



WORKSHOP ON COMPETITION POLICY IN TELECOMMUNICATIONS

GENEVA — ITU NEW INITIATIVES PROGRAMME — 20 - 22 NOVEMBER 2002

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CHAIRMAN'S REPORT

1. At the invitation of the ITU Secretary-General, a workshop was held in Geneva from 20-22 November 2002, to discuss competition policy in telecommunications and its implications for ITU Member States and Sector Members. The Strategy and Policy Unit (SPU) organized the Workshop; the tenth in the series under the Secretary-General's "New Initiatives" programme. Some 36 experts participated in the meeting, representing a range of regulatory and policy-making agencies, competition policy authorities, Public Telecommunication Operators and new entrants, academic institutes, user representatives and others. Those present at the meeting participated in an individual capacity. Hank Intven, Senior Partner, McCarthy Tétrault (Canada), chaired the meeting.
2. A background issues document, plus a suggested list of questions for discussion, had been prepared by Eric Lie, Strategy and Policy Unit (SPU), ITU. In addition, a number of country case studies had been commissioned, covering Chile, Denmark, India, and the USA.¹ These were presented, along with the experiences of other economies, including Australia, Germany, Hungary, Hong Kong, China, and Japan. A number of other presentations were made, including from the European Commission, INTUG, Verizon and the WTO. This was the first ITU meeting on implications of competition policy for telecommunications and it was agreed that the information provided and the discussion generated were extremely useful, especially to those currently involved in drafting national policies in this area.

Country case studies

3. Michael Minges and Martha Garcia-Murillo presented the case of **Chile**, which had liberalized its telecommunications sector through a combination of privatisation and new market entry in the late 1980s. The immediate response had been a price war, with the price of international calls in particular being set below cost (the settlement rate) for a couple of years in the early 1990s. Thereafter, market consolidation set in and prices rose again before falling more steadily since the late 1990s. Chile achieved a higher network growth than its neighbours during the 1990s, partly as a result of its pro-competitive stance but also due to private sector participation and high economic growth. Chile currently has a complex structure of competition authorities, with at least four different levels of jurisdictional competence. This structure is currently being simplified.
4. Anders Henten presented the case of **Denmark**, which he had prepared with Lara Srivastava. Denmark has achieved the status of one of the top ICT economies worldwide, in line with its "best and cheapest" policy launched in 1995. This policy moved Denmark ahead of the liberalization schedule established in EU policies. There is a concern now among non-incumbent operators that retail prices, for instance for ADSL, are so low that cross-subsidization occurs, and that, as a result, competitors are deterred from future market entry. Denmark followed a process of consolidation of regional operators into TDC, followed by full privatisation and the licensing of competition in the late 1990s, in line with EU policy. Denmark has both a sector-specific regulator (NTIA) and a competition policy authority, which work in close co-operation.

¹ All of the meeting documents, including presentations and case studies, are available on the ITU website at: <http://www.itu.int/competition>, and will be made available on CD-ROM.

5. Prof. Sidharth Sinha presented the case of **India**, which had relied until recently almost entirely on sector-specific policies, some of which have caused problems for the introduction of effectively competitive markets. The 1994 National Telecommunication Policy (NTP), for instance, focused on the maximization of government revenue through the auction of regional licences for mobile communications (circles and metros). High market entry prices and unfavourable interconnection arrangements had slowed the development of this market segment. Subsequently, the 1999 NTP shifted the focus towards competition, with spectrum fees being converted into a revenue-sharing agreement and additional entrants being licensed. In 2001, the national long distance market was liberalized and in 2002 the international market too. The result has been price cuts of around 40 per cent with the emergence of Bharti as a full-service competitor to the incumbents MTNL and BSNL. A competition law is now being elaborated.

6. John Alden presented the case of the **United States**, where both competition law and sector-specific regulation have evolved from origins in the 19th Century. There are multiple actors in the US policy environment: the Congress and FCC; the Executive Branch, including the Department of Justice; the Federal Trade Commission and other independent agencies; the regulatory commissions of the individual states; and the state and federal courts. Some of the most important decisions, such as the break-up of AT&T in the early 1980s, had been made through the legal system. Current policy concerns include the promotion of broadband networks, the reformulation of universal service funding, and the market consolidation occurring as a result of the industry slowdown. The US system represents a balance between anti-trust and sector-specific policies as applied respectively by the courts and the FCC.

