guiding principle: Concept of leverage is part of market analysis/SMP designation

Article 14 (3) of the Framework Directive reads as follows "Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking." This means that the conclusion whether an undertaking can leverage market power from one market to a close related market is part of the assessment whether undertakings have significant market power. The SMP guidelines elaborate in paragraph 84 that an NRA may consider it appropriate to find that such operator has SMP on both markets taken together. The guidelines continue by stating that, in practice, if an undertaking has been designated as having SMP on an upstream wholesale or access market, NRAs will normally be in a position to prevent any likely spill-over or leverage

application program interfaces and electronic programme guides to ensure accessibility to specified digital TV and radio broadcasting services (Article 5(1), 5(2) and 6 of the access Directive), — obligations that NRAs may impose for co-location where rules relating to environmental protection, health, security or town and country planning deprive other undertakings of viable alternatives to co-location (Article 12 of the framework Directive), — obligations for accounting separation on undertakings providing electronic communications services who enjoy special or exclusive rights in other sectors (Article 13 of the framework Directive), — obligations relating to commitments made by an undertaking in the course of a competitive or comparative selection procedure for a right of use of radio frequency (Condition B7 of the Annex to the authorisation Directive, applied via Article 6(1) of that Directive), — obligations to handle calls to subscribers using specific numbering resources and obligations necessary for the implementation of number portability (Articles 27, 28 and 30 of the universal service Directive), — obligations based on the relevant provisions of the data protection Directive, and — obligations to be imposed on non-SMP operators in order to comply with the Community's international commitments.

effects downstream into the retail or services markets by imposing on that undertaking any of the obligations provided for in the Access Directive which may be appropriate to avoid such effects. Therefore, it is only where the imposition of ex-ante obligations on an undertaking which is dominant in the (access) upstream market would not result in effective competition on the (retail) downstream market that NRAs should examine whether Article 14(3) Framework Directive may apply. Footnote 92 of the SMP guidelines elaborates further that "Article 14(3) of the Framework Directive is not intended to apply in relation to market power leveraged from a 'regulated' market into an emerging, 'non-regulated' market. In such cases, any abusive conduct in the 'emerging' market would normally be dealt with under Article 82 of the EC Treaty." The ERG/EC document gives the impression to cease from the perspective expressed in the SMP guidelines. We recommend that it is made clear in the ERG/EC document that this is not the intention.

For the completeness, we would like to note that the legal concept of leveraging is not clearly established yet either. Like other demanding competition law issues, the concept of leveraging is currently under review at the European Court of Justice. The reason for this review is that the current legal standard is a very demanding one. The Commission itself has doubts whether they really can apply the legal standard on leveraging as identified by the Court of First Instance.⁸ In this respect, it is critical that the ERG/EC document refers to the concept of leveraging in such an extensive way. The ERG/EC document would benefit from a more thorough discussion. This in particular true because the SMP guidelines were issued in July 2002 whereas one of the leading cases, the Tetra Laval/Commission case, was decided in October 2002.

⁸ The CFI required the Commission to consider the extent to which the incentives of a merged entity to leverage its market power from one market (e.g. carton) into a neighboring market (e.g. plastic) may be reduced, or even eliminated, given that such conduct may be illegal under Community or national law. The Commission believes that this requirement is impossible to meet in practice. See EC Press Release, Commission appeals CFI ruling on Tetra Laval/Sidel to the European Court of Justice [DN: IP/02/1952,Date:20/12/2002](#)

