Two recent veto decisions under the new Regulatory framework for electronic communications: The importance of competition law principles in market analysis

Dirk GREWE, András G. INOTAI and Stefan KRAMER,
Directorate-General Competition, unit C-1

1. Introduction

In October 2004, the Commission exercised its so-called ‘veto power’ under Article 7 of the Directive on a common regulatory framework for electronic communications networks and services (Framework Directive) for the second and the third time (1) On 5 October 2004, the Commission adopted a veto decision requiring the Finnish Communications Regulatory Authority (Ficora) to withdraw its draft regulatory measure concerning the market for access and call origination on public mobile telephone networks in Finland. On 20 October 2004, the Commission requested the Austrian Telecommunications Regulatory Authority (TKK) to withdraw its draft regulatory measure concerning the market for transit services in the fixed public telephone network in Austria.

Both veto decisions provide clarifications as to the standard of competition law based market analyses as required from National Regulatory Authorities (NRAs) under the new regulatory framework for electronic communications networks and services. These two notifications are also examples of a regulatory (designation of an undertaking with significant market power (SMP)) and a deregulatory (non-designation of an undertaking with SMP) measure which were subsequently considered incompatible with Community law. In other words, the Commission's assessment of the draft measure has been independent of the fact whether it has a regulatory or deregulatory effect on the market. What is important is to ensure the appropriate regulation of electronic communications markets, if necessary, on the basis of a thorough economic analysis in accordance with Community competition law principles.

2. The case of mobile access and call origination market in Finland (FI/2004/0082)

2.1. The draft measure notified

The draft measure notified by Ficora concerned the Finnish market for access and call origination on public mobile telephone networks (mobile access and call origination market). In this market, service providers (SPs) and mobile virtual network operators (MVNOs) buy access and call origination services from mobile network operators (MNOs), in order to be able to offer their own mobile services on the retail market.

Ficora's market analysis concluded that TeliaSonera had SMP in the defined market, based on the following factors: (i) high market share (in excess of 60%), (ii) the fact that the most significant independent SP operates in TeliaSonera's network, (iii) the lack of countervailing buying power and (iv) network effects, economies of scale and scope, and financial strength.

2.2. The Commission's veto decision

The information that the Commission received in the notification and as a result of several requests for information did not warrant the conclusion that Ficora had undertaken the assessment in accordance with Articles 14 and 16 of the Framework Directive, which specifically refer to the notion of SMP and the task of the NRA to determine whether or not there is a dominant operator on the market.

In its examination Ficora had to ensure on a forward-looking basis whether TeliaSonera was in a position to behave to an appreciable extent independently of its competitors, wholesale customers

and ultimately consumers in the relevant market. The evidence provided did not constitute a sufficient basis for concluding that this was the case. The Commission’s view was based on three main reasons: first, the lack of taking into consideration the apparent market dynamics; second, the lack of evidence of capacity constraints and barriers to switching; and third, the undue weight given to evidence of network effects, economies of scale and scope, and substantial financial advantages.

2.2.1. Lack of taking into consideration the apparent market dynamics

The Commission noted that, despite the fact that the market share of TeliaSonera in the relevant market was in excess of 60%, other factors relevant for the assessment of SMP should have also been taken into account.

Firstly, even though there were no regulatory obligations for MNOs to provide access, both SPs and MVNOs have been able to conclude agreements on a commercial basis with each of the three nationwide-operating MNOs in the relevant market. There were over 10 SPs in the market, and at least three MVNO agreements have been concluded, with one SP concluding an MVNO agreement with two MNOs.

Secondly, SPs were usually negotiating with all MNOs and comparing prices and other terms. MNOs were apparently able to conclude agreements with different SPs due to their ability to provide flexible offers or types of services that were not provided by other MNOs.

2.2.2. Lack of evidence of capacity constraints and barriers to switching

The Commission found that, provided that MNOs are not subject to capacity constraints of their networks, and SPs are not locked in to their suppliers as a result of high switching costs and the absence of countervailing buying power, the competitive threat of other MNOs’ attracting SPs or MVNOs which proved to be successful at retail level is likely to limit TeliaSonera’s market power in the relevant market.

