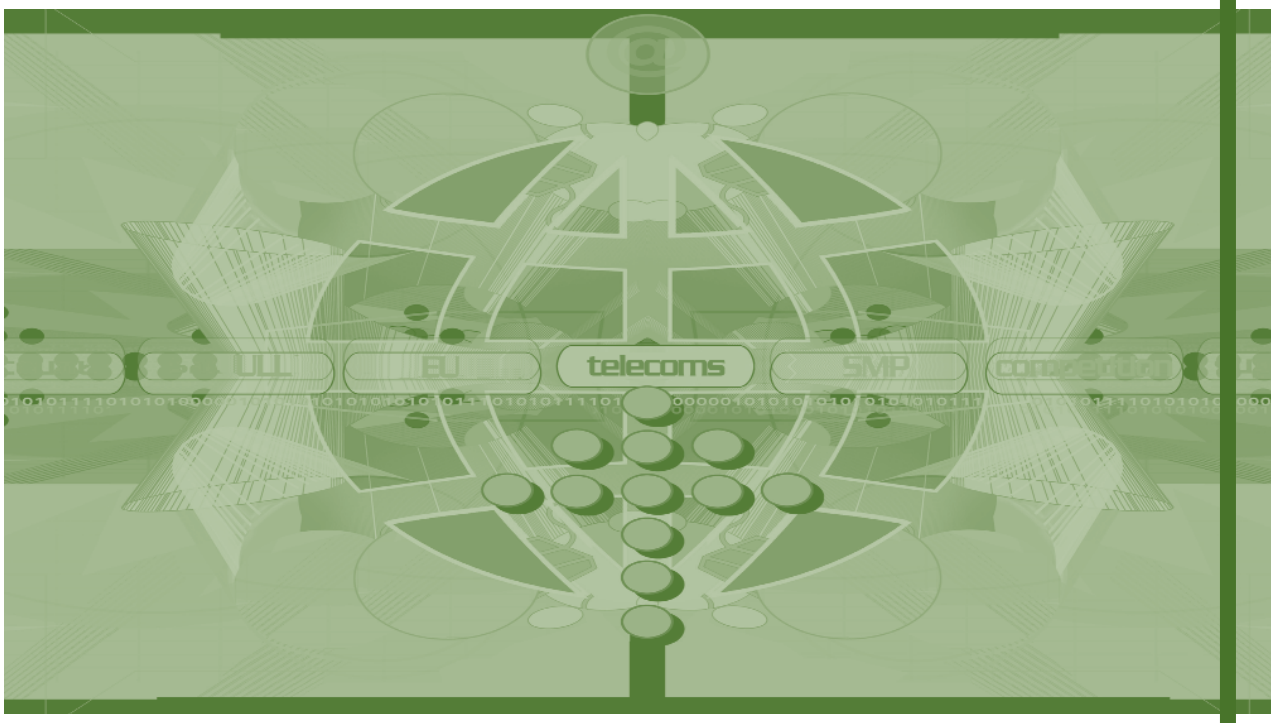
European competition law and the communications sector:

the shift from regulation to enforcement



Christian Duvernoy and Omar Shah

Wilmer, Cutler & Pickering

Post-liberalisation restructuring of the European communications industry continued in 2001, albeit at a slower pace than in 2000. The burst of the "New Economy" bubble and the high cost of obtaining UMTS licences dampened the appetite for large-scale deals and reduced the amount of available capital. On the regulatory front, however, competition and communications regulatory authorities continued to focus on enforcement proceedings to achieve their policy goals. This shift from regulation to enforcement can be seen both in the fundamental revision of the EU communications regulatory framework and in the active process of review of mergers and acquisitions, often cleared only subject to conditions (*see also chapter "EU regulatory framework for telecommunications"*).

The year began with entry into force of a last, purely regulatory measure, as part of the EU's telecommunications framework: as of 1st January, 2001, Regulation (EC) 2887/2000 mandated unbundled access to the local loop. This Regulation evolved into a key component of the proposed Telecoms Package that was adopted on an accelerated timetable separately from the other measures in the Package. Regulation 2887/2000 was intended to open access to the incumbent's local loop, both for competitive infrastructure operators and service providers. By the end of 2001, however, the European Commission had to bring enforcement proceedings against three member states (Greece, Portugal and Germany) to push implementation of the Regulation. It has noted that implementation of local loop unbundling has been very disappointing, in part due to complex operational issues that arose in regard to collocation and pricing (*the Commission's 7th Report on the Implementation of the Telecommunications Regulatory Package*).