Market definition and Dominance

7. The definitions of markets and dominance are key to the application of competition policy and law in telecommunications and other sectors. In the past, two principal approaches have been taken in defining relevant markets, one based on statutory service classifications commonly used in sector-specific regulation, and the other based on demand and supply substitutability, used in competition law. In the latter approach, a hypothetical monopolist test is typically applied as a tool to identify the range of services and the geographic area that constitute a market. Since markets evolve continually, there is a risk of obsolescence if market definitions are cast in legislation or regulations for the purpose of sector-specific regulation. In this regard, technologically neutral market definitions, such as those underlying the new European Union telecommunications regulatory framework are seen as more flexible than those of countries such as the United States, where traditionally different services, such as fixed, wireless mobile and cable services are regulated under different parts of the US *Communications Act*.

8. Concerns were raised regarding the different approaches taken in the definition of markets by competition authorities and by sector-specific regulators. There were also concerns regarding the difficulties encountered by many sector-specific regulators in the application of the complex economic concepts used to define relevant markets and dominance. It was noted that some of the new competition authorities, including those in developing countries would also face significant technical challenges in applying such concepts. There may be a need to increased programmes of technical assistance programmes, particularly in developing countries. One possible solution is to have competition authorities, possibly jointly with sector-specific regulators, conduct the economic analyses to determine which markets are subject to dominance, and thus subject to *ex ante* regulation by the sector-specific regulators. In this respect, the experience of the EU in trying to develop a new regulatory framework will be closely observed.

9. The topic of how to define suitable markets for mobile services was widely discussed. Possibilities ranged from having separate markets for call termination on each network and call origination, to treating all services involved in the provision of mobile services as a single market. Over time, it was noted that if there is sufficient competition and technological development, a competition authority or sector-specific regulator conducting a market definition analysis may recognize mobile and fixed services as a single access market.

10. A number of countries have used simple measures of market share (e.g. 25, 35 or 40 per cent) to determine which operators are dominant. The new EU regulatory framework has replaced this approach in favour of the traditional tests of dominance used in competition jurisprudence. In the new European practice, dominance is defined to exist when “ an undertaking, either individually or jointly with others, enjoys a position of economic strength affording it power to behave to an appreciable extent independently

of competitors, customers and ultimately consumers”. In identifying dominance, a greater reliance on this type of analysis is generally favoured over simple market share thresholds, which may be poor indicators of dominance, particularly in dynamic markets.

International Competition Policy Developments and the WTO

11. As global telecommunications markets were liberalized and incumbent operators privatized, there has been a growing use of competition policy in regulation of the sector, not only at the national level, but also the international level. The most significant multilateral instrument governing telecommunications sector regulation has been the Reference Paper on Regulation developed by the World Trade Organization (WTO) as part of its 1998 Agreement on Basic Telecommunications.

12. It is recognized that the key regulatory measures required by the Reference Paper, and the concepts underlying these measures, are based on the economic literature and jurisprudence of competition law and policy. While many countries applied competition policy to the telecommunications sector before the WTO Agreement, the more than 70 countries that have adopted the Reference Paper are now legally required to do so, as part of their obligations under the WTO’s *General Agreement on Trade in Services*. Depending on the country, some of these competition policies are being applied by both multi-sectoral competition authorities, but most are applied by sector-specific regulators under sector-specific legislation.

13. The number of countries committing to the WTO Reference Paper continues to grow. In addition to sector-specific instruments, such as the Reference Paper, an increasing number of countries have adopted competition policies and laws of general application. There are around 100 such countries today. At the multilateral level, a number of WTO Member governments have proposed the development of a ‘multilateral framework on competition policy’, which will be discussed as part of the new round of multilateral trade negotiations launched at Doha. The proposal calls for an agreement on competition policy, which would expand principles such as those adopted in the WTO Reference Paper to other industry sectors. One element of the proposal would call for increased co-operation between WTO Members on competition policy matters.