Firstly, no sufficient evidence was provided as to the existence of barriers to expansion in the relevant market. In fact, TeliaSonera’s competitors had lower capacity utilisation rates, and there seemed to be no immediate impediment for them to take more traffic on their networks. Secondly, although switching between MNOs does entail some costs (such as the switching of the SIM card), Ficora did not consider the incentives of MNOs to bear the costs of switching themselves, taking into account the apparent incentives for MNOs to provide access to SPs. In the course of the Commission’s assessment it was revealed that some MNOs had already considered paying costs to be incurred by an SP ready to switch to their networks.

2.2.3. Undue weight given to evidence of network effects, economies of scale and scope, and substantial financial advantages

While not contesting that network effects and economies of scale and scope resulting from the overall size of a network may of course be taken into account as indicators of SMP, the Commission found that in this case these factors were themselves — in the absence of more detailed evidence as explained above — insufficient to substantiate a finding of SMP.

In particular, TeliaSonera’s competitive advantage seemed to stem primarily from its superior capacity utilisation and not primarily (scale) economies. As opposed to differences in scale, differences in capacity utilisation do not offer a sustainable competitive advantage to an operator and can be overcome by attracting a larger number of customers onto existing capacity.

Furthermore, no evidence was provided that financial advantages of TeliaSonera — taking into account the fact that its competitors are also parts of large vertically and horizontally integrated telecommunications groups — were of such a degree that could serve as the basis of an SMP finding.

3. The case of the fixed transit services market in Austria (AT/2004/0090)

3.1. The draft measure notified

TKK’s draft measure concerned the Austrian market for transit services in the fixed public network. In addition to call origination and call termination, transit services are used to convey calls between telephone exchanges either at a local level or across regions. Telekom Austria (TA) is the incumbent operator which owns the traditional nationwide fixed telephony network and at the time of the market review offered around 90% of transit services to alternative network operators. Only a small number of operators had at the time of the review provided transit services in competition with TA, together accounting for the remaining 10% of the market.
Over the period taken into consideration for the market analysis, a number of operators had ceased purchasing transit services directly from TA and began to further roll out their networks by directly interconnecting with each other and/or TA either at the level of local or regional exchanges. With each direct interconnection, an operator would not need to buy the transit service from TA any longer. TKK’s inclusion of such operators into the relevant market was based on the assertion that they can also act as a supplier of transit services to third parties. TKK included all operators which no longer demand transit services into its market definition irrespective of whether this has actually led to additional offers of transit services to third parties or not.

TKK had calculated that taking account of such direct interconnection decreases TA’s share of all call minutes relating to transit services to below 50%. As a consequence, TKK found no SMP in the relevant market and considered the market for transit services in the fixed public telephone network to be effectively competitive.

3.2. The Commission’s veto decision

3.2.1. The inclusion of direct interconnection into the relevant market

The Commission Recommendation on relevant markets within the electronic communications sector (Recommendation) sets out those markets that are susceptible to ex ante regulation and that regulatory authorities are required to analyse under the Framework Directive. The Recommendation requires regulatory authorities to decide on the elements to be included in particular markets identified in the Recommendation, while adhering to competition law principles. The Commission concluded that, on the basis of the information provided in the notification, there was insufficient evidence to include direct interconnection in the relevant market.

The Commission was of the view that when determining the existence of demand-side substitutability, TKK did not provide sufficient evidence showing that network operators purchasing transit services could promptly shift to other products or services in response to price changes. In contrast, TKK found in its market analysis, that direct interconnection requires network roll-out associated with high investments as well as substantial planning and time.

As far as supply-side substitutability is concerned, the Commission expressed the view that TKK should have ascertained whether a network operator that ceased to purchase transit services because of direct interconnection would actually use its productive assets, i.e. the newly-created capacity, to offer (relevant) transit services to third parties. The Commission states in its veto decision that a merely hypothetical supply-side substitution cannot be sufficient for the purposes of market definition. TKK did not provide evidence that network operators which ceased to purchase transit services subsequent to direct interconnection would systematically offer part of their new capacity to other operators demanding transit (1). Therefore, the Commission made clear that TKK should not automatically include all direct interconnection in the relevant market (2).