The New Regulatory Framework

The New Regulatory Framework for electronic communications, approved in final form by the European Council on 14th February, 2002, introduces a more enforcement-oriented approach to regulation. The New Framework, which member states have 15

Technological developments and policy goals

The shift from regulation to enforcement that is embodied in the New Framework is likely to be reinforced by the following interlinked and overlapping factors:

- **Convergence.** The telecoms, media and IT industries continue to converge to form an electronic communications sector. The response of NRAs and competition authorities is to try to prevent the emergence of bottlenecks and of firms seeking to act as gatekeepers to those bottlenecks on the emerging economic value chain in the electronic communications sector, primarily through the use of competition law-based standards (*see main text "Key cases: Preventing bottlenecks in convergent markets"*).

- **Infrastructure competition.** Regulators will be keen to facilitate convergence by stimulating competition between alternative infrastructures and by encouraging incumbent telcos to divest overlapping infrastructure assets. This may be achieved more and more through the use of *ex post* competition law procedures, in the context of a deal clearance, rather than *ex ante* sector-specific obligations.

- **Behavioural undertakings.** Regulators are likely to be increasingly prepared to see the enforcement of behavioural undertakings put into place in the context of merger control proceedings as a half-way house between the imposition of structural remedies and simply relying on sector-specific regulation. Although fewer new behavioural remedies were imposed in 2001 than in 2000, the effect of earlier remedies was a significant issue in several cases.

months to implement into national law, is based on two fundamental principles:

- A more flexible substantive test, based on competition law, is better suited to regulating the emerging electronic communications sector than the previously applicable standard. The New Framework thus replaces the somewhat mechanical 25% market share test for significant market power (SMP) with the more flexible concept of dominance developed under the EC competition rules.

- Since the national regulatory authorities (NRAs) have now achieved a considerable degree of independence and expertise, they should have even greater responsibility and discretion in applying the regulatory framework to domestic electronic communications markets. Thus, for example, the New Framework entrusts NRAs with the task of defining relevant markets within their territory, in accordance with principles of competition law and taking account of the Recommendation and Guidelines to be published by the Commission on this issue. NRAs are also responsible for assessing, where appropriate in co-operation with national competition authorities, the competitiveness of these markets. As a check on this increased authority, the Commission obtains a veto right on certain NRA decisions, where they would conflict with internal market objectives.

Fact-based inquiries

The New Framework is likely to spur NRAs to achieve regulatory goals using enforcement procedures that turn even more on the individual facts of the case and the weight of the evidence. They will no longer be able to rely on mechanistic application of the SMP threshold under existing sector-specific regulation to justify regulatory intervention. NRAs will have to prove, on the basis of evidence gathered during their investigations, that undertakings are dominant, individually or collectively, before they are in a position to intervene. The Commission will be able to take part in this process only as an observer in national cases or, in extreme cases, by exercising its right to substitute its judgment for that of the NRA. Judicial review may increase in importance if significant differences of opinion develop between NRAs and the Commission.

Key cases

Beyond the changes in approach to regulation that can be expected to result from adoption of the New Package, several cases in 2001 demonstrate the ongoing importance of merger clearance and regulatory enforcement proceedings in achieving the policy goals of the Commission and national regulators. These goals include:

- Ensuring open access to broadband networks.

- Safeguarding against excessive market power through the vertical integration of delivery networks with exclusive rights to content.

- Preventing new bottlenecks in convergent markets (for example, interactive TV services).

- Stimulating increased competition in the provision of mobile services.

