Specific regulation of telecommunications oligopolies would harm the economy and be unnecessary to regulate duopolies

The cornerstone of EU market regulation is the mandate given to National Regulatory Authorities (NRAs) to impose obligations such as non-discriminatory and cost-based access to the infrastructure of undertakings with significant market power (SMP). Criteria characterising SMP under telecom regulation are criteria characterising dominance under competition law. SMP or dominance may be simple or joint. Undertakings are deemed to enjoy joint SMP if they can tacitly collude in order to collectively behave as one monopoly. In practice, NRAs have generally identified the incumbent telecommunication operator as being the only SMP operator in the narrowly defined market of wholesale access to its own infrastructure.

However since the framework was approved, the landscape has drastically evolved with competitive players present also on the infrastructure markets. This is notably the case with cable networks providing triple play services (telephone, Internet access, IP-TV) in competition with telecommunications operators. Cable is present in numerous European regions and has national coverage in some Member States, in which case the fixed broadband access market tends to be served by a duopoly of vertically integrated infrastructure based providers, one cable operator and one incumbent telecommunications operator.

In this case of national duopoly, it has become inefficient and unfair to consider the incumbent telecommunications operator alone as enjoying SMP and being subject to regulatory obligations. As there are doubts that such national duopoly would lead to effective competition, deregulation is unlikely to be the right option. Are the regulatory tools provided by the current regulatory framework or proposed in the proposal for a European Electronic Communications Code fit to address this situation?

Some NRAs, and the body representing them, BEREC, are claiming that existing regulation falls short of providing the necessary instruments to address this case of national duopolies. They demand that the threshold for regulation be lowered in order to regulate ‘oligopolies’ without being required to demonstrate the existence of SMP. They request the introduction of a new concept of “UMP” (Unilateral Market Power) in addition to the notion of SMP or as a sectoral extension of the notion of SMP. This raises serious concerns and should be discarded.

Whereas regulation of monopolies (resulting either from simple or from joint dominance) is framed by robust economic literature and legal practice, there is no such handbook for the regulation of non-collusive ‘oligopolies’ which would guarantee that regulatory intervention would improve market outcome. If oligopolies in general were to be regulated, then large parts of the European economy – from supermarkets to insurance – should also be access-regulated when evaluated by such standards. It would create legal insecurity for investors in mobile and fixed markets, running directly against the European objective to move towards a Gigabit society, relying on state-of-the-art network infrastructures.

Moreover, no new regulatory instrument is actually needed to properly address the case of national duopolies. A specific analysis shows that the criteria necessary to characterise tacit collusion, and therefore joint dominance as defined by the “Airtours” competition case law, may be met for a duopoly serving a national fixed broadband access market, unless appropriate access to the infrastructures of the duopoly is provided. Such a market is perfectly transparent as any variation in the number of customers of one party is mirrored in the other. Each party has a sustainable individual interest not to compete, because maximizing profit on 50% of the market is more attractive than costly attempts to attract a fringe of the other party’s customers. Moreover, if one party gained a strategic competitive edge over the other, retaliation may not only come from the other party, but also from the NRA which may impose SMP regulation to the winner. So no party in the duopoly has any interest to out-perform the other. Consumers cannot escape the duopoly, as BB access has become a necessity and mobile is not a real substitute. Therefore, the 3 Airtours criteria necessary to identify tacit collusion may be fulfilled, unless the parties of the duopoly provide appropriate access to their infrastructure, making potential entry possible.

Therefore no new regulatory instruments are required to ensure that duopolies provide appropriate access.

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Specific economic regulation of telecommunications oligopolies would lack economic or legal foundation and would threaten the efficiency of telecom markets to the detriment of the economy. Some NRAs in the European Union, and the body representing them, BEREC, request that the future European Code of Electronic Communications grant them the power to regulate telecom oligopolies, outside the case of simple or joint SMP provided for in the current framework. This claim is mainly advocated using the particular case of the fixed cable-telco duopolies. Although the current framework gives NRAs all appropriate means to act in this case, the BEREC nevertheless requests either the introduction of a new concept of "UMP" (Unilateral Market Power), in addition to the notion of SMP, or a sectoral extension of the notion of SMP which would distance the concept of dominance as defined by competition law. This request has been taken up by some MEPs who have tabled amendments along these lines in the parliamentary debate on the draft Code.

Although the BEREC claims to have been inspired by the concepts of "unilateral effects" and "Significant Impediment of Effective Competition" (SIEC) used in merger control, it actually asks for a specific means of regulating telecommunication oligopolies without equivalent in any other sectors of the economy. Indeed, the reference to unilateral effects and to the 'SIEC' used in merger control is not relevant in the case of a market analysis carried out by a regulatory authority. The analysis of the unilateral effects makes the comparison between two situations, one known a priori, before merger and the other anticipated after the merger. The analysis of the variation in competitive intensity or equilibrium market outcome makes it possible to characterize or not a potential "SIEC", which would be a degradation of the level of competition if the merger took place. Therefore SIEC measures the gap between two situations, and does not provide an assessment of a given competitive situation – even on a forward looking basis – as required by a regulatory market analysis.

