Response to the consultation on the ‘BEREC Report on Oligopoly analysis and regulation’

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Introduction and executive summary

The FTTH Council Europe welcomes the opportunity to comment on the draft BEREC Report on Oligopoly analysis and regulation.

The FTTH Council Europe is an industry organisation with a mission to accelerate the availability of fibre-based, ultra-high-speed access networks to consumers and businesses. The Council promotes this technology because it will deliver a flow of new services that enhance the quality of life, contribute to a better environment and increase economic competitiveness. The FTTH Council Europe consists of more than 150 member companies. www.ftthcouncil.eu Telecoms operators are not members of the FTTH Council and we have our own perspectives regarding the appropriate regulatory policies to accelerate NGA deployments.

The FTTH Council Europe believes that market forces can and will deliver the best outcomes for European consumers in the absence of market failures. Market failures can be a failure to internalise all the benefits coming from a migration to FTTH for instance (a failure to price positive benefits to society) which justify public finance; or market failure can take the form of excessive market power such that output is restricted or pricing raised to the detriment of consumers. It is appropriate that BEREC review the question of when and where the limit of ex ante regulatory intervention should be.

The FTTH Council takes a view that the regulation of jointly dominant entities is something which, if controlled, is best controlled by ex-post authorities. As the FTTH Council sees these proposals, what has been proposed by BEREC, in particular the regulation of tight oligopolies, could amount to a fundamental change in the threshold for regulation and the FTTH Council Europe does not believe that this is appropriate.

The FTTH Council believes ex-post regulators are better placed to consider issues of tacit collusion and that ex-ante regulators do not have the appropriate tools to make a full analysis of such behaviour. This is for a variety of reasons but principally because a market outcome could be misinterpreted and relatively good market outcomes could be undone. Competition Authorities have more checks and balances (e.g. a requirement to show consumer harm) than ex-ante regulators and also have greater powers (eg. the ability to conduct dawn raids and to question witnesses under oath). When dealing with borderline cases, such differences may be crucial.

From a practical perspective as well, the FTTH Council does not believe that telecom markets exhibit the kind of characteristics that would facilitate tacitly collusive co-ordination. Telecommunications markets, both from a supply and from a demand perspective are continuously evolving and morphing. Stability, even if heavily orchestrated and institutionalised as within company groups, is difficult to maintain. Taking that requirement outside a company and seeking to create and maintain a collusive agreement through a ‘nod and a wink’ looks fanciful.

From a fixed market perspective, the FTTH Council believes that Fibre/Copper/Coax networks do not have common functionality or cost structures and views these asymmetries as extremely prejudicial to the emergence of joint dominance in fixed networks.

The FTTH Council Europe therefore believes that in terms of the incentives to collude, transparency and in terms of the market structure and development, telecom markets are not typically suited to the emergence of joint dominance. It could be that this will change in time, because these markets may stabilise in the future but that is no basis for action today.

Finally, the FTTH Council agrees with BEREC that further work and research is needed with respect to tight oligopolies. The FTTH Council would be against any attempt to lower the threshold for market intervention below the current SMP requirement.

The FTTH Council advocates a quick and clear conclusion to the current debate in the interests of creating market certainty so that investors contemplating putting large sums of money at risk understand clearly what the regulatory regime will look like in the future.

Our response looks first at issues of Joint Dominance and then Tight Oligopolies before concluding in a final section.

1. JOINT DOMINANCE

Collective dominance

The assessment of SMP in the market and whether the market is conducive to supporting joint SMP (*i.e.*, “collective” or “joint” dominance)[1] in the form of tacit collusion, is separate from the assessment of the market definition. In particular, an NRA must demonstrate that:

– the characteristics of the market make it conducive to joint/collective dominance by means of a tacit agreement on a clear focal point which profits the firms involved by more than normal profit (WACC); and