Access to broadband networks

Unbundling the local loop: OFTEL enforcement action against *BT*. Although the definition of SMP introduced by the New Regulatory Framework has not yet been implemented into national law, there is evidence to suggest that NRAs may already be anticipating the reform. They are tending to adopt a more sophisticated approach based upon market analysis rather than simply intervening on the basis that the 25% SMP threshold is satisfied. For example, although the Regulation on unbundling of the local loop continues, at present, to refer to the old concept of SMP as embodied in existing sector-specific regulation, the UK NRA, OFTEL, has shown that it will carry out a thorough market analysis before intervening in certain markets. In an *ex officio* investigation, OFTEL found that *BT's* charges for certain services to unbundled local loop operators were excessive and that *BT* had SMP. However, OFTEL took immediate regulatory action only in respect of certain services (provision of line information and escorted access to exchanges). With respect to connection and rental charges for external tie cables (which link operators' equipment with *BT's* local exchanges), it deferred any regulatory action pending a separate analysis of competition in the relevant market. OFTEL took the view that the requirement (of existing sector-specific regulations) for such prices to be cost-oriented could not be considered in isolation from the extent of competition for the services in question.

Broader implications. OFTEL's approach in this case is likely to foreshadow the approach that will be taken by NRAs to the new concept of SMP once it is adopted into national law. This approach is also likely to expose the inherent tension between the overlapping roles of the NRA and the Commission in the New Regulatory Framework. In particular, there is likely to be considerable controversy over:

- The extent to which the Commission is prepared to substitute its judgment for that of NRAs.

- Whether any inconsistency between views at NRA and EC level can be exploited by the addressees of any formal decisions in judicial review proceedings before the national and Community courts.

Digital transmission of radio and TV via alternative infrastructures. With the advent of broadband, downstream services are viewed as becoming more important than upstream infrastructure provision on the economic value chain. As a result, the focus of regulatory scrutiny is shifting from the regulation of individual types of infrastructure to the assessment of the competitive interaction between infrastructure alternatives. Regulators appear to be proceeding on the assumption that competition between alternative infrastructure providers that are not subject to specific regulation, and are all capable of carrying broadly the same services, should lead to a better competitive outcome. The consumer is better served by a lower infrastructure cost component in the prices paid for downstream services than would be achieved solely through competition between individually regulated infrastructure providers.

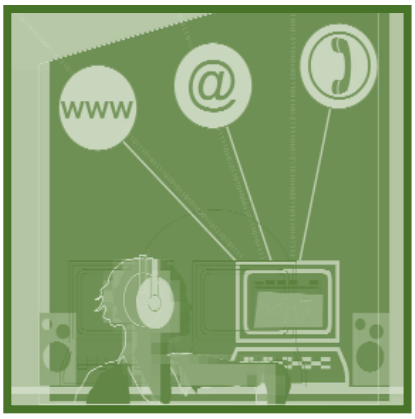
One problem that arises with this assumption is where there are existing, asymmetrical, regulatory obligations, such as between cable and xDSL in *UGC/Liberty Media* (*see below "UGC/Liberty Media"*). Another is where penetration levels for different types of infrastructure in a particular geographic market are asymmetrical. This issue was raised in the Commission's investigation of the acquisition by *Télédiffusion de France* (*TDF*) of joint control of *Digita Oy* (*Digita*) from *Yleisradio Oy*, Finland's national public broadcaster. In its assessment, the Commission found that the market for terrestrial transmission of high/low power frequency radio and TV programmes was distinct from the markets for cable and satellite transmission because of the different relative levels of penetration of satellite, cable and terrestrial broadcast infrastructure. It would not be economically feasible, due to Finland's topography and relatively limited market for radio and TV broadcasting, to replicate national coverage of the terrestrial transmission infrastructure by cable or satellite. As a result, the Commission required that the parties divest their overlapping terrestrial transmission infrastructure (*TDF*'s subsidiary, *Telemast*, was *Digita's* main competitor).

Further issues of market definition. The Commission also found that the introduction of Digital Audio Broadcasting in Finland would create a distinct market for digital (as opposed to analogue) transmission of radio programmes. Additional investment would be required to implement digital transmission as well as co-operation in the allocation and management of frequencies over multiplexers (not required for analogue transmission services). The issue of market definition may need to be revisited in future, since the simultaneous transmission of TV and radio via the internet (for example, over xDSL networks) may amount to a future competitive constraint.

