Oftel Office of Telecommunications

Oftel’s market review guidelines: criteria for the assessment of significant market power

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Summary

S.1 Four new EC Communications Directives entered into force on 24 April 2002. These are the Framework Directive (FD), the Access and Interconnection Directive, the Authorisation Directive and the Universal Service Directive[1]. These Directives must be implemented by Member States to take effect on 25 July 2003

S.2 The new Directives include the requirement that Member States should carry out reviews of competition in communications markets, to ensure that regulation remains proportionate in the light of changing market conditions. More detailed requirements and guidance concerning the conduct of market reviews are provided in the Framework Directive and in European Commission documents.

S.3 Oftel already carried out market reviews as part of its long-term strategy, focusing on effective competition as the best means to deliver a good deal to consumers. Market reviews under the new EC Directives will involve some changes to how Oftel evaluates competition.

S.4 These guidelines outline the criteria that Oftel will use in market reviews to assess whether there is effective competition. The assessment involves many factors, and the analysis is more sophisticated than a simple checklist of criteria. This document therefore provides further guidance on how the criteria will be applied.

S.5 These guidelines are intended to support a consistent application of the market review criteria, and transparency about how Oftel will assess competition.

[1] A fifth key Directive on Communications Data Protection is still to be finalised.

Chapter 1

Introduction

The purpose and scope of these guidelines

1.1 This document explains the criteria that Oftel intends to use to assess the existence of significant market power (SMP) when conducting market reviews in accordance with EC requirements. Oftel's aims in producing this document are

- to support consistency in the application of the market review criteria; and
- to make Oftel's analysis more transparent to stakeholders.

1.2 This document is in three parts

- Chapter 1 provides the background to the production of these guidelines;
- Chapter 2 lists the criteria that Oftel will use to assess the existence of SMP;
- Chapter 3 outlines how other market indicators can inform the review process.

1.3 These guidelines replace the Oftel *Effective Competition Review Guidelines* published in August 2000. Many of the same criteria for assessing effective competition were included in those Guidelines and Oftel's new guidelines, so there is not a radical departure in Oftel's approach.

1.4 This document does not cover the market definitions that Oftel will use in its market reviews. The definitions will be finalised when the European Commission publishes its final Recommendation on the relevant markets, although Oftel has begun its reviews in order to meet tight deadlines. This document also does not cover the remedies that may be applied where SMP is found to exist. Oftel will separately publish a statement on how it will apply certain provisions of the Access and Interconnection Directive (AID) which relate to imposition of 'access' obligations on operators found to have SMP.

The market review requirements

1.5 The obligations in the Framework Directive (FD) relating to market reviews include:

- the overall objectives and principles that Oftel and other National Regulatory Authorities (NRAs) must take into account when making regulatory decisions;

- the principles that (in most cases) reviews of effective competition in markets must be carried out before regulation is imposed, and that regulation should only be imposed where a market is not effectively competitive;

- the requirement that Member States should carry out reviews of competition in communications markets as soon as possible after 24 April 2002;
- the requirement that the market reviews should take into utmost account
    - the EC Recommendation on the relevant product and service markets to be reviewed (final version awaited)[2]; and
    - the EC Guidelines for market analysis and the assessment of significant market power[3];
- the requirement that NRAs review periodically (or after any updating of the Recommendation) whether markets are effectively competitive.

1.6 The FD and the EC Guidelines clarify that a market shall be deemed to be effectively competitive where no operator in that market possesses Significant Market Power (SMP). SMP has been newly defined so that it is equivalent to the competition law concept of dominance. Article 14 of the FD states:

> "An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."

1.7 SMP may be held by only one company in the market (single dominance) or by more than one company (collective, or joint, dominance).

1.8 When determining whether competition is effective or not, NRAs should take into account expected or forseeable market developments.

Developing the market review criteria

1.9 Oftel has produced guidance on the criteria with which to assess effective competition in market reviews, based on the following requirements:

- the need to follow the Framework Directive by maximising consistency in the assessment of SMP, and thus taking the utmost account of the criteria laid down in the European Commission's Guidelines;

[2] A draft Recommendation was issued by the Commission for consultation on 17 June 2002.
[3] *Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services*, OJ [2002] C 165/6.

- the need to promote transparency in Oftel's market analysis, by providing more clarity about how each criterion might be applied.

