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Speech

European Competition Policy in the New Economy

Jean-François Pons, Deputy Director General, DG Competition,
European Commission

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Introduction

Dear Professor Yarrow,

Ladies and Gentlemen,

I am very pleased to have been asked to talk to you this afternoon about the European Competition Policy in the new economy. About 18 months ago, there was lots of excitement in the media about the new economy and also about “new economics”. Events since then have demonstrated that though the new economy continues to exist - although a little battered and bruised - new economics does not and has never done. The fundamentals of economic theory remain in place, we need to apply them in different ways to the problems presented by the new economy, and that is something I would like to demonstrate today.

Many of our key actions in the new economy derive from the eEurope initiative launched at the Lisbon European Council in March 2000. Most of all, we have been trying to increase the numbers of European citizens who have access to and use the Internet. We have already seen the introduction of high speed Internet - for example ADSL and cable Internet modems. However, these represent only 1.1% and 7.8% of EU Internet households respectively. And, even though Internet access costs have reduced quite considerably since eEurope was launched by around 9% for residential customers and 23% for business customers, much still remains to be done.

Liberalisation covers a number of new economy sectors - I would like to concentrate today on telecommunications and Internet. I will also talk briefly about developments in the postal sector linked to the new economy. But I will begin by looking at two important areas where we in the Commission have to make decisions about what to do. These two areas are:

- The choice between applying general competition rules or sector specific regulation; and,
- in the case of the new economy, when to intervene and when to trust the market.

Competition and regulation

The overall aim of regulation and competition rules is the same, i.e. to create and secure competitive industries to the benefit of consumers. This is standard "old economics". The process of liberalisation of the telecom sector in Europe has been driven by a combination of sectoral regulation and implementation of competition rules. In the first phase sectoral regulation mostly under the control of 15 independent national regulators has played the major role. Now that the liberalisation process has made good progress, the general nature of the competition rules gives them an important advantage, because they apply to the factual circumstances of a particular case, no matter how quickly industries develop or change. This allows them to keep pace with technological developments, in a way that more specific regulatory frameworks cannot.

This link between intervention by regulators and competition rules becomes even more clear-cut within the current review of the regulatory package for electronic communications. One of the main shifts in the new framework will be the replacement of the current threshold for significant market power (based on a market share of 25%) with the dominance criterion, as it is defined by Commission practice and the case law of the European Courts under competition law.

Technological change and new emerging activities (like those linked to the Internet) require us to constantly review market developments and update our criteria of assessing cases. The correct definition of the relevant product and service markets and of their geographical scope is a key element in this respect, as it will determine the application of both regulation and competition law. That is the reason why we are consulting on a notice which is intended to provide further guidance to all concerned players about how these principles apply to electronic communication services. Indeed, we had a very successful hearing last week in Brussels with the industry and regulators.

To ensure a thorough implementation of both regulation and competition law, we will continue to co-operate closely with the national authorities and only intervene in cases of particular interest for the whole of the European Union, or at least for a major part of it. This will allow for the most flexible approach, which, we believe, is best suited to this fast moving communications industry.

So, we seek to use the more flexible and durable framework of competition law wherever possible, relying on tried and tested economic principles. Regulation must still be applied to areas where competition law cannot yet act effectively. For example, local loop unbundling is now being introduced, following agreement at Community level for a Regulation which applies directly in the member states. Though local loop unbundling had been mandated by competition law as a condition for the abortive Telia/Telenor merger case, this applied to only two markets. In contrast, the regulation applies right across the whole EU.

Intervention versus non-intervention

I would now like to turn to the application of competition law. Assessing individual cases as a competition authority requires an understanding of the underlying technology, a close following of market developments and a great deal of healthy scepticism. The scepticism is useful when, for example, companies claim that simply because this is a high technology sector, competition problems could not arise. Experience suggests otherwise.

For some, the competition rules are no longer necessary in the world of the new economy. They believe that the pace of change that we are seeing renders the role of regulators, including competition authorities, both unnecessary (the market will correct itself) and impossible to fulfil (the change is too rapid for a competition authority to make timely decisions).