The context of a merger analysis gives the authority the ability to observe the functioning of the market before merger and in particular to assess the viability of the players and their ability to finance investments. In principle, if the situation before the merger is sustainable, the competition authority in charge will not threaten the viability of the players or the financing of investments, even if it rejects the merger or if accepts the merger with remedies. This would not be true if a regulatory authority regulated an oligopoly, except in cases of tacit collusion, as the outcome of such an intervention would be unknown. There are economic foundations supporting the regulation of a monopoly. In this respect it should be noted that the market outcome of the joint dominance is identical to the market outcome of a monopoly. But no robust economic theory can anticipate the effects of imposing regulation on something other than a monopoly, and ensure that a regulated oligopoly would provide a better outcome than an unregulated oligopoly.

This is why, in market economies such as those required by European treaties, the oligopolistic structures that characterize most sectors of the economy are not subject to any specific ex ante regulation. Therefore, complying with BEREC’s demands for specific regulation for telecommunications oligopolies would subject the telecom sector to a specific and more stringent competition policy than that applied to other sectors, beyond the requirements of the transition from monopoly to competition. It would no longer be a matter of preventing the existence of conduct which would be prohibited by competition law, but of prohibiting or regulating in telecommunications markets situations which are commonplace in all other sectors of the economy without generating intervention.

This would run counter to the primary principle of European competition policy which is to be a horizontal policy that does not privilege or disadvantage any economic sector in order to support efficient resource allocation between economic sectors. Unequal pressure to the disadvantage of the telecom sector would thus lead to a sub-allocation of financial resources to telecom industry, exactly the opposite of the policy desired by the European Union, which is to make telecommunications attractive for investment.

National fixed duopolies may be found to be jointly dominant absent appropriate access to their infrastructures

European jurisprudence (the "Airtours" case) imposes 3 necessary conditions to characterize a situation of joint dominance resulting (by definition of joint dominance) from tacit collusion between actors:
- Transparency in the market allowing each actor to know what each other actor is doing.
- A stable and joint incentive to remain on a collusive equilibrium rather than seeking a competitive advantage over the others, and the possibility and incentives of other players to retaliate against a player which departed from the collusive equilibrium.
- The absence of foreseeable risk of reaction to the collusive behaviour on the part of customers or of potential entrants.

These three cumulative conditions are those considered by the jurisprudence as necessary for companies in a market to be able and willing to maintain an implicit non-aggression pact in order to benefit jointly from a monopoly rent based on their respective acquis rather than compete.

The following paragraphs demonstrate that these three criteria can be shown to be satisfied when the domestic fixed broadband market of a country is served by the duopoly of the cable operator and the incumbent telecommunications operator, when the market is saturated and absent adequate wholesale access to the infrastructures:

- The first criterion on transparency is fulfilled when the market is saturated and inelastic. Then the total number of customers does not vary. This is now the case for the fixed broadband market in most European countries: the market is saturated in number of customers, it is inelastic because internet access is essential to households and mobile is not a satisfactory alternative as it can only support a small percentage of the data traffic generated by the users. Consequently, any variation in the number of customers of one of the two operators of the duopoly corresponds to an opposite variation in the number of customers of the other operator. Each operator thus knows exactly the level of activity of the other operator. Moreover, in all European countries, regulators, public authorities and financial analysts publish detailed statistics of fixed broadband markets which reinforce the transparency of the market.

- The second criterion of joint and stable incentives for the two parties of the duopoly not to compete is fulfilled in the particular context of European telecommunications regulation:
  - Sector-specific regulation of telecommunications provides a compelling motivation for each of the two parties of a duopoly not to seek a decisive strategic competitive advantage over the other. Telecom regulation implies that if one of the two parties of the duopoly obtains a strategic competitive edge over the other, it risks being considered dominant and enjoying SMP on the broadband access market and consequently subject to asymmetric regulation. This asymmetrical regulation would have the object and the effect of annihilating its competitive advantage, reduce the value of its infrastructure and encourage the entry of other players. This ultimate outcome implies that each party of a fixed duopoly has much more to lose rather than to gain in seeking to dominate the other by lowering price or improving service. Hence, due to telecom regulation, each party of a duopoly which considers an aggressive competitive strategy should expect retaliation not only from the other party, but also from regulatory authorities.
  - Besides regulation, pure market forces support the same collusive equilibrium. This is because in a duopoly with balanced market shares and when the market is saturated, the economic incentives to collude are higher than the incentives to compete. The gain in the relative size of the customer base which can be expected from a competitive strategy can only be small (because the existing customer base is already very large) and a competitive strategy is likely to be very costly (because the opponent is of equivalent strength and has a vital need not to become undersized). By contrast, the expected benefit of a collusive strategy is high, as increasing prices on a large customer base up to monopoly price generates large gains, and the risks are low, as the other party has more to gain than to lose by following the same strategy.