Tetra/Laval judgement

The use of the concept of leveraging is in principle fine. However, the approach has to be applied with carefulness and in line with the legal principles developed by the EC Courts. The Commission for example failed to prove the leverage of market power in the Tetra/Laval case.⁹ The Court of First Instance (CFI) annulled the Commission's decision because of lack of evidence on Tetra's ability to harm competition mainly through exploiting its market power in a neighbouring market. In this case, the Commission alleged a type of leveraging that could be achieved through tying (or bundling) products together and using "pressure" and "incentives" such as predatory pricing, price wars and loyalty rebates.¹⁰ According to the Commission it was sufficient that Tetra Laval had in principle the possibility of leveraging.¹¹ Furthermore, the Commission stated that on the wholesale level, the merged entity Tetra/Sidel would have a clear technological advantage over their competitors including a viable barrier technology. In its judgment, the CFI concluded that the Commission did not provide sufficiently convincing evidence in its examination of the potential leveraging methods. The CFI stated that the Commission had to demonstrate that there is an economic incentive for the parties to engage in leverage practices. In its judgment, the CFI identified criteria which have to be applied to prove horizontal leveraging¹²: (1) It must be held that the incumbent would create a horizontal overlap between the activities of the different markets.¹³ (2) It must be shown that there is a significant negative effect on competition in the market for barrier technologies, enhancing the merged entity's position to the extent that a dominant position would be created. On the other hand, negative vertical effects could occur,

⁹ Judgments of the Court of First Instance in Case T-5/02 and Case T-80/02, Tetra Laval BV v Commission, 25.10.2002

¹⁰ EC Commission decision Tetra/Sidel, Case No COMP/M.2416, recital 364

¹¹ Ibid, Recital 330.

¹² CFI Judgment, Recital 127.

¹³ The existence of significant, horizontal effects on competition could be ruled out by a dynamic analysis of market shares, including an analysis of new rivals entering the market.

according to the CFI, when a highly integrated company leverages its position on a vertically integrated market in order to be able to offer integrated products/services. Hence, the level of vertical integration and its influence of the production chain needs to be analysed.

Lessons learned from this judgement for the telecommunication sector should be that it would be wrong and misleading to focus too much in an abstract way on the leverage effect. Since the economic incentives to leverage have to be proved extensively in fact a case-by-case analysis is required. If a general catalogue is applied, like in the ERG/EC document, there is a high risk of biased analyses with the consequence of not imposing proportionate and appropriate remedies.

Market failures and competition problems

Ex-ante regulatory obligations should only be imposed where national and Community competition law remedies are not sufficient to address the problem.¹⁴ It is in particular an appropriate complement to competition law in circumstances where the application of competition law do not adequately address the market failures concerned. In this context, the focus is clearly on market failures. In its document the ERG defines on page 24 a competition problem as any practice of the incumbent which is aimed either at driving competitors out of the market (or prevent them from entering the market) or at exploiting consumers. According to our view, this quote is too general to provide proper guidance for the NRAs. In practice, competition problems can only be identified on a case-by-case basis. This means that depending on the actual circumstances of the case in the same market different competition problems can be identified. That is why in our opinion a classification of the competition problems – the paper mentions 27 - includes the risk to guide public intervention in an improper direction. According to our view, obligations must be appropriate and be based on the nature of the problem identified on a case-by-case basis in order to be proportionate and

¹⁴ Framework Directive, Recital 27.

justified in the light of the objectives laid down in the Framework Directive.¹⁵ Therefore we strongly recommend to avoid a general classification of competition problems.

Clarification of competition issues

The ERG/EC document continues to identify three issues that arise for the regulator:

1. First, the dominant undertaking may attempt to transfer (leverage) its market power to an adjacent vertically or horizontally related market;
2. Second, the undertaking may engage in practices to defend its SMP market;
3. and finally it might engage in what might be called 'textbook monopoly behaviour', such as excessive pricing, the provision of low quality, and inefficient production.

All those three aspects relate to clearly defined legal concepts (leveraging and abuse) which could be elaborated in a more extensive way in this document. Instead, common assumptions are used to illustrate competition concerns. Further clarification is recommended.

Selection of market constellations

The document stresses the importance of entry barriers. The conclusion drawn is that a lack of effective competition and the existence of significant market power in electronic communications markets tend to be linked to structural and legal/regulatory entry barriers. There is no evidence provided which supports that conclusion. However, the authors of this text part use this argument to focus their whole assessment on four basic market constellations where standard competition problems can be identified. Those constellations are: 1. vertical

15 COMMISSION RECOMMENDATION, of 11 February 2003 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, OJ L 114/45, 8.5.2003

leveraging of market power; 2. horizontal leveraging of market power; 3. single market dominance; 4. termination (two-way access). We do understand the wish to structure the discussion on remedies. However, the classification could be improved.