14. International co-operation between competition authorities already occurs as a result of bilateral agreements. However a small group of countries currently have co-operation and information sharing arrangements. Increased co-operation appears essential, among other things, to deal with significant transnational mergers and acquisitions, such as those that have recently occurred in the telecommunications and IT sectors. Additional co-operation between national competition authorities may also be necessary to deal effectively with abuses of dominance and other anti-competitive conduct by transnational telecommunications firms. Such co-operation could also reduce or eliminate the double jeopardy and delays in which such firms are placed by having the same issue determined in more than one jurisdiction.

15. In countries where competition policy and laws are implemented by both telecommunications sector-specific regulators and multi-sectoral competition authorities, it is common, and indeed essential, to have some co-operation between the two. Given the prime role played by sector-specific regulators in *ex ante* application of competition policies to the sector, it would be desirable to increase the level of international co-operation and information sharing at the international level, among both sector-specific regulators and competition authorities.

Anti-competitive Behaviour

16. One of the key differences between *ex ante* sector-specific regulation and *ex post* competition law is that the latter is typically triggered by complaints against anti-competitive behaviour that is potentially punishable by the imposition of penalties or other remedies. Anti-competitive behaviour may include conduct intended to harm competitors or abuse of dominant position. Some competition policy authorities also regulate deceptive or misleading conduct or discrimination among customers. The major difficulty in applying competition law in the fast-changing ICT environment is that it may sometimes take several years to resolve a particular case, during which time the market, the technology and the actors involved might change significantly. For instance, a case brought by MFS (now WorldCom) against KPN in the

Netherlands in 1998 is not due for resolution until 2003, which might be too late to assist the complainant. A successful strategy for the defendant is to engage in delay and to withhold data.

17. There are a number of areas in telecommunications, especially mobile communications, where accusations of anti-competitive behaviour have been made. These include:

- Fixed-to mobile call termination, especially in Europe, where rates are considered to be well above costs (see for instance the research available on the ITU web site at: www.itu.int/fmi). Australia decided to regulate this market in 2000 by encouraging operators to mirror reductions in retail tariffs in their termination charges, and by using the threat of *ex post* action if there was evidence of anti-competitive behaviour. The UK Competition Commission is conducting an enquiry that will be reported in January 2003. The questions of why call termination fees to mobile networks are higher than the termination fees to fixed networks, and the appropriateness of recovering all non-traffic sensitive costs through access charges, were raised.
- Mobile roaming, where users typically have little or no information about the rates they will be charged, may not receive the bill until much later, and where no one jurisdiction may be able to handle complains in the event of faulty billing or poor quality of service. Roaming may be an example of a service where domestic market dominance is used to obtain high fees from foreign operators.
- Pricing for SMS (short message service), where the trend has been for prices to rise, despite a huge increase in the volume of SMS traffic being generated. As SMS is carried over the signaling channel, the costs should be relatively low, but prices are not. Because of the bundling of SMS with other services, it is sometimes difficult to make meaningful price comparisons.
- State aid to former incumbents. Several incumbent operators have debts that run to tens of billions of US Dollars. Should such companies, in some case still partly state-owned, be permitted to receive state aid in the form of loans, refinancing or subsidies?

18. The costs of anti-competitive behaviour fall on the economy as a whole, not just on the sector. For instance, the European Commission estimates that barriers and bottlenecks in the ICT market have slowed GDP growth by around half a percentage point during the 1990s.

Mergers, Acquisitions and other Corporate Alliances

19. Mergers, acquisitions and other corporate alliances may be subject to review by competition authorities and/or sector-specific regulators on an *ex ante* basis, typically through pre-notification requirements, or an *ex post* basis. While *ex post* merger regulation theoretically involves a lighter regulatory burden on business, it raises problems in undoing anti-competitive aspects of mergers after they have been implemented. It was noted that different standards are applied to merger reviews. Competition authorities typically consider the effects on competition, applying tests such as whether there has been a “substantial lessening of competition”. Sector-regulators may apply similar tests, but may also apply broader sector-related policies or ‘public interest’ standards. It was noted that some regulators have applied diverse public policy objectives, leading to merger conditions that appear unrelated to competition concerns.

20. There is a risk of conflicting decisions where both agencies oversee mergers. One solution is to have the sector-specific regulator provide recommendations, including sector-specific policy recommendations, for a final decision made by a competition authority. This solution could overcome problems of jurisdictional overlaps, the danger of industry capture and the relative inexperience of sector-specific regulators in dealing with the analytical techniques of competition law. A more common approach is to promote co-operation and information sharing between the agencies. Co-ordination of deadlines to expedite both processes can also assist, so that the agency making the later decision does not use the earlier decision as a starting point to extract further, and possibly unnecessary conditions for the merger.