This view is wrong, both on the facts and on the law. On the facts, we have already seen a number of cases where there were very real risks to competition often through pre-existing positions of market power on infrastructure or content markets. I also have doubts that the pace of development in technology sectors will inevitably mean that market failures will last only for a short time. The risk is rather that a position of market power may be temporary in the absence of anti-competitive action but anti-competitive action by the company with market power would render that temporary strength permanent. This is one of the concerns of the Microsoft case in the US.

On the law, if parties are proposing a merger or a joint venture, then we do not have the luxury of being able to see how the market develops in the future. We have to take a view on the basis of what we know today. Similarly if we are faced with a complaint, we must assess the complaint in light of current knowledge, of course allowing for the pace of development in the sector: but we cannot simply reject the complaint because it is a new economy case.

Applying competition law in new economy cases is very difficult. The judgements that have to be made are often fine ones - allowing an operation to go through could close a new market completely, whilst prohibiting or imposing conditions on another could stifle innovation and prevent technical progress. Having to make these judgements in advance is very difficult indeed. However, we have been building up our experience in the new economy cases that we have dealt with up to now. I would now like to turn to some of these cases, and the issues behind them, in more detail.

Telecommunications liberalisation

I would now like to look at some specific cases in the telecommunications and Internet sector. But first, I would like to recall the progress that has been made in the period since telecommunications liberalisation was put in place at the beginning of 1998.

The development of the market in that period has been remarkable. In the fixed telephony market, around 475 operators are offering public voice telephony for international calls and 400 for local calls. In the mobile market, penetration has increased over the last year from 36% to 55% and around 60 operators are licensed now. Almost one third of the population of the EU made use of Internet in the first half of 2000, but the situation varies widely between the Member States.

However, the incumbent telecommunication operators however still retain dominant positions with average market shares of 96% for local calls, 88% for long distance calls, and 81% for international calls. On mobile markets, the subsidiaries of the incumbents are still the leading providers with 50% market share on EU average and for Internet services, around 40% of all subscriptions are still held by the subsidiaries of the incumbent telecommunication operators.

These overall figures, however, disguise often large differences between member states. And the pace of effective competition also differs between Member States and markets. Five major issues will determine the evolution of the telecommunications sector:

- We must bring the de facto monopolies in the local loop to an end. Our priority will be the implementation of local loop unbundling in practice, by ensuring access and avoiding delays and distorted prices. Competition law (Article 82) will be necessary in complementing the regulation that will be adopted soon.
- We have to address the emergence of oligopolies in mobile telephony. Competition in mobile markets has been limited mainly to national retail markets, even if recently new pan-European operators started to operate. Problems remain regarding network access, call termination and roaming charges. The cost of UMTS licences and future investments in this technology have also to be taken into account. Some co-operation between operators - for example site sharing - can be accepted as long as there is no appreciable restriction of competition which cannot be justified under Article 81(3).
- We need to achieve cheaper Internet access by ensuring that leased lines prices are substantially reduced and that the Internet remains an open medium. On the Internet backbone market, concentrations could lead to dominant positions. Our priority will therefore be to ensure an open and competitive environment for the development of Internet.

- Co-ordination of national administrative procedures must be fostered, because the low level of harmonisation creates problems for the condition of cross-border interconnection and interoperability between the different networks and for the roll out of new infrastructure.
- We must make sure that mergers do not jeopardise gains from liberalisation. In particular, mergers between incumbent operators, or mergers in emerging markets with vertical links that may enable market players to leverage dominant positions from one market to another will raise competition concerns.

The main recent competition cases

The role of EU competition law is to make sure that such benefits are preserved and that future innovation is not hindered. There are numerous examples of the successful enforcement of the EU competition rules in the telecommunications sector since the liberalisation started. The three main fields in which we were active are the application of Article 82 on abusive behaviour by dominant operators, merger control and infringement procedures against Member States. By contrast, the application of Article 81 on anti-competitive agreements between companies has so far played only a minor role.

Abuses of dominant position (Article 82)

Regarding the application of Article 82, most of the abuses we examined were related to pricing matters and our proceedings, opened either upon complaint or at our own initiative, have repeatedly resulted in significant price reductions. Many cases of this nature were also dealt with by the national regulators on the basis of their national telecoms laws implementing the EU-directives.