First mover advantages

The ERG/EC document emphasizes the importance of first mover advantages. The quote on page 24 states that “wherever high barriers to entry exist and ... in the presence of significant first mover advantages, incumbent undertakings may have significant market power.” Again, SMP designation is part of the market analysis section. The ERG/EC document would benefit to quote Recital 27 of the Framework Directive in this respect. On the issue of newly emerging markets, where de facto the market leader is likely to have a substantial market share, the framework directive states that the market leader should not be subjected to inappropriate obligations. However, the ERG/EC document only discusses the concern that incumbents could try to maintain or even expand their SMP position by leveraging their dominant position in the traditional access markets on emerging markets. The fear is that new technologies with a high growth potential would be exhausted to foreclose new markets for new entrants and to sustain incumbents’ exploitative behaviour or production inefficiencies. The ERG/EC document elaborates further that as an adverse effect on competition - due to incumbents’ so-called first-mover advantage in infrastructure - incentives of alternative network providers to invest in technological developments would be cut off. According to the ERG, NRAs have here the responsibility to find remedies that balance these desired outcomes in the long-run. However, in our point of view, the draft of the ERG/EC document on remedies is seeking for arguments supporting regulations that are not intended by the new regulatory package for the electronic communications network and services as mentioned above. In addition, the telecommunication market is a highly dynamic one and a strong market position might be eroded within short time periods. Hence, NRAs are left with vague concepts of market constellations and a long list of potential competition problems, missing concrete criteria and guidance how these criteria should be applied in legal terms.

In the following we address some of the questions:

Chapter 1: Typology

Do you agree that the description of the competition problems provides the requisite level of detail? If not, please highlight areas where you would like more detail to be included in the final document.

The ERG/EC document classifies competition problems¹⁶. In their view three categories of problems may arise:

1. The dominant undertaking may attempt to transfer (leverage) its market power to an adjacent vertically or horizontally related market.
2. The undertaking may engage in practices to defend its SMP position by building up barriers to entry (e.g. increasing consumers switching costs).
3. The undertaking might engage in what is called 'textbook monopoly behaviour', such as excessive pricing, the provision of low quality, and inefficient production.

In general it is true, that in principle the above mentioned problems might arise. However, within a legal framework it is too vague to discuss general possibilities. NRAs need concrete guidance on possible competition problems within coherent and established legal principles. As with the other steps – market definition and market analyses – the classification of the competition problems should be aligned to competition law principles. In our opinion, the discussion on case 1 and case 2 type of competition problems (Vertical and horizontal leveraging) is artificial and not well-grounded in legal principles. The same is true for the "cause-and-effect" dimension of competition problems. There is clear guidance in the case law of the European Communities how to assess these effects. The ERG/EC document lacks this discussion. We recommend that the ERG/EC document is not departing from its own point of view namely that leveraging is not explicitly depicted in the regulatory framework. Therefore we do not agree with the conclusion that leveraging could be thought of as a 'heading' for all competition problems in case 1 and 2. As already elaborated, the conclusion that

¹⁶ ERG/EC document, page 25

leveraging creates market power in a potentially competitive market, which is usually detrimental to overall welfare¹⁷ depends heavily on the application of the legal standard of proof.

Besides this major concern, we believe that some terms require clarifications. For example how to analyse strategic variables like the price, quality, time, information of the incumbents' behaviour. How can a NRA clarify in practice that the SMP undertaking applies "delaying tactics" or pretends technical problems to prevent competitors from entering the market ? In our point of view, it is not enough to allege SMP undertakings to behave in such a way. NRAs need concrete guidance how to prove that behaviour in order to apply proportionate remedies. We recommend that the ERG/EC document should elaborate further on these aspects.

Another example is the discussion on the possibility that SMP undertakings might abuse their position for "exploitative" behaviour. Again, NRAs need more guidance in this respect. The quote that a price is excessive if it exceeds the hypothetical competitive level requires legal backing as well as explanations how to calculate prices at hypothetical competition levels. Regarding the legal backing ERG/EC document should refer to the comprehensive established case law on this matter which clearly states the criteria that have to be applied to prove excessive pricing. In our opinion, a coherent application of the case law would also guarantee that remedies throughout the Community are applied in a harmonised way.