– that the form of coordination adopted is sustainable, namely: (i) whether any of the oligopolists in question has the ability and incentive to deviate from the coordinated outcome, considering the ability and incentive of the non-deviators to detect such behaviour and retaliate; and (ii) whether buyers/fringe competitors/potential entrants have the ability and incentive to challenge any anti-competitive coordinated outcome.[2]

The *SMP Guidelines* indicate that two or more undertakings can be found to be in a joint dominant position if, even in the absence of structural or other links between them, they operate in a market, the structure of which is considered to be conducive to coordinated effects. Without prejudice to the case-law of the European Courts on joint dominance, it is indicated that this is likely to be the case where the market satisfies a number of appropriate characteristics, in particular in terms of market concentration, transparency, market maturity, stagnant or moderate growth on the demand side, low elasticity of demand, homogeneous product, similar cost structures, similar market shares, lack of technical innovation, mature technology, absence of excess capacity, high barriers to entry, lack of countervailing buying power, lack of potential competition, various kind of informal or other links between the undertakings concerned, retaliatory mechanisms and lack or reduced scope for price competition.[3]

As noted by the European Commission[4]:
Since the list in Annex II [setting out the condition for joint dominance] *is neither necessary nor exhaustive, it may be misleading for national regulatory authorities conducting market analysis. Furthermore, the concept of joint dominance also depends on the case law of the European Court of Justice.*

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[1] The definition of SMP is equivalent to the concept of dominance as defined in the case law of the Court of Justice and the Court of First Instance of the European Communities (Article 14 and Recital 25 of the *Framework Directive*). Consequently, the notion of “joint SMP” is equivalent to the EC competition law concept of “collective dominance”, and the two notions should be considered as interchangeable for the purposes of this assessment.

[2] Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (the “*SMP Guidelines*”), OJ C 165, 11.7.2002, point 96, referring to past decisions of the Commission related to collective dominance and the Judgment of the Court of First Instance in Case T-342/99 *Airtours* [2002] ECR II-2585.

[3] Paragraph 97 of the *SMP Guidelines*.

[4] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007PC0697:EN:NOT

Depending on the market circumstances and the focal point identified, a selection of the factors above will become more or less important. What is clear is that a simple check list approach cannot be adopted and that a nuanced and careful assessment of the specific elements analysis, in particular the focal point identified, will impact greatly the weight given to those factors listed in the SMP guidelines.

What has been proposed by BEREC, in particular the regulation of tight oligopolies, amounts to a fundamental change in the threshold for regulation and the FTTH Council Europe does not believe that this is appropriate.

What would be the focal point of a jointly dominant strategy?

For a finding of joint or collective dominance in the form of tacit collusion, members of the dominant oligopoly must be aware, sufficiently precisely and quickly, of the way in which the other members' market conduct is evolving.[5]

The degree of transparency is important for the purpose of permitting each member of the oligopoly to detect deviation from the common policy and to ascertain whether it is necessary to react to any such deviations by punishing them.[6]

An NRA will need to identify a focal point, around which the tacit collusion can be organised. AS noted by BEREC this collusion is often identified as being around a denial of access and that the incentive will be higher prices (and lower consumption) in the retail market.

An NRA will need to consider a number of characteristics to be present in the focal point including transparency, i.e. that any deviation from this focal point would be immediately visible though the appearance of a service provider on the retail market. An NRA will need to judge the product in question to be homogeneous (so that there is clarity in terms of what is on offer).

The focal point identified will also need to be capable of allocating profits in the market in some fashion. It is only logical to deny access on a collective rather than a unilateral basis if there is an equilibrium to be protected by such a denial. This equilibrium must be achieved either by reduced competition centred on either price or output. This equilibrium, if it exists, should be observable in the form of high prices, poor choice/quality.

For joint dominance to exist then evidence of conscious parallelism in the market or strategic signalling interactions in the market must be provided. However, in most instances, such company behaviour might be a normal commercial strategy rather than conscious parallelism or tacit collusion. Hence the FTTH Council believe that ex-ante regulators are not best placed to interpret that observed behaviour but that ex-post regulators are. Ex-post regulators can examine documents in dawn-raids and normally have the power to examine/interrogate senior executives. This allows a

[5] Case T-342/99 *Airtours* [2002] ECR II-2585, at para. 62.