After we carried out, in 1998 and 1999, two major own initiative investigations into the prices for call termination between fixed operators (accounting rates) and for interconnection between dominant fixed and mobile operators in the entire EU, these prices decreased significantly in nearly all the Member States where such problems had been identified. The same also happened following a complaint from *MCI-Worldcom* and which was directed against termination rates charged by five dominant mobile operators in three different Member States. After we initiated investigations in late 1999, rates decreased early in 2000 by up to 50% for a number of the operators involved. However, where points of principle or precedents are at stake, price reductions will not necessarily ensure that the Commission discontinues its investigation in the interest of reaching a formal decision.

In addition to those individual cases, there are currently three ongoing formal sector enquiries based on our competition rules. These allow us to broadly address issues where there appears to be market distortion in order to identify the causes. Starting a year ago, we have examined excessive prices for leased lines, the high rates for roaming between mobile operators, and finally the conditions for access to the local loop networks of incumbent operators.

Regarding leased lines, the mere fact that we launched our sector inquiry has pushed the prices down. Powerful competitive pressure appears to be at the retail level, demonstrated by substantial discounts offered by the incumbents. Tariffs for international and long-distance leased lines have decreased on average by up to 60% over the last three years. However, there are still problematic areas remaining. In certain national markets, prices are still too high, the fairness and transparency of discount schemes are questionable and there are long and

unpredictable delays in the provision of leased lines. We have started formal proceedings in individual cases in Spain, Portugal, Belgium, Italy and Greece.

The sector inquiry on roaming focuses on costs, prices and restrictive commercial practices. Both wholesale and retail markets remain predominantly national, with almost no trans-national retail offers. We found concentration ratios of over 90% for the two incumbent operators in most national wholesale markets, and a pervasive lack of cost-orientation and of competitive offers throughout the EU. We are working on a number of follow-up actions, including analysing the Vodafone Eurocall and GSM STIRA notifications and working with the member states to address issues raised by the inquiry.

Local loop unbundling and tariff rebalancing

With regard to local loop unbundling, we launched a sector inquiry in parallel with the adoption of the proposed regulation making local loop unbundling mandatory. This inquiry is about possible abuses of dominant position in the form of refusal to grant full or shared access to subscriber lines, or related to the conditions for such access, including collocation and pricing.

We have also been tackling local infrastructure issues through regulation.

The Commission adopted, in July of last year, a proposal for a regulation on local loop unbundling. More than two years after full liberalisation of voice telephony, the incumbents' control over the local loop remained almost untouched, due to their gatekeeper position over key infrastructure. The regulation will thus oblige the operators having significant market power to offer unbundled access to their local networks. Regulation and competition laws pursue the same goal in this respect, namely the provision of easy and affordable access to the local loop.

The issue of prices for local access is indeed very sensitive. Both regulators and competition authorities have to ascertain that incumbents charge access fees which they could equally claim from their own downstream operations while continuing to make profit on retail services. Otherwise incumbents would force new entrants in a situation of margin squeeze, which can be an abuse under Article 82. If national Ministries or regulators fixed these prices, our action is mainly directed against Member States and that is what we have done in a number of cases.

Let me focus on one example, which is of utmost importance for competition in the local loop, namely the rebalancing of voice telephony tariffs. Under the legal monopoly, operators used to cross-subsidise low retail subscription fees with high call charges. However, according to the Full Competition Directive and the Voice Telephony Directive, tariffs for voice telephony services offered by dominant operators have to be cost-oriented. We have therefore started infringement proceedings against three Member States (Germany, Italy and Spain) in which we found insufficient rebalancing of tariffs. In December 2000, Italy finally accepted a rebalancing of tariffs which was judged satisfactory. .

Our action may lead to an increased retail subscription fee for all telephone users. However, this does not necessarily mean that consumers will have to pay more. We believe that rebalancing should be a "zero sum operation", because increases of subscription fees should be compensated by decreases of call charges. Furthermore, we have promoted the application of social tariffs and low user schemes, avoiding that the weakest consumers would be hit by increases of telephone tariffs.

Key merger cases

Mergers have the potential to bring increased choice and lower prices to consumers. However, the Commission has to make sure that mergers do not jeopardise the gains from liberalisation or constrain the flow of innovation by capturing new markets.

So what have been the key cases which have occurred during this period of rapid market expansion.