The same can be said on price discrimination. NRAs need concrete guidance that their remedies are proportionate and can be contested in Community courts.

A similar issue is the calculation of productive inefficiencies¹⁸. Again there is substantial effort done within DG Comp how to assess efficiencies. We recommend that the ERG/EC document share this know-how.

17 ERG/EC document, page 32

18 ERG/EC document, page 40

Another issue is the discussion on welfare effects¹⁹. Here, the approach proposed by the ERG/EC is really theoretical. While in theory NRAs' interventions may be justified to minimize negative welfare effects, NRAs need more guidance on the concept to quantify these effects.

Chapter 2: Remedies

Another major concern is that the impression is given that remedies can be imposed on the retail level quite easily although "regulatory controls on retail services should only be imposed where NRAs consider that relevant wholesale measures or measures regarding carrier selection or pre-selection would fail to achieve the objective of ensuring effective competition and public interest."²⁰ On page 53 for example, the ERG/EC document states that Article 17(1)(b) suggests that if measures taken under the Access Directive or the use of a carrier selection or pre-selection obligation on these markets are not capable of resolving the problems on the market other obligations can be applied. The document concludes that "*It is clear that the obligations available in the Access Directive may, if appropriate, be available for application at the retail level.*" For clarification, the ERG/EC document should add that appropriate regulatory obligations can only be imposed on SMP undertakings in the retail market. For SMP undertakings, specific retail obligations may include requirements that the identified undertakings do not charge excessive prices, inhibit market entry or restrict competition by setting predatory prices, show undue preference to specific end-users or unreasonably bundle services.

Chapter 4: Matching problems and remedies

9. Do you agree with the description of problems and related remedies? If not please provide an alternative analysis.

No. We recommend that the ERG/EC document on remedies should apply well-established competition law principles too.

¹⁹ ERG/EC document, page 44

²⁰ Directive 2002/22/EC, Recital 26, Article 17.

10. Do you agree that the document offers sufficient guidance concerning the approach on remedies to be taken by the NRAs?

No, we do not agree. The guidance is superficial and lacks legal backing needed by the authorities. Both goals – harmonisation throughout the Community and proportionality of remedies – will be difficult to be met.

11. Does the document provide sufficient guidance on which particular cost accounting methodology would be appropriate for those competition problems for which NRAs may consider price regulation? If not, please highlight those areas where you would wish to see more guidance provided.

We welcome the section on the setting of wholesale access prices because it provides a general overview of available pricing instruments, which might be of particular interest for the new Member States. However, we believe that experienced NRAs would need more guidance in this respect.

13. Does the document provide sufficient guidance with the text boxes on bitstream, re-selling access lines and international roaming in Ch. 4?

The text-box discusses the possibility of finding SMP on the Wholesale broadband access market. Reason given is that e.g. voice telephony incumbent operators leverage their market power of the local loop into the wholesale broadband access market. We would like to stress again that the burden of proof on leveraging is demanding. Therefore we recommend to add this remark in order (1) to avoid misleading conclusions as well as (2) remedies which are not proportionate.

14. Do you agree that the principles developed also apply in cases of joint dominance? Do you have observations regarding specific remedies that may be appropriate in situations of joint dominance?

When analysing if joint or collective dominance prevails in a market, again it should not be neglected that the analysis according to the SMP guidelines sets high standards which are difficult to met by the NRAs. NRAs are well advised in this context to follow the principles developed in EC competition law.

15. Do you think the discussion in Chapter 4 will assist NRAs in achieving a consistent application of the framework ?

Is it sufficient to focus on harmonisation of outcomes or should there also be harmonisation of regulatory approaches.

No. We would recommend to adhere in the discussion on remedies to established competition law principles too. Harmonisation on the application of remedies would be the logical consequence of such an approach. This does not mean that similar remedies have to be applied throughout the Community. But the approach how to find the appropriate remedies would be coherent. National NRAs then have the possibility to select remedies that balance different national requirements. Hence, remedies need to be adjusted to these differences on a country specific basis.

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