[6] *Airtours*, at para. 159.

proper understanding of the origin and objective of the commercial behaviour observed.

The FTTH Council believes ex-post regulators are better placed to consider issues of tacit collusion and that ex-ante regulators do not have the appropriate tools to make a full analysis of such behaviour.

Transparency

In order to punish deviation, there must first be detection. If there is a pricing focal point, then detection will be difficult as product and pricing plans are generally not homogeneous in telecommunications markets.

The choice of services in the communications sector is large and differentiated. Consumers have to make significant search costs to find the best deal. Although the consumers are helped through comparisons made by consumer unions and independent internet sites, it is likely that market transparency is relatively low. This will inhibit tacit collusion because monitoring the behaviour of the competing firms and the finding of a focal point to collude on becomes more difficult.

More fundamentally, if the focal point identified by an NRA is denial of access by an operator then that is anything but transparent (or logical). In the first instance, for broadband markets, telecom operators make offers in the wholesale market, either of their own volition or on foot of a regulatory obligation. Since access is normally already available, its putative denial would seem rather pointless as a collective action. Nevertheless, it may be that the denial by a cable operator of a third party access product could unilaterally dampen competition in the retail market.

Even if this was accepted, it cannot be known what negotiations with which parties are underway at any given moment in time since any such negotiations are not subject made public and would not be until any agreement was in place. No parties other than those in the negotiations are aware of these discussions. Third parties will only become aware of the discussions if they conclude successfully. In the absence of such transparency, an operator could not make any assessment of how likely entry is from one moment to the next. It is also unclear what the nature of any agreement would be until sometime after agreement.

The issue is even more acute for mobile markets since several parties might be in discussions at any moment in time – at the moment of a request for access the assumption must be that similar requests have been made to others. The game theory possibilities are endless but the observable facts is that there are MVNO agreements in every EU market almost exclusively based on commercial terms.

The FTTH Council does not believe that telecom markets exhibit the kind of transparency that would facilitate tacitly collusive co-ordination.

The Incentive to coordinate and the Sustainability of tacit co-ordination over time

For a finding of collective dominance, the situation of tacit co-ordination must be sustainable over time; in other words, there must not be an incentive to depart from the common policy.[7] Tacit collusion would require that the individual interest of each operator (maximising profits while competing with the others) does not outweigh the common interest of the members of the alleged dominant oligopoly (not to accept any significant wholesale customers or lower pricing in order to grab market share).

To compare whether the alleged common interest not to grant access to third parties outweighs individual profit maximising interests, each operator has to be able to assess the expected profits in the tacit collusion. However, such profits can only be estimated on the basis of expected output and price levels in the market. Therefore, the sustainability of alleged tacit co-ordination would only be possible if there is a common understanding of equilibrium level of output and prices. For such an understanding to exist in any market is unusual – but in markets as dynamic as those in the telecoms sector it is unimaginable.

Any focal point which is to deny access can only be considered as a secondary focal point to facilitate the primary focal point which is to agree a price/output equilibrium.

The evidence of such a primary focal point could only be observed in the retail market and, while it is not an absolute legal necessity to conclude that there is tacit collusion taking place at the retail level, any view of the observable level of competition at the retail level must be consistent with the existence of a primary focal point. In effect, if the retail market is working well enough then there is no basis for believing anything needs to be addressed at the wholesale level.

Mature and Static Markets

Far from these being static markets which are not worth competing for, as suggested by entering an agreement to divide the market, it is clear that there is still significant growth in both fixed and mobile markets in terms of number of users and the value of that market.

Therefore the value of potential future profits will be significant and this in turn will reduce the incentive to collaborate and increasing the incentive to 'cheat' should a tacit agreement ever be entered into. The likelihood of establishing an agreement is very small given the differences between the network operators in terms of size, cost structures etc.