1.10 The EC Guidelines list a number of criteria that should be used in assessing whether one or more market players have dominance. Separate criteria are listed for the assessment of single and collective dominance. Oftel has not simply reproduced the lists of criteria as they exist in the EC Guidelines, for four reasons:

- The EC Guidelines confirm that the listed criteria are not intended to be exhaustive, rather that they represent the main criteria on which an assessment of market power should be made. In the same way as the EC Guidelines should follow the principles of Competition law, it is necessary that Oftel apply both the listed criteria and any other relevant criteria consistent with the principles of competition law;

- The meaning of the criteria is not fully explained in the EC Guidelines. Oftel considers that transparency of its procedures and consistency in their application requires further explanation of the individual criteria;

- Whilst the EC Guidelines do not specifically state that the single dominance criteria are also relevant when assessing collective dominance, it is consistent with standard competition analysis to consider the relevance of all the criteria before coming to a conclusion about collective dominance;

- The EC Guidelines explicitly state that other criteria than the ones listed in that document may be considered when assessing competition. Oftel has therefore identified such criteria it considers relevant.

The status of these Oftel guidelines

1.11 This document provides guidance only on the assessment of dominance. While the EC Guidelines are non-binding, Oftel is required to take the utmost account of them in the market review process. Thus, the Director General would normally explain any departure from those EC Guidelines.

1.12 The Director General expects to follow these guidelines when carrying out market reviews. However the Director General cannot lawfully fetter his discretion in advance. He therefore retains the ability to depart from these guidelines where the circumstances warrant it. These guidelines are, therefore, not legally binding on the Director General.

1.13 Furthermore, should there be any issue of inconsistency between these guidelines and the EC Guidelines, an interpretation that is consistent with the EC Guidelines will prevail. Both the EC Guidelines and these Oftel guidelines will be subject to review. As noted by paragraph 14 of the EC Guidelines, both those Guidelines and these Oftel guidelines are without prejudice to the case law of the European Court of Justice and the Court of First instance.

Chapter 2

The criteria to assess effective competition

2.1 The tables below list the main criteria that Oftel will consider when assessing dominance in market reviews. They are not a comprehensive list of all possible criteria, rather they show the types of evidence that could be used to support a finding of dominance. Further, the criteria are not cumulative. A dominant position can derive from any combination of the criteria, which taken separately may not be sufficient to determine whether or not there is dominance.

2.2 Also, in accordance with standard competition analysis, flexibility in application of the criteria is necessary between markets, in terms of the criteria used and the weightings applied. Not all criteria will be obviously relevant, although each market review will explain the selection of criteria. The impact on the competition assessment of findings under individual criteria will often differ according to the findings under other criteria, and the relative importance of criteria may change as evidence emerges in the course of a review.

Single dominance

2.3 The existence of a dominant position cannot be established on the sole basis of large market shares. An overall analysis of the economic characteristics of the relevant market is necessary before concluding the existence of SMP. The following criteria are cited in the EC Guidelines as relevant to the assessment of single dominance. Oftel also here provides guidance on the relevance of each criterion for a finding of single dominance.

Table 1: Single dominance criteria listed in EC Guidelines

Criterion	Implication for assessment of market power
Market shares	Market shares are not conclusive on their own. Suppliers with market shares below 25% are not likely to enjoy single dominance. According to case law a market share over 50% would lead to a presumption of dominance. In the European Commission’s decision-making practice, single dominance concerns normally arise where an undertaking has at least a 40% market share. However, there may still be concerns about dominance where an undertaking has less than 40%, according to the size of that undertaking’s market share relative to its competitors. The persistence of a high market share over time is an important factor. The ease with which new entrants might erode that market share and the relative shares of

Criterion	Implication for assessment of market power
	competitors are also relevant. A declining market share may indicate rising competition, but this does not preclude a finding of dominance. Where markets are emergent or growing more quickly, high market shares are less indicative of market power than in more mature or slow-growth markets. Fluctuations in market shares may also indicate a lack of market power. Market shares may be assessed by volume or value of sales. The appropriate measure will vary between markets, although it is likely that the most appropriate measures will be volume for bulk products (eg wholesale conveyance minutes), and value for differentiated (branded) products (eg retail mobile products). Where a firm has a higher share by value than by volume it may indicate that it can price above rivals due to market power.
Overall size of the undertaking	This refers to the potential advantages, and the sustainability of those advantages, that may arise from the large size of an undertaking relative to its competitors. Areas where such advantages may exist include economies of scale (see also separate criterion below) ; finance; purchasing; production capacities; and distribution and marketing. Such advantages may accrue in part due to other activities of the undertaking outside ~~of~~ the market under consideration.
Control of infrastructure not easily duplicated	One example is control/ownership of a large network that a competitor would find costly and time-consuming to build. Such control may represent a significant barrier to entry.
Technological advantages or superiority	Such advantages may represent a barrier to entry as well as an advantage over existing competitors.
Absence of or low countervailing buying power	The existence of customers with a strong negotiating position, which is exercised to produce a significant impact on competition, will tend to restrict the ability of providers to act independently of their customers. Such power is more likely where a customer accounts for a large proportion of the producer's total output, is well-informed about alternative sources of supply, is able to