Worldcom / MCI

In 1998 the Commission authorised the proposed merger between Worldcom and MCI, two US telecoms companies with substantial Internet backbone interests. However, the authorisation was granted only on the condition that MCI divested its Internet backbone activities. Both Worldcom and MCI were major players on the Internet backbone market i.e. the market for transmitting Internet data traffic around the world. The Commission concluded that if the merger were to go ahead as planned, the combined entity would have a dominant position on this market. Thus, MCI was forced to sell its Internet backbone activities.

Essentially the same issue arose again in 2000 in the proposed MCI Worldcom / Sprint merger: Sprint was in fact one of the companies that intervened in the earlier case to complain about the merger of Worldcom and MCI. The Commission was unconvinced by the parties' proposed remedy in the Sprint case (which would have led to a divestiture of only part of Sprint's activities), and formally prohibited the merger.

These cases provide excellent examples of the strength of the competition rules: before the Worldcom / MCI merger, little attention had focussed on the regulatory implications of the Internet backbone market. However, the competition rules enabled the identification of the problem and the remedy, and did so rapidly.

Local Infrastructure

The Internet's greatest strength is its ability to connect millions of individual users, regardless of their geographic location. However, given that these users often connect using the telecoms networks of dominant, often former monopoly, companies, it is no surprise that competition problems also arise at the local level. Moving therefore from global communications networks to local networks, the Commission also imposed stringent conditions on the abortive Telia / Telenor merger of 1999. There the Commission concluded that the parties' horizontal and vertical integration across a range of markets would lead to dominance problems. The Commission required both the divestiture of the parties' cable networks, and the unbundling of their local loops (i.e. opening up the parties' local telecoms networks for the use of third parties). This was highly significant for the development and deployment of residential and business Internet infrastructure in those countries. Competition in both cable and broadband telecoms networks would lead to faster and cheaper deployment of broadband services.

Although in very different areas, these three cases highlight an important point. It is a truism to say that the more users there are connected to telecoms networks, the more valuable that network becomes. The corollary of this, however, is that the more important the network becomes, the greater the risk that competition problems will emerge.

In each of the above cases, one of the Commission's concerns was that control over important infrastructure (backbone infrastructure in the first two cases, local infrastructure in the third) could be used to leverage the parties' positions into related markets.

Mobile Infrastructure

The same concern arose in the Vodafone / Mannesmann case of 1999: there we had to address issues of horizontal concentration an accumulation of national mobile networks to form a potentially pan-European network. The Commission was concerned that this accumulation would provide the combined entity with an insurmountable lead in the delivery of pan-European services. To remedy this, the Commission sought to strike a balance between the immediate problem, and the long term development of the market. By requiring the entity to provide competitors with access to its network, the Commission ensured that the strong position in infrastructure could not simply be used to create an equally strong position on the services market. But by limiting the remedy in time (for three years) the Commission ensured that competing investment would not be undermined, and that competitors would be forced to develop their own networks.

Vertical issues, in particular gate-keeper effects

Competition issues have also emerged as a result of some notable cases of vertical integration. In AOL / Time Warner, for example, there was a concern that the concentration would bring together AOL's service provision with Time Warner's content, and Bertelsmann's content (the latter through the AOL Europe joint venture). This vertical integration could have led to a strengthening of the combined entity's position on a number of markets. The commitment to separate AOL / Time Warner from Bertelsmann allowed the merger to proceed.

The same theme arose again in the Vizzavi case: Vizzavi is a joint venture between Vodafone (which recently bought the Mannesmann group) and Vivendi (which controls Canal+). The parties propose to create an Internet portal service an Internet site bringing together various information and transactional services - accessible not only via standard PCs, but also via television and via mobile phones. There may well be distinct markets for Internet services provided over each access mechanism PCs, televisions and mobile phones, and there may well be a distinct consumer demand for portal services the gathering together in one convenient site various information and links to other sites. However, the Commission was concerned that the market positions of the parents in particular markets (such as pay television and mobile telephony) could be leveraged into the Internet portals markets. The conditions imposed on the clearance ensure that third parties have the same access as the joint venture to the parents' facilities.

Internet and e-commerce markets

We can see in a number of European markets that some Internet and e-commerce markets appear to be dominated by companies who formerly benefited from monopoly positions, most notably in the telecommunications sector. The position of T-Online in Germany, for example, appears to be very strong: and I can see similar situations in several other Member States. Competition authorities must remain vigilant, in these circumstances, to ensure not only that there are no unlawful benefits being derived from the former monopoly position, but also that these strong positions on e-commerce markets are not strengthened further through anti-competitive means. Strategic alliances and exclusive or preferential content arrangements revolving around these e-commerce markets will therefore be examined very closely.