The FTTH Council Europe notes that in terms of the incentives to collude, transparency and in terms of the market development, telecom markets are not typically suited to the emergence of joint dominance.

Significant symmetries between operators

7 *Cf. Airtours,* at para. 62.

In order for members of an alleged dominant oligopoly to have common interests to tacitly coordinate their behaviour, it is normally required that the undertakings concerned are sufficiently symmetric in terms of their products, cost structures, market shares and so forth.

Telecom markets typically exhibit large differences in market shares where legacy customer attachment typically means incumbent telecom operators lead with certain altnets and cable operators often being geographically limited – this would *a-priori* seem to make reaching and enforcing tacit collusion very difficult, even if it does not exclude it.[8]

Traditionally, the alternative operators with the lowest market share have a stronger interest to deviate from any restrictive agreement, since cannibalisation of the margin at retail level by wholesale operators would cost less.

The importance of economies of scale in this industry also entails that large differences in network sizes and in market shares may result in large differences in cost structure and operating at sub-scale levels incurs significant costs.

Some of the main differences between cable networks and DSL based networks is that DSL networks offers a dedicated line in the local loop instead of a shared medium. As currently set-up, the cable network that the customer uses e.g. an Internet access service through a third party will automatically also have access to the other downstream channels (analogue broadcast services). Another important difference is the fact that the DSL network tends to be national in character and owned and maintained by one operator, as opposed to tens of different cable operators. Although the two largest cable operators pass the vast majority of homes, a third party will still need to negotiate with multiple operators in the absence of a joint initiative by the cable operators. Another difference is the fact that the national DSL network is far more standardized than would the amalgamated cable networks whose technical evolutions differ markedly and this in turn increases the (technical) complexity for a third party seeking national coverage over cable networks.

The net effect of these elements suggests that network operators have networks which have radically different structure, functionality and cost structures which are clearly not conducive to aligned behaviour.

The FTTH Council does not see Fibre/Copper/Coax networks having common functionality or cost structures and views these asymmetries as extremely prejudicial to the emergence of joint dominance in fixed networks.

Product choice and quality.

Pricing is not the only indicator of competition at the retail layer. Product and service innovation, and the quality of service delivered, are also crucial factors in measuring consumer welfare. Both of these indicators in the European market also indicate a very good deal for end users.

8 Commission's Decision in case M.2499 *UPM/Kymmene*.

Ease of switching between operators.

There are number of factors which impact on the ease of switching in a given market. The most important of these factors concerns search costs, the ready identification of superior products or more advantageous prices, contract terms (including minimum contract duration), and the ease with which consumers can move from one operator to another.

A level of advertising in turn feeds through to a particular level of brand awareness, reflecting the extent to which end users are aware of the firm's presence in the market and the various competitive offers. Special offers from operators to end users are an important part of the competitive dynamic in Telecoms market.

Special offers are normally given in exchange for minimum commitments in terms of contract duration and the European Regulatory Framework has a maximum contract period of 24 months thereby limiting lock in periods. Broadband and mobile customer contracts therefore often have a minimum duration normally reflecting the level of handset-subsidy/modem or other acquisition costs involved.

Therefore, contract terms as a facilitator of switching is driven by two important factors. First, the nature of the contract between the network operator and the end user is important, *i.e.,* whether it is stand-alone contract for broadband/mobile service or a broader contract for multiple services. Second, in the event that the relationship is already in place then the percentage of consumers which are 'off contract', *i.e.,* that have already met the minimum duration requirement, is also important since they will be the effective switching target group.

The conclusion on this point is that customer switching between operators occurs at a level which is greatly affected by the contract terms. Even if one party sought to put a dramatic offer into the market in order to discipline a rival, the ability to 'punish' is greatly diminished even to the point where it is completely ineffective.

The FTTH Council notes that methods to enforce discipline are not obvious in telecom markets in general.