UGC/Liberty Media. The Commission's assessment of the acquisition by *Liberty Media Corporation* of joint control over *UnitedGlobalCom* (*UGC*), and its subsidiary *UPC*, illustrates the importance of cable infrastructure as a platform for the provision of broadband communications services. In its investigation the Commission considered, for the first time, a possible market for the provision of broadband triple play services provided over cable networks. Third parties argued that an upgraded cable network would be the only network that could simultaneously provide broadcast TV (analogue and digital), high-speed internet access, interactive TV services and telephony. They also argued that cable operators could foreclose competitors' access to their networks, whereas competing xDSL operators, with (in their view) a technologically inferior product, were under a regulatory obligation to grant such access.

The Commission left open the issue of market definition, but dismissed these arguments. The Commission noted that it had not been shown that there was such a distinct consumer demand for this combination of services that a cable operator could target specific customers for sales.

Increasing importance of open access. This decision demonstrates again that as cable operators continue to increase market penetration and the range of services that they provide to consumers, the issue of open access to their networks is likely to become more contentious. Both the UK (OFTEL) and the Dutch regulators (NMa and OPTA) have investigated and published reports on the issue in 2001. It appears unlikely, given the conclusions of the NMa, OFTEL and others in their reports, that regulators would be inclined to rely on sector-specific legislation on this issue. Instead, it seems more likely that they will keep under review, under EC and national competition laws, the relative levels of market power held by cable operators. Regulators could be expected to seek open access undertakings only in the event that cable operators' market power allowed them to act as gatekeepers to emerging downstream services markets. Much will depend on the speed of rollout, in the various national markets, of alternative xDSL, broadband fixed wireless and UMTS infrastructures, and their relative success in attracting investment by potential service providers on downstream markets.



Vertical integration between network operators and content providers

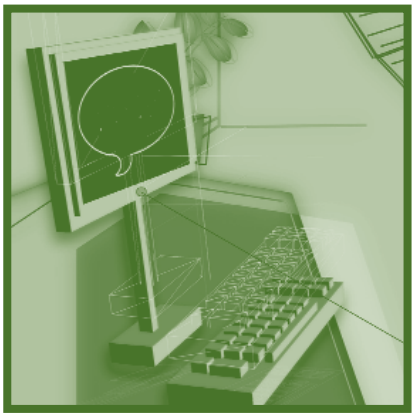
Liberty Media/KDG. The Bundeskartellamt, Germany's competition regulator, just completed an investigation into *Liberty Media's* acquisition of *KDG* (*Deutsche Telekom's* cable television assets). The Bundeskartellamt prohibited the acquisition on the grounds that it would strengthen dominant positions in the markets for:

- Signal transmission to cable TV customers.

- Supplying content feeds to broadband cable networks.

- Supplying pay-TV channels to pay-TV operators.

The Bundeskartellamt also took the view that the acquisition would give the merged entity better access to content than other network operators. Using its position as the largest content buyer in Germany, the merged entity would not only gain superior access to content from entities related to *Liberty Media* (for example, *Discovery Communications*, *UPC*, *QVC* and *News Corp.*) but also to the content of other companies. In addition, the regulator believed that *Liberty's* content offering would become relatively much more important once it had entered the German market. *Liberty* would then supply around 60% of all broadband cable customers in Germany and use the network to distribute its own content.



The Bundeskartellamt did not accept the view that the merger would lead to improvements in competition sufficient to outweigh the negative effects of resulting dominance in the markets identified. Substantial competition between *Liberty* and *Kirch* would be unlikely, due to existing links between the two (*Liberty* holds a significant minority stake in *News Corp.* which, in turn, is linked with *Kirch Pay-TV* through *BSkyB*) and their relationship of interdependence. In the market for the supply of pay-TV channels to pay-TV operators, the monopoly platform operator (*Premiere World*) would, in the view of the Bundeskartellamt, simply be replaced by two monopolistic platform operators (*Liberty* for the cable sector and *Premiere World* for the satellite sector). Upgrading the network to offer a competitive voice telephony service and providing sufficient bandwidth to compete with *Deutsche Telekom's* xDSL broadband services might have generated sufficient countervailing competitive benefits to allow the Bundeskartellamt to clear the deal. However, *Liberty* refused to enter into commitments to undertake all of the investments required. Absent the emergence of a viable competitor to *Deutsche Telekom*, the Bundeskartellamt viewed the harmful competitive impact of the merger as too substantial to approve the transaction.