Criterion	Implication for assessment of market power
	switch to other suppliers readily at little cost to itself, and where it may even be able to begin producing the relevant product itself.
Easy or privileged access to capital markets/financial resources	Such access may represent a barrier to entry as well as an advantage over existing competitors.
Product/services diversification (eg bundled products or services)	Bundling may support dominance by foreclosing the market for part of the bundle to other suppliers, even where the different elements of the bundle are supplied separately. By bundling a service in the supply of which it is dominant with that of another service for which the market is at least potentially competitive, an operator with SMP can exclude rivals and so lever its dominance from the former to the latter market.
Economies of scale	Economies of scale arise when increasing production causes average costs to fall. Economies of scale are common where the production process involves high fixed costs. One other way in which increasing scale can lower unit costs is by allowing greater specialisation, and in turn higher productivity. Economies of scale can act as a barrier to entry as well as an advantage over existing competitors.
Economies of scope	Economies of scope exist where average costs for one product are lower as a result of it being produced jointly with another product by the same firm. Cost savings may be made where common processes are used in production. Economies of scope are common where networks exist, as the capacity of the network can be shared across multiple products. Economies of scope can be a barrier to entry as well as an advantage over existing competitors.
Vertical integration	Vertical integration can promote dominance in two ways • by making new market entry harder due to control of upstream or downstream markets • through the potential ability to lever market power into upstream or downstream markets, thereby adversely affecting competition

Criterion	Implication for assessment of market power
A highly developed distribution and sales network	Well-developed distribution systems are costly to replicate and maintain, and may even be incapable of duplication. They may represent a barrier to entry as well as an advantage over existing competitors.
Absence of potential competition	This refers to the prospect of new competitors entering the market within the timeframe considered by the review. The record of past entry is one factor that can be looked at, as well as potential barriers to entry such as those under 'Ease of market entry' below.
Barriers to expansion	There may be more active competition where there are lower barriers to market growth and expansion. However, the higher the barriers to entry into the market, the less significant the absence of barriers to expansion will be in assessing competition, because with high barriers to entry competition is less likely to extend beyond the existing market players.

Criterion	Implication for assessment of market power
Ease of market entry	The threat of potential entry may prevent incumbent firms from raising prices above competitive levels. However, if there are significant barriers to entry, this threat may be weak or absent. Incumbent operators may then be able to raise prices and make persistent excess profits without attracting additional competition that would reduce them again. The impact of these barriers is likely to be greater where the market is growing slowly and is initially dominated by one large supplier, as entrants will be able to grow only by attracting customers from the dominant firm. However, barriers to entry may become less relevant where markets are associated with ongoing technological change and innovation. Structural barriers plus any evidence of both potential and actual entry are relevant to the assessment, although lack of entry may also be a rational decision given price signals and potential profits. For example, not enough customers may be willing to switch given the level of potential savings available. Reviews should consider whether there is evidence that new competitors might have a significant impact within the time frame considered by the review. There are two broad categories of barriers to entry - strategic and absolute. Absolute barriers exist where firms own, have access to, or are granted privileged use of important assets or resources which are not similarly accessible to potential entrants. Strategic barriers arise due to the strategic behaviour of existing market players, for example through pricing behaviour (such as predatory pricing, price-squeezing, cross-subsidies and price discrimination) or through non-price behaviour (such as increased investment, promotion and distribution). Whilst structural and behavioural aspects can be interwoven, making the absolute-strategic distinction may better indicate the appropriate remedies to apply to address dominance. Sunk costs can be an important barrier to entry. These are costs which are needed to enter an industry but which cannot be recovered on exit – for example investment to set up a production plant or to build a network. Existing firms, which only have to cover ongoing costs, could set

Criterion	Implication for assessment of market power
	prices too low to allow entrants to both recover sunk costs and compete. Other potential barriers to entry are cited among the criteria listed above. Further examples are: patents and other intellectual property rights; legislative or other regulatory requirements; brand image (including high advertising); and distribution agreements.

Criteria for assessing collective dominance

2.4 The EC Guidelines quote the Framework Directive and jurisprudence that states that collective dominance refers to the situation where a dominant position is held by two or more undertakings that are legally and economically independent of each other.