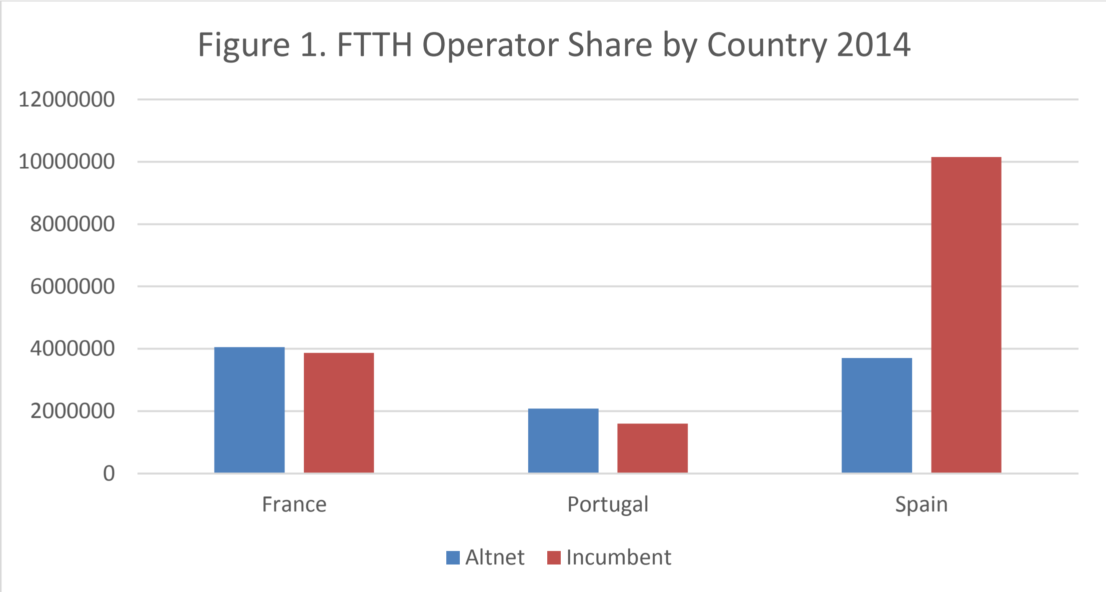
Factors facilitating competition - entry barriers and technological change.

An NRA will need to show evidence of a combination of entities having the ability to restrict output and thereby raise prices profitably or otherwise, since any reduction in output can easily be met by any other operator in the market simply by either entering, expanding output or availing of any existing regulated access products.

Entry is also facilitated by the general absence of evidence of consistent 'first mover advantages' in telecom markets since the rapid pace of technological change often means that operators entering later are enabled at a lower cost and with greater functionality either in back office functions, deployment methods and so on.

Technological change is also a significant feature of these markets and the implications of such technological change, in terms of capacity, cost structure and future access offerings are not clear or fully understood today. However, such uncertainty creates a destabilising environment in which any possible tacit collusion would find it hard to persist.

While the periodic evolution of mobile networks is a feature of that part of the telecoms market (with 4G still being completed and 5G under development) some rather dramatic evolutions can be observed in those markets where infrastructure based competition has been promoted. Figure 1 below demonstrates that even in local access, measures to reduce entry barriers (infrastructure sharing, in-building wiring regimes etc.) have allowed significant entry in those markets



Furthermore, while it is certainly true that in the first wave of investment that there was limited overbuild (so discreet geographic areas were observed) there is some evidence that over time more significant overbuilds have taken place or will take place. For instance Orange intends to match Telefonica's footprint in Spain[9] while Altice suggests similar amibitions in France with Orange[10]. In addition the Commission's Directive on cost reduction for broadband deployment ought to mean that such lowering of entry barriers can be expected to move across other Member States in the future.