As with the *UGC* case (*see above "UGC/Liberty Media"*), it is clear that the Bundeskartellamt's primary concern was to prevent the creation of a bottleneck on the cable TV market. The concern was that *Liberty Media* would emerge as a gatekeeper to both content and infrastructure.

Preventing bottlenecks in convergent markets

Microsoft/Telewest/UPC/NTL/TV Cabo. Regulators have become increasingly vigilant about preventing dominant players from exercising control over emerging markets through the use of equity stakes in other companies. An example of this is the decision of the Commission to open an *ex officio* antitrust investigation into *Microsoft's* strategic investments in European cable operators, following on from its prior merger control investigation of *Microsoft's* acquisition of joint control over *Telewest*, a UK cable operator, in 2000. In that case, the Commission had required *Microsoft* to limit its investment in the UK cable operator. This was intended to preserve *Telewest's* ability to make independent commercial decisions as to the type of software to be used in its digital television set-top boxes and thus preclude a *de facto* standardisation of the industry around *Microsoft* software. The own-initiative investigation revealed that *Microsoft* was seeking to influence the technology decisions of other European cable operators by using its minority stakes to establish joint Technology Boards that would make binding recommendations as to operators' technology decisions. In order to prevent the emergence of supply bottlenecks and maintain competition in the market for the supply of software for digital television set-top boxes, the Commission required *Microsoft* and its strategic allies to abolish or change these Technology Boards so that their recommendations were no longer binding.

As regards *Microsoft's* minority stake in *Telewest*, the UK's Office of Fair Trading (OFT) obtained jurisdiction over approval of the investment, following *Microsoft's* decision to relinquish joint control at the insistence of the Commission. The OFT took the view that the existence of *Microsoft's* stake in *Telewest* was unlikely to materially increase the risk of creating a bottleneck on the market for set-top box software, since *Microsoft* had no presence in this market. However, the OFT did note that given the leading position of *Microsoft* in other areas of software development, and the possible convergence of PC and set-top box software, the potential for foreclosure at some point in the future could not be ruled out.

Concerns with leveraging. The approach of the Commission and the OFT in these cases suggests that where dominant players seek to capture value in emerging convergence markets, their behaviour will be judged in accordance with a dominant operator's higher standard of care. They will not be allowed to extend their dominance through the acquisition of majority stakes or through the acquisition of decisive influence over the technology decisions of key market operators using strategic minority stakes. It is also likely that such strategic minority stakes will continue to be the subject of regular complaints by competitors and therefore the target of continuing regulatory scrutiny.

Roaming and termination charges in the mobile sector

Vodafone/Airtel/Eircell. Behavioural undertakings imposed in an earlier procedure do not appear to be a bar to subsequent acquisitions in the same sector provided that such acquisitions do not create unacceptable levels of market power. As part of its conditional clearance of the landmark *Vodafone AirTouch/Mannesmann* merger in 2000, the Commission had imposed behavioural undertakings on the merged entity (*Vodafone*) with respect to an emerging market for advanced seamless pan-European mobile telecoms services for internationally mobile customers and in particular multinational customers (*Mannesmann* Undertakings). In the Commission's view, the merger would allow *Vodafone* to dominate this newly created market. Thus the *Mannesmann* Undertakings sought to stimulate competition within that market by forcing *Vodafone* to provide third parties with non-discriminatory access to certain services (that is, wholesale interconnection services and discounted inter-operator tariffs) for a three year period until 2003.

When *Vodafone* sought to acquire control in first *Eircell* (in Ireland) and then *Airtel* (in Spain), certain third parties argued that the acquisitions should be blocked as they would create anti-competitive effects on the pan-European roaming market and the international wholesale roaming services markets. In the alternative, it was argued that the

Mannesmann Undertakings should be extended beyond the initial three year period to ensure that *Vodafone* could not take advantage of the increased market power it would achieve as a result of these acquisitions. In rejecting these arguments, the Commission noted that the acquisitions would not add significantly to *Vodafone's* existing European footprint, nor, as a result of the *Mannesmann* Undertakings, would they result in foreclosure of third parties to *Vodafone's* enlarged network: both *Eircell* and *Airtel* would also be subject to the *Mannesmann* Undertakings as soon as they came under *Vodafone's* sole control. In addition, there would be sufficient competition on the international wholesale roaming services markets in Ireland, Spain and in other countries where *Vodafone* was active, because of the presence of alternative network operators in both countries after the acquisitions. Finally, the three year duration should not be extended because it was set in the light of the anticipated timetable for the rollout of UMTS network infrastructure and, in any event, the undertakings had already achieved their objective of stimulating competition because other operators such as *Orange*, *KPN* and *Telecom Italia* were offering competing pan-European flat rate services.