- The third criterion necessary to establish joint dominance is the inability of customers or of potential competitors to react to collusive behaviour on the part of the duopoly:
  - Customers cannot unsubscribe from broadband access because it has become essential for everyone's life. Nor can they substitute a mobile subscription for a fixed subscription, because mobile access allows only a very limited use compared to fixed: mobile data traffic represents only 2 to 3% of the total data traffic, 97-98% of which uses fixed access. Hence, the condition that customers have no significant possibilities to react to the collusive behaviour of a duopoly is satisfied.
  - The potential reaction from possible competitors depends on the existence either of a symmetric obligation to share non-replicable fixed access infrastructures, or of appropriate commercial co-investment or co-financing offers giving access seekers long-term rights and competitive variable costs on fixed infrastructure. Such symmetric regulation of infrastructure, or such commercial offers, allow entrants willing to invest to share the non-replicable segments of the fixed access infrastructure. If such access is available, the market can attract entry if the incumbents' margins are
excessive in relation to their investments: market structure can endogenously evolve to reach the right economic equilibrium. But absent appropriate access to the infrastructures of the duopoly, the Airtours criterion that no reaction from potential competitor can be expected would be fulfilled, and joint dominance would be established.

In conclusion, if the national fixed broadband access market is served by a duopoly consisting of the cable operator and the incumbent telecommunications operator, then the criteria for identifying a situation of joint dominance based on tacit collusion are likely to be fulfilled unless symmetric obligations to share non-replicable access infrastructures are imposed, or if the incumbent cable and telecom operators offer wholesale access offers with long-term access and at competitive variable costs. The identification of such tacit collusion can be further confirmed if its symptoms are apparent on the market: high and growing prices, stable market shares, limited level of investment and leverage of joint dominance on related markets. In particular, both fixed operators may own a mobile network operator and develop fixed-mobile convergent offers for which the incremental price of mobile service cannot be matched by pure MNOs, which therefore risk being driven out of the market: such a move would confirm that jointly dominant fixed operators can cross-subsidise their mobile service with the profits made on their fixed activity.

The above argument proves that the case of national duopolies on fixed broadband can be addressed in a legally reliable and economically efficient manner, using the instruments available in the current framework and in the draft Code:

- As a first best option, symmetrical rules for sharing non-replicable fixed access infrastructures or incentives to provide commercial co-investment or commercial co-financing access offers, will reduce entry barriers and allow an endogenous adjustment of competitive market structures taking into account investment requirements.
- As a second best option, absent such access solutions, the NRA will be able to identify joint dominance and to impose access remedies.

Hence wholesale access may well be necessary to prevent tacit collusion in a duopolistic fixed broadband retail market. However, wholesale access may also require regulatory intervention. Formal economic analysis\(^1\) shows that market equilibrium of wholesale access offers provided by a duopoly of vertically integrated operators is likely to be collusive if their retail products are substitutes, the parties of the duopoly choosing a set of two complementary pricing strategies, a monopolistic wholesale price for one of them, and an even higher price, equivalent to refusal of access, for the other.

### Conclusion

BEREC’s request that NRAs should be granted new powers to impose a specific economic regulation on telecommunications oligopolies beyond the requirement of the transition from monopoly to competition and with no equivalent on other sectors in the economy is at odds with the very principles of European competition policy. It would be legally and economically dangerous. It would make investment in telecommunications unattractive and runs counter to the European Union’s policy objectives for the roll-out of very high-speed infrastructure.

Moreover, this request is unjustified as NRAs do not need additional powers to fulfil their tasks. The criteria required by case law to identify joint dominance may indeed be met in the case of a duopoly of incumbent cable and telecommunications operators serving a national fixed broadband access market, absent appropriate access to these fixed infrastructures. The option to identify tacit collusion can be used by NRAs either to incentivise the two parties of the duopoly to provide appropriate access to their infrastructures, possibly under the framework of symmetric infrastructure sharing obligations, or if necessary to impose it. Economic analysis suggests that conditions for wholesale access as provided by a vertically integrated duopoly may also require regulatory intervention.

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\(^1\) M. Bourreau, J. Hombert, J. Pouyet, N. Schutz « Upstream Competition Between Vertically Integrated Firms” The Journal of Industrial Economics 0022-1821 Volume LIX December 2011 No. 4