[9] http://www.orange.com/en/investors/financial-presentations/financial-press-releases/Essentials2020-Orange-s-new-strategic-plan

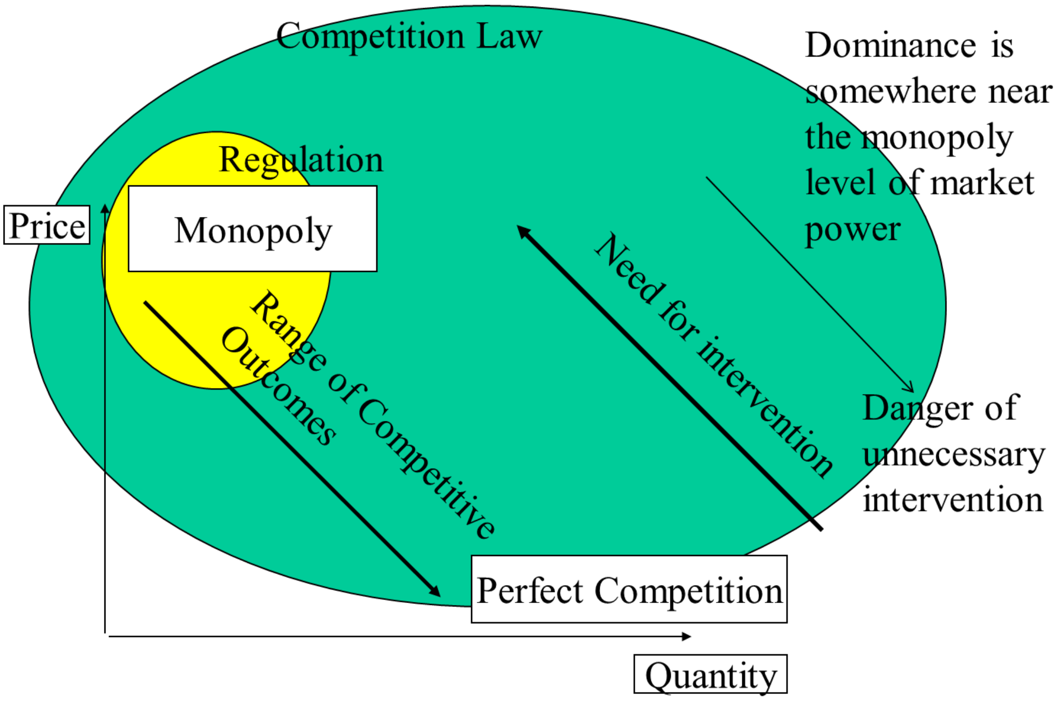
[10] http://altice.net/wp-content/uploads/2015/04/140319-pr-altice.pdf

2. Tight Oligopolies

The FTTH Council would express a profound concern at the suggested approach to tight oligopolies put forward in the draft BEREC document. The conclusion from the FTTH Council's analysis of the issue of Joint Dominance is that it is not suited to oversight by ex ante regulators and is best left to ex post supervision. The analysis from BEREC also sees the difficulty of imposing ex ante regulation but principally sees this as something that might be circumvented by extending regulation to any tight oligopoly. It is, to quote John Wayne, a 'shoot them all and let God sort them out' approach. Such a blunder bust approach risks creating a massive number of type I errors which, as noted in the BEREC paper, are more costly to society than type II errors. It also raises a fundamental concern about the nature of regulatory oversight in the sector and its impact on certainty and investment.

If we consider the scope of regulation in terms of a price output chart we might consider the stylised depiction of competitive outcomes in figure 1-1 as running from a notional monopoly with very high price and correspondingly lower output to the notional perfect competition with low prices and very high output. A range of competitive outcomes which sit closer or further from either extreme are also possible.

Figure 1-1 Stylised depiction of competitive outcomes



It is clear that certain oligopolistic outcomes will sit closer to monopoly (for example Cournot type equilibria) and others will be closer to the ideal of perfect competition (betrand type equilibria). It is often difficult to tell where the resultant outcome sits in a real world example since the outcomes are less stark than those of the stylised example.