International roaming: enforcement action by the Commission. The provision of international roaming by mobile operators has been coming under increasing regulatory scrutiny as a result of persistent allegations that consumer pricing is excessive. As a follow-up to the EU-wide sector inquiry into mobile roaming in January 2000, Commission inspectors and officials from national competition authorities carried out simultaneous dawn raids at nine European mobile telephony operators located in the UK and Germany on 11th July, 2001. According to the Commission, the sector inquiry had established serious competition concerns regarding pricing practices for mobile roaming that warranted further investigations, in particular in the UK and Germany. The purposes of the inspections in these countries were:

- To investigate whether mobile operators had fixed retail prices.

- To establish whether German operators had fixed wholesale prices, and whether these prices were excessive or discriminatory.

The Commission is currently examining these suspected infringements under Articles 81 and 82.

As the status of roaming under existing sector-specific regulation is still unclear, the Commission has been careful to describe it as a form of access under the Access Directive that is part of the New Regulatory Framework. The Commission's sector inquiry showed that operators may not necessarily be individually dominant on wholesale or retail roaming markets. The new concept of SMP will therefore need to be interpreted as incorporating situations of collective dominance in order to allow for regulatory intervention by NRAs in roaming markets. The Commission has referred to (*in its working document "On the initial findings of the sector inquiry into mobile roaming charges"*):

- The existence of a number of economic links between mobile operators (interconnection agreements, memberships of the GSM Association, the WAP and the UMTS forum, and the standardised terms and conditions of roaming agreements).

- The existence of high barriers to entry.

In its assessment, the Commission also suggested that the technology-driven nature of the mobile market did not seem to have affected the conditions of competition prevailing on the wholesale international roaming market.

International roaming is clearly the type of issue in which the Commission is likely to take the lead, as NRAs lack sufficient incentives to intervene and the ability to co-ordinate any intervention. NRAs may, however, rely on the findings of the Commission's investigation in future national enforcement procedures in relation to national roaming. In particular, the Commission's findings on the question of whether mobile operators collectively have SMP on international roaming markets are likely to be of considerable benefit in assessing whether mobile operators collectively have SMP on national roaming markets. Further, the Commission's analysis of relevant markets in the roaming case may also affect the UK Competition Commission's ongoing (and the European Commission's own recently announced) investigations of mobile termination rates. The issue of whether there is a market for the termination of calls on an individual operator's network is clearly going to be crucial in these investigations.

The future

In a mutually reinforcing cycle, the main cases in 2001 show that the shift to enforcement from regulation has much to do with the effort to come to grips with convergence and, in particular, competition between alternative technological platforms. In turn, the phenomenon of convergence reinforces the move from regulation to enforcement, in order to allow regulators to deal on the facts with complex competitive relationships. Convergence may also trigger a (somewhat belated) restructuring of sectoral regulators. Thus, the UK government plans to merge its five existing sectoral regulators (OFTEL, Independent Television Commission, Broadcasting Standards Commission and so on) into one super-regulator, the Office of Communications (OFCOM) by the end of 2003. Similar initiatives may follow in other national jurisdictions. There may also be an increased emphasis on co-operation between NRAs and national competition authorities in the context of assessing M&A transactions.

The long-awaited consolidation of national incumbent telecoms operators is another variant of convergence that seems likely to re-emerge on the agenda. The combined pressure of high debt levels and low profitability in increasingly commoditised core fixed-line businesses could force incumbents to explore defensive cross-border mergers. Such a new wave of restructuring would provide more opportunity to achieve policy goals in the communications sector through enforcement proceedings. Assessment of the competitive interaction between broadband cable, ADSL, satellite, terrestrial, UMTS and broadband fixed wireless networks is likely to increase in significance as the battle to capture maximum value from the European broadband revolution hots up. Given the shift from regulation to enforcement, a co-ordinated approach to the Commission, NRAs and national competition authorities will be required.