21. It was noted that industry consolidation would likely be a continuing trend as a result of a correction in the market structure stemming from over-capacity in the industry. As such, industry consolidation does not necessarily lead to a lessening of competition. Participants indicated that it would be inappropriate to modify the application of competition law principles, simply to protect certain industry players from financial failure.

Access and interconnection

22. In principle, access and interconnection permit operators and their users to reach a larger network with increased benefits for all concerned. The aim is to achieve ubiquity. Where networks are of similar size, and traffic flows are roughly symmetrical, then non-paid interconnection (or peering) benefits all parties. One example of this is the tier one backbone providers in the United States, which continue to peer with each other while requiring charges from ISPs with asymmetric traffic (c.f. the Genuity/Exodus case), for traffic exchange. Another example is the exchange of international SMS messages, which was originally conducted under a sender-keeps-all (“bill and keep”) arrangement, but has transitioned towards a paid termination model as the service has become more commercially attractive and as traffic flows have become asymmetric. For instance, operators in the United Kingdom now charge a termination fee of 3p per SMS terminated.

23. One of the challenges is to understand when asymmetries cease to be a matter of cost recovery and instead become one of anti-competitive discrimination. A further issue for consideration occurs when operators in regulated markets interconnect with unregulated ones. For instance, some have argued that fixed-to-mobile termination charges are much higher than mobile-to-fixed termination charges in some countries, at least in part because of asymmetric regulation. In this view, lifting regulation from the fixed-line market would enable operators to negotiate termination rates on equal terms, and would eventually lead to lower prices for all. However, it remains possible that unregulated fixed-line operators might then use their market dominance to extract excessive termination charges from the mobile operators. Examples of unregulated interconnection arrangements can be found in the Internet market.

24. One example of the significance of asymmetries is in the area of Internet peering. The case of Australia was cited. Here, the ACCC undertook a review in 1997-98, in response to complaints about the refusal of Telstra to peer with three smaller backbone providers (C&W Optus, WorldCom/UUNet and AAPT/Connect). As a result of the review, the ACCC issued a competition notice in 1998 that set penalties, increasing on a daily basis, which could be imposed on Telstra if it was found to have abused its dominant position. In the event, Telstra agreed to peer and, in any case, a large increase in backbone capacity led to a fall in prices. There has also been more regulatory consideration of the broader issue of interconnection among next-generation IP-based networks.

Institutional Approaches to Competition Policy

25. A wide range of institutional approaches has been adopted to implement competition policy in telecommunications markets. At one end of the range is New Zealand, which had neither a telecommunications sector-specific regulator nor until recently sector-specific legislation. Competition policy is implemented by the courts, which apply the generic competition legislation set out in the *Commerce Act* to the telecommunications industry. At the other end of the range, many countries have only telecommunications sector-specific regulators, and no generic competition authorities. In between lie the increasing number of countries with both agencies. In countries with both agencies, there may be risks that need to be addressed of delay, inconsistent rulings and “forum shopping” by complainants. However, in practice, co-operative mechanisms can be developed between the agencies to clarify their respective roles, and to share information and analyses to reduce duplication of efforts and inconsistent rulings. There may be a requirement for more assistance for developing countries in developing a road-map of how to make the best use of sector-specific regulation and competition policy.

26. One approach that is consistent with good competition and telecommunications policy involves defining the relevant product and geographical markets and determining if there are dominant firms in relevant markets based on competition policy analyses. Dominant service providers can be regulated by sector-specific regulators on an *ex ante* basis in the markets where they are dominant. Markets with no clearly dominant service providers can be deregulated or subject to much lighter regulation. However, in those markets, competition authorities may be able to intervene on an *ex post* basis, to apply competition law-based remedies, for instance to deal with cross-sectoral market entry by firms that have a dominant position in a different market segment.

27. The institutional framework must be consistent with the constitutional and institutional framework of each country. Nevertheless, regional and global arrangements, including European Union legislation, multilateral agreements such as those sponsored by the WTO, and bilateral agreements, are likely to lead to a greater harmonization of institutional arrangements.