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TELECOMMUNICATIONS LAW UPDATES

***Ex Ante* Regulation in the Communications Sector: The European Commission's Draft Guidelines on Significant Market Power**

Introduction and Summary

On March 28, 2001, the European Commission published draft guidelines outlining a new market analysis for calculating significant market power ("SMP") in the electronic communications sector. On April 4, 2001 the European Council endorsed the substance of this analysis.

The guidelines are part of a new regulatory package for electronic communications that will replace the current EU telecommunications regulatory framework. The package will govern any paid transmission of signals over a network — including wireline, wireless, satellite, broadcast, cable TV, and Internet networks.¹ The package's Framework Directive requires national telecommunications regulatory authorities ("NRAs") to impose *ex ante* regulatory obligations on firms with SMP in specific product or service markets. The guidelines list criteria NRAs should consider to assess SMP.

The guidelines are intended to provide NRAs with a more flexible approach to assessing market definition and market power that is taken from EU competition rules and is akin to the process for evaluating market power in mergers. Their application should result in regulatory decision-making that is based more on economics than it is now. (For example, current rules presume SMP when a firm has a market share greater than 25%.) They are also intended to promote predictability and consistency in SMP findings by NRAs.

The Commission is accepting public comments on the guidelines, including on issues such as joint

(collective) dominance, and will hold a public hearing in June. The European Council's formal position on the new regulatory package is not expected until the end of June. The Commission will finalize the draft guidelines when the final Framework Directive is adopted.

Analysis

The Product and Service Markets at Issue

Article 14 of the Framework Directive establishes a two-step SMP analysis. First, the Commission issues a decision identifying product or service markets with competition concerns. Second, within two months, NRAs assess the identified markets, using the criteria in the guidelines. In addition to those in the directive, NRAs may assess markets they define, provided they first obtain Commission agreement. The NRAs then publish their assessments, which will be subject to public consultation before finalization.

Assessment of SMP

The SMP criteria are the most significant part of the draft guidelines. SMP, as defined by European courts under competition law, is a firm's ability to act independently of competitors and consumers.

Ex ante analysis. The SMP criteria emphasize the role of *ex ante* analysis, and certain indicators of dominance will be absent in such an analysis (*e.g.*, past behavior demonstrating market power). *Ex ante*, "market power is essentially measured by reference [to] the power of the undertaking concerned to raise prices by restricting output without incurring a significant loss of sales or revenues." NRAs will initially look at market

share. A firm with a large market share may be dominant if its market share holds over time (the guidelines suggest at least three years for dynamic markets characterized by technological change).

Potential competition and barriers to entry.

As the SMP criteria recognize, potential competition is a key constraint on dominance. NRAs must consider the likelihood that firms not in the relevant market may, in the medium term, enter following a small but significant non-transitory price increase, eroding the power of other firms. A related consideration is ease of market entry. If entry is easy, potential competition will tend to constrain a firm's market dominance.

(Collective) dominance. The guidelines also address the concept of collective dominance, which is still a developing concept in EU competition law. The guidelines stress that structural links between firms are not necessary for there to be collective dominance, and observe that such dominance tends to arise in oligopolistic or highly concentrated markets where structure is conducive to coordinated effects. The guidelines observe that absent certain market characteristics, collective dominance of three or more players is unlikely to persist. Additional criteria relevant to assessing collective dominance are: (i) few market players; (ii) mature markets; (iii) stagnant growth in demand; (iv) homogeneous products; (v) similar cost structures; (vi) similar market shares; (vii) transparent market conditions; (viii) lack of innovation; (ix) links between market players; (x) retaliatory mechanisms; and (xi) lack of price competition.

Leveraging. Concerns arise when a firm can leverage power from one market in a related market. For example, an operator with SMP in an infrastructure market and a significant presence in a downstream services market can have SMP in both markets.

Procedural issues

The guidelines reflect the Commission's desire for more coherent electronic communications regulation

and more consistent regulatory decision-making in the areas of electronic communications and competition. NRAs will have access to investigation and enforcement information held by National Competition Authorities and will be able to request other NRA information from the Commission. Also, NRAs must publish their findings and proposed regulations for comment by interested parties, NRAs, and the Commission. The Commission will then review the proposed measures under the regulatory framework. A measure may be adopted unless the Commission requires its withdrawal or amendment within two months.

Status of the draft

On April 4, 2001, the EU Council reached agreement on potential changes to the proposed regulatory package concerning the definition of SMP and the Commission's power to supervise NRAs. First, the Council defined SMP to be "equivalent to a dominant position," which is the ability to act independently of competitors, customers, and consumers. Also, the Council agreed that "jointly dominant" companies may have SMP under the guidelines. The criteria for SMP findings will be annexed to the Framework Directive and made legally binding.

Second, under the draft proposal, the Commission would not be able to demand amendment or withdrawal of a proposed NRA measure. NRAs would circulate draft measures to other NRAs and the Commission for comment. If the Commission opposes a measure, the NRA would have to justify its reasoning within one month, but the Commission could not demand its withdrawal or amendment.

¹ See WCP Telecommunications Law Update of July 25, 2000, at <http://www.wilmer.com/docs/frameset.cfm?SECTION=ourfirm&PAGE=news>.

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