3.2.2. The importance of applying a thorough green field analysis

When assessing the need for sector-specific regulation, a green field analysis should examine whether the market conditions that would prevail in the absence of regulation reflect those of an effectively competitive market. In this case the Commission was therefore interested to find out what effect a withdrawal of obligations may have on TA’s supply of transit services, especially against the background that TKK had stated in the notification that the proposed withdrawal of regulation may lead to competitive disadvantages for operators with relatively small networks. Because of a lack of such examination, the Commission stated in its veto decision that insufficient consideration was given to the possibilities that would be open to operators which have, at this point in time, still insufficient traffic volumes to justify a further network roll-out in the event regulation were lifted.

In conclusion, the Commission asked TKK to focus in its future review of the market, necessary subsequent to the veto decision, on those undertakings that are actually offering transit services or those which would, in the short term, be willing and consider it economically viable to offer such services to third parties. The Commission also asked for a more detailed consideration of how

(1) In case UK/2003/0016, OFTEL emphasised in the case of interconnected mobile operators the lack of spare capacity and the high costs of developing systems for dealing with wholesale customers (including billing and account management).

(2) TKK itself argues that, since TA’s captive sales are not offered on the market, these should not be considered for the calculation of market shares.
business models of alternative operators are affected by a possible withdrawal of remedies and how this may affect competition in the provision of the relevant electronic communications services.

4. Conclusion: the importance of competition law principles

When defining markets and determining whether an undertaking has SMP in the defined market, NRAs must act in accordance with Community law, especially Community competition law and the relevant case law of the Community Courts.

As regards the definition of the relevant market, NRAs shall base their definition on the factors which are used to define markets under Community competition law, namely demand-side substitutability and supply-side substitutability (1).

In the Austrian case, the NRA had taken into account mere hypothetical supply-side substitution for the purposes of market definition. This led to inflated market boundaries and, at the subsequent stage of the SMP assessment, to a significant reduction of TA’s market share, which presumably resulted in a substantial under-estimation of TA’s market power. Therefore, the Commission had serious doubts as to the compatibility of the notification with Community law and vetoed the draft measure.

In the Finnish case, the NRA did not properly assess the barriers to switching on the part of SPs and MVNOs, by not establishing whether MNOs have incentives to bear the costs of switching themselves, and that some MNOs had already considered paying costs to be incurred by an SP ready to switch to their networks. Furthermore, Community competition law was not correctly applied when the dynamic nature of the market and its effect on the market power of TeliaSonera was not properly assessed. In this context, it should be reiterated that a fundamental principle of SMP assessment in accordance with competition law principles is that market power should normally not be established on the sole basis of the existence of large market shares, but that NRAs should undertake a thorough and overall analysis of the economic characteristics of the defined market (2).

Although the underlying notifications were quite different on substance, they have in common that European competition law principles have not been properly taken into account in the respective market analyses. The most important part of the Commission’s assessment of the draft measures of NRAs is to verify whether Community law, in particular Community competition law, has been correctly applied to the facts gathered by the NRA. It is in this area that the Commission undertakes the most thorough scrutiny and checks whether the NRA has not erred in the application of the legal principles set out in Community law, including the case law of the Community courts.

In general, however, it has to be noted that the Commission has exercised its veto power only in case of 3 of the 134 notifications which have been assessed so far (3). Although the Article 7 consultation is no approval regime, one may therefore conclude that the NRAs have well implemented the swift from the old regulatory framework to the new regulatory framework, i.e. from sector-specific regulation and antitrust law being two widely different but complementary regimes to one regime which is uniquely based on European competition law principles.

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(2) Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165, 11.7.2002, p. 6, point 78.

(3) This number refers to the notifications which have been completely assessed as of 31.1.2005.