The need for international co-operation

Having mentioned the two Worldcom cases earlier, I would like to briefly recall the issue of international co-operation, not least because I see that Joel Klein will be talking about this tomorrow.

Globalisation is all the more evident in the new economy. Increased co-operation with other anti-trust authorities is therefore an obvious, indeed indispensable, response to the challenges which the Commission faces as a result of this globalisation

Our experience with bilateral EU/US co-operation has been that it works very effectively - and particularly so in merger cases, substantially reducing the risk of divergent or incoherent rulings. Indeed, Commission staff are in close and daily contact with their counterparts at the Antitrust Division of the US Department of Justice and Federal Trade Commission.

Co-operation in merger cases has been particularly fruitful in New Economy cases, such as MCI Worldcom / Sprint and AOL / Time Warner. Such cases often raise novel issues on the definition of markets, the likely competitive impact of a transaction on those markets, and the viability of any remedies suggested by the merging parties.

There are various proposals on the table for how this form of anti-trust co-operation can be advanced globally notably in the WTO framework. We have also contributed to the debate by offering some ideas on what could be an international forum for competition among authorities from all over the world. We clearly need to spend some more time reflecting on the scope of the forum, the options and solutions, but the momentum that has been developing in recent months should not be lost.

Postal issues

I would now like to carry out my promised diversion into the postal sector. However, this is not as far from the new economy as you might think!

In December 2000, the Commission adopted a decision regarding the provision in Italy of new postal services offering value added elements, in particular a guarantee that items created electronically arrive at a predetermined date or time.

More precisely, the Commission took the view that the law which implemented the Postal Directive 97/67 preventing private suppliers from offering the full range of hybrid mail services, was incompatible with both Article 86(1) and Article 82 of the Treaty. No Member State apart from Italy had, at that stage, included the delivery phase of hybrid mail at a predetermined date or time in the area reserved to the incumbent operator. The incumbent operator in Italy - Poste Italiane- did not offer that service.

Delivery at a predetermined date or time is considered to be a separate market which is very different from traditional delivery services (universal service). There were therefore no grounds for reserving it for a universal service provider which did not offer that service.

Furthermore, in this case as in other cases where the incumbent operator does not offer yet a particular added value postal service, the investments needed in order to enter in the new market far outweighs any income likely to be generated by those niche services.

The decision, which was designed to create the necessary legal certainty for private operators, obliged the Italian Government to make it clear that remittance at a predetermined date or time of hybrid electronic mail is not one of the services which can be reserved.

I should add that the decision in question was adopted in application of the relevant competition rules (*i.e.* Articles 86 and 82 of the EC Treaty). The decision was not aimed at evaluating the way the Italian State has transposed the Postal Directive. Therefore, the Commission has taken this decision without reference to the ongoing discussions in Parliament and the Council on the new Postal Directive.

So, I hope that this demonstrates: first that the postal sector is closer to the new economy than we might think, and second that the Commission is acting to ensure that competition rules are increasingly applied to this sector, which has been protected from them for so long.

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Conclusion

I would like to draw some conclusions from the above, and in particular, highlight some issues that will be important in the future.

First, I am sure that it is now clear that even though the development of the new economy is extremely beneficial to competition, there remain areas where the competition rules should intervene. And the competition rules can intervene effectively in those areas.

Secondly, in applying the competition rules, it is important that they are interpreted flexibly bearing in mind the underlying principles so as to take into account the new factual situation and new problems that the new economy produces.

Third, that the trend must be to reduce the scope of regulation in favour of the application of competition law as soon as is possible. This is what is happening with the Commission's new framework for the regulation of the communications sector.

Finally, it's also important to keep some general objectives in mind for Europe and its citizens. Telecoms liberalisation, for example, has already led to significant improvements in telecoms services in Europe, but that does not mean that we should be content with the progress made. Whether or not the Internet can become a truly mass market phenomenon (and remember only a minority of households currently have access to the Internet in Europe) will depend fundamentally on the pricing and availability of communications infrastructure, both narrowband and broadband, into the home.

Thank you for your attention.