2.5 The FD and jurisprudence also state that a finding of collective dominance is not limited to situations where there are structural links between the undertakings concerned. The EC Guidelines state that a finding of collective dominance "can also be made in relation to an oligopolistic or highly concentrated market whose structure alone, in particular, is conducive to co-ordinated effects on the relevant market"[4]

2.6 When assessing in a market review the likely existence (or emergence) of a market which is (or could become) conducive to collective dominance in the form of tacit co-ordination, NRAs should assess:

a) whether the characteristics of the market make it conducive to tacit co-ordination;

b) whether such co-ordination is sustainable, in that
   - any of the undertakings have the ability and incentive to deviate from the co-ordinated outcome, considering the ability and incentives of the non-deviators to retaliate; and
   - buyers, fringe competitors and potential entrants have the ability and incentive to challenge any anti-competitive co-ordinated outcome.

2.7 In Table 2 below, Oftel lists as criteria for collective dominance the characteristics that the FD and EC Guidelines list as being likely to be conducive to co-ordinated effects on the market. Oftel also provides guidance on the relevance of each criterion for a finding of collective dominance.

[4] EC Guidelines, paragraph 94.

2.8 Annex II of the FD states that the criteria in this list are not exhaustive, nor are they cumulative. Rather, that these criteria are intended to illustrate the sorts of evidence that could be used to support assertions concerning the existence of a collective (oligopolistic) dominance in the form of tacit co-ordination.

Table 2: Collective dominance criteria listed in EC Guidelines

Criterion	**Implication for assessment of collective dominance**
Market concentration	Collective dominance is more likely in a highly concentrated market. However, even where a market is highly concentrated it does not necessarily warrant a finding that the structure of the market is conducive to collective dominance in the form of tacit co-ordination.
Transparency	A situation where companies can easily obtain good knowledge of their competitors' prices and customers is more conducive to collective dominance.
Mature market	In more mature markets, it is harder to enter the market and attract new customers.
Stagnant or moderate growth on the demand side	The faster demand is growing, the more likely providers are to compete aggressively due to the potentially higher returns available in terms of future market share and profits.
Low elasticity of demand	Where customer demand does not change much in response to price changes, there is less incentive to reduce prices in order to undercut competitors. Elasticity of demand may be low for various reasons, including low importance of the product in customers' total spending. Some other potential reasons appear in Table 3 below, under the 'Barriers to switching' and 'Consumers' ability to access & use information' criteria.
Homogenous product	The more similar the products, or the more similar they are perceived by customers, the stronger the potential for price competition between providers which may increase the incentive to collude.
Similar cost structures	Similar cost structures would make muted price competition easier, as for a given price level similar costs will produce similar levels of profit
Similar market shares	Large imbalances of market share between suppliers may make collective dominance less likely. Behaviour that limits

Criterion	Implication for assessment of collective dominance
	competition may be more likely where market shares are similar. A situation of static market shares may result from collusion or muted competition.
Lack of technical innovation, mature technology	The more mature the technology, the lower the scope for providers to compete by being differentiated on technology grounds.
Absence of excess capacity	Absence of excess capacity would tend to make it easier to maintain an anti-competitive agreement, as providers would not have an incentive to break an agreement by using their excess capacity to produce at a lower price, and in so doing make more profit overall.
High barriers to entry	Barriers to entry are covered in Table 1 above, mainly under the ‘Ease of market entry’ criterion.
Lack of countervailing buying power	The existence of customers with a strong negotiating position, which is exercised to produce a significant impact on competition, will tend to restrict the ability of providers to act independently of their customers. Such power is more likely where a customer accounts for a large proportion of the producer’s total output, is well-informed about alternative sources of supply, is able to switch to other suppliers readily at little cost to itself, and where it may even be able to begin producing the relevant product itself.
Lack of potential competition	This refers to the prospect of new competitors entering the market within the timeframe considered by the review. The record of past entry is one factor that can be looked at, as well as potential barriers to entry such as those under ‘Ease of market entry’ in Table 1 above.
Various kind of informal or other links between the undertakings concerned	Evidence of such links will inform an assessment of the potential for collusion. However such evidence is not a pre-requisite for finding a collectively dominant position. For example, links may exist to legitimately resolve common issues through self-regulation. Patterns of price movements are one piece of evidence that might indicate concerted action by firms.
Retaliatory mechanisms	Such mechanisms can deter action that might break collective

Criterion	Implication for assessment of collective dominance
	agreements. An example of such a mechanism would be a credible threat of stronger price competition that would impact unequally upon providers. In this example, a provider that would be likely to suffer more than at least some competitors were an agreement to be broken and retaliatory price competition ensued would be less likely to try to break that agreement.
Lack of or reduced scope for price competition	If competition were effective, one would generally expect to see prices close to or moving towards cost. But the potential for tough price competition can create an incentive not to compete actively. An assessment of some of the other collective dominance criteria may also indicate limited scope for price competition. So a potential result of collective dominance is evidence of a history of market price movements within a narrow range

2.9 Where a sufficient number of the above collective dominance criteria are met, Oftel will examine whether, in particular, the market operators have a strong incentive to move towards a co-ordinated market outcome rather than competing. Such an incentive will exist where the firms in question are conscious that the long-term benefits of anti-competitive conduct outweigh the short-term gains from competitive behaviour.