A critical difference then between ex ante and ex post regulation is thrown into sharp relief. Ex ante regulation is like an accelerated competition law procedure with some

differences (which facilitate the speed of the intervention). The first difference is that interventions are limited to those areas where, in the presence of market failure (dominance), the resultant harm to consumers is self-evident and so a regulatory intervention is warranted without further consideration. The European regulatory regime uses the so called ‘three-criteria’ test to select those market areas where such intervention are justified. The areas where such interventions are warranted are not many and the number is decreasing over time.

The problem with the proposal from BEREC is that we would start to regulate in areas where consumer harm is not self-evident, i.e. areas which would be covered by Article 101-3 under competition law or its equivalent under Article 102. In essence, once we move to the middle range of market outcomes depicted in Figure 1-1 above, consumers are likely to be better off than under a regulated outcome. In the absence of a consumer harm test there can be not justification for an intervention, either for tight oligopoly or indeed under tacit collusion.

If it is agreed that a consumer harm test should be conducted then the line between ex-ante and ex-post interventions would blur considerably. It therefore becomes clear that such interventions ought to be left to competition authorities and not to sector regulation.

The proposal from BEREC would see oligopolies regulated based on the structure of the market rather than on behavioural aspects. Oligopolistic markets have worked well in the absence of regulation (for example Mobile Origination/retail mobile markets) and in such circumstances regulatory interventions would likely be counterproductive.

The FTTH Council agrees with BEREC that further work and research is needed with respect to tight oligopolies. The FTTH Council would be against any attempt to lower the threshold for market intervention below the current SMP requirement.

The FTTH Council notes the short passages on remedies in the consultation document and would observe that symmetrical remedies, even if not disproportionate, may be counter-productive in that they may reinforce similarities and facilitate co-ordination.

The FTTH Council would like to highlight one concern with respect to the current discussion which is the signal that the current discussion and consultation market is sending to the market and to long term investors in particular. It can be observed that BEREC remains convinced that joint-dominance is an ‘active’ means of intervention and indeed that it wishes to consider lower thresholds for intervention in markets exhibiting joint dominance in general. One concern that the FTTH Council holds is that long term investors, particularly entrant investors face more regulatory uncertainty in such a context. It can be seen that in countries such as Portugal and France the number of incumbent access lines in FTTH is less than 50%. While incumbent market shares may be driven by historical factors in the short term it can be expected over time that the other networks will start to take a stronger position in the market.

From a position of regulation being unlikely to probable will inevitably impact business cases and the decision to invest. The FTTH Council advocates a quick and clear conclusion to the current debate.

The FTTH Council advocates a quick and clear conclusion to the current debate in the interests of creating market certainty.

3. Conclusions

The FTTH Council Europe does not believe that the current approach to regulation of what are basically oligopolistic markets should change. The FTTH Council believes that market forces can and will deliver the best outcomes for European consumers.

The FTTH Council believes that the regulation of jointly dominant entities is something which, if controlled, is best controlled by ex-post authorities. The reason the FTTH Council believes ex-post regulators are better placed to consider issues of tacit collusion is two-fold. In the first instance, ex-ante regulators do not have the appropriate tools to make a full analysis of firms's behaviour and are better placed to regulate where the basis for intervention is clear (single dominance). Competition Authorities have greater powers (eg. the ability to conduct dawn raids and to question witnesses under oath). The second reason is that Competition Authorities have more checks and balances before they intervene (e.g. a requirement to show consumer harm) which NRA's do not have. When dealing with borderline cases, such differences may be crucial.

From a practical perspective as well, the FTTH Council does not believe that telecom markets exhibit the kind of characteristics that would facilitate tacitly collusive co-ordination. As we have seen, telecommunications markets, both from a supply and from a demand perspective are continuously evolving and morphing. Stability, even if heavily orchestrated and institutionalised as within company groups, is difficult to maintain. Taking that requirement outside a company and seeking to create and maintain a collusive agreement through a 'nod and a wink' looks fanciful.

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The FTTH Council advocates a quick and clear conclusion to the current debate in the interests of creating market certainty so that investors contemplating putting large sums of money at risk understand clearly what the regulatory regime will look like in the future.