

January 2005

## ETNO Reflection Document commenting on the ERG Working Paper on the SMP concept

### Executive Summary:

We welcome the ERG's effort in its Working Paper (WP) to interpret and harmonise the use of this concept so it better meets the actual state of competition in the relevant markets. ETNO is not convinced that the ERG Working Paper on SMP adds much value to the Commission Guidelines on SMP. The Working paper does neither provide guidance based on practical evidence on how to apply SMP assessment nor does it bring clarity regarding SMP criteria such as market share, excessive pricing or joint dominance.

Several of the criteria discussed in the paper, for example barriers to switching or scale advantages, are not analysed throughout. As can already be seen from the ongoing market analysis in Member States, the ERG has not enabled a harmonised approach to market analysis and the Working Paper is not likely to assist NRAs in achieving this important goal.

The notion of SMP is a core concept in EU's new regulatory framework that triggered the European Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services adopted on the 11<sup>th</sup> of July, 2002. These guidelines represent for the moment the basis for NRAs to analyse a relevant market before concluding on SMP designation. In line with the NRF and these guidelines, SMP will be assessed using the same methodologies as under competition law.

We welcome the ERG's effort in its Working Paper (WP) to interpret and harmonise the use of this concept so it better meets the actual state of competition in the relevant markets. However, a specific ERG paper can only be useful if it provides a real complement to the established Commission guidelines. It seems that the current WP mainly summarizes the guidelines instead of providing clarity and effective added value. As it is written for the moment, the WP neither helps to harmonise the use of the SMP concept since NRAs will have to interpret one more reference paper, nor does it add guidance based on practical experience.

ETNO agrees with the ERG that the appropriate framework for any additional elaboration of the concept is the Commission's Guidelines

together with relevant jurisprudence. So if NRAs deem necessary to add an ERG paper regarding the SMP concept, it should describe how the Commission Guidelines should be interpreted in a practical way.

Unfortunately, apart from the WP's overview of the well-known Guidelines concepts, ETNO is not convinced how much clarity and value for the following reasons:

- The WP emphasises that it will look at the '*theoretical implications*' as well as the '*theoretic economic background*' (p.1). However, this emphasis does not correspond with the WP's laudable intention to provide '*further explanation and common sense interpretation of relevant criteria*' (p.2). While we prefer sound theoretical justification rather than 'common sense' when SMP is analysed, ETNO also believes that practical guidance based on the experience already achieved better reflects the actual requirements.
- In several instances, the WP takes a flexible approach which has an effect on the degree of clarity. When the WP for example concerning market shares recommends that for bulk products market shares should be calculated in terms of volume and for differentiated products in terms of value whilst at the same time stating: '*in most cases it might be appropriate to analyse both for a proper assessment*' (p.4) the exact guidance is difficult to see and could be omitted. The same applies for the conclusion on '*excessive pricing*' (§20) where apparently both high and low profit are indicators of lack of competition.
- We welcome that the ERG seeks to substantiate the criteria mentioned in the Guidelines §78-79, but we haven't in the WP found many concrete examples that would facilitate an appropriate choice and application of the criteria. This would be more helpful than references to although interesting then rather theoretical game theory principles (as '*topsy-turvy*' in §30).
- The ERG seeks to identify '*further possible indicators*' of SMP; we rather call, in accordance with §78, for a thorough analysis not uniquely focussing on market shares but considering more evidence based market analysis. However, concerning '*further indicators*', we are surprised to see indicators proposed such as the number of unsettled disputes:

*'Evidence of previous anti-competitive behaviour'.  
...Supplementary to this is the number of reported complaints on the exercise of anticompetitive practices. (§42)*

If this criterion should be taken seriously it may open the door for an abuse of the complaint system in order to create 'SMP' and does not meet the requirement of the Guidelines to take a forward-looking approach.

- We suggest that central criteria of the SMP assessment such as 'economics of scope/scale' as well as 'vertical integration' if applied, have to be demonstrated. We have in several instances during the ongoing market analysis seen these theoretical concepts used to identify lack of competition leading to SMP status without further justification or evidence.
- The WP fails to acknowledge that not all criteria are of relevance in a given type of market. The WP explains rightly that:

*What (set of) criteria is of particular importance, has always to be considered in the context of a certain market taking into account the specific facts of the individual case. In order to evaluate the relevance of criteria to assess effective competition, it is also useful to consider them against the background of the respective market phase: concentration processes, the mixture of behavioural parameters and the resulting performance indicators etc. are often different, depending to the particular market phase' (§6)*

However, the WP should highlight that not all criteria are relevant ones in a given type of market. Our experience so far with the market analysis process indicates that the