2.10 Collective dominance may be assessed after considering both the collective dominance criteria in Table 2 and the single dominance criteria in Table 1. It is appropriate to consider the various factors affecting the power of the individual undertakings as well as the criteria that suggest whether those undertakings are behaving in a co-ordinated way.

Other criteria for assessing dominance

2.11 The EC Guidelines explicitly state that criteria other than the ones listed in that document may be considered when assessing competition. Oftel considers that the following criteria may also provide useful evidence in the assessment of both single and collective dominance.

Table 3: Dominance criteria further to those in the EC Guidelines

Criterion	Implication for assessment of market power
Excess pricing and profitability	The ability to price at a level that keeps profits persistently and significantly above the competitive level is an important indicator of market power. The EC Guidelines (paragraph 73) refer to the importance, when assessing market power on an

Criterion	Implication for assessment of market power
	ex-ante basis, of considering the power of undertakings to raise prices without incurring a significant loss of sales or revenue. In a competitive market, individual firms should not be able to persistently raise prices above costs and sustain excess profits. As costs fall, prices should be expected to fall too if competition is effective. Factors that may explain excess profits in the short term, such as greater innovation and efficiency, or unexpected changes in demand, should however be considered in interpreting high profit figures. Conversely, low profits may be more an indicator of the inefficiency of the firm than of effective competition.
Lack of active competition on non-price factors	Non-price competition refers to differentiation between products and providers. Differentiation may be both vertical (differences in quality) and horizontal (differences in terms of variety). The impact of differentiation will be greater to the extent that customers fully perceive the differences that providers are promoting. More differentiation may be expected where customer priorities are more oriented to quality and features of their service relative to low prices. In practice, the practical difficulties of monitoring retail offerings in detail may limit the analysis on this criterion to a very general level.
Barriers to switching	Limited customer ability to switch between providers increases the extent to which providers can act independently of their existing customers. Barriers might exist on the demand side or be maintained by suppliers. The former include the cost and practical difficulty of switching relative to the potential benefits, and customers' awareness of both their ability to switch and the procedures involved. Other potential barriers are the perceived quality of service and reputation of alternative suppliers, and customers' reluctance to take risks with alternative providers.
Customers' ability to access & use	Limited customer access to and use of reliable information on prices and other aspects of the services can dampen

Criterion	Implication for assessment of market power
information	competition by reducing the degree to which customers act upon differences between providers. As a result, providers are better able to act independently of customers. However, it is possible for active behaviour by relatively more aware customer segments to produce competitive effects disproportionate to the number of customers involved. This criterion is distinct from ‘Barriers to switching’ in that switching does not cover first time purchasers of a product. These customers may be more numerous than switchers at certain stages of a product’s life cycle.

Chapter 3

Other indicators

3.1 In addition to the criteria described above for assessing effective competition, Oftel considers that some other indicators can also provide a valuable input to the market reviews. These indicators would include items such as:

- benchmarking of the deal received by UK consumers against that received by consumers in similar economies;
- consumer satisfaction with service; and
- evidence of previous anti-competitive behaviour or collusion.

3.2 These indicators are not underlying factors influencing the effectiveness of competition, so should not be used to assess whether there is dominance. But they could nonetheless prove useful as factors to consider :

- when developing an appropriate regulatory response, if there is a finding of dominance;
- in deciding on the timing of the next market review; and
- as an additional source of information when considering provisional findings of dominance, especially where finely balanced

Next steps

3.3 This document has been published as a statement in order to give early visibility of the basis on which Oftel's market review teams are now conducting their work. Further, as most of the criteria to assess dominance derive from the EC Guidelines, of which Oftel must take utmost account, the added value from consultation may be limited. Finally, individual market reviews will have to choose appropriate criteria to assess dominance, and will publish consultation documents that will afford the opportunity to comment on the criteria in the context of each specific market.

3.4 However, Oftel would welcome any general comments from stakeholders on these Oftel guidelines. These should be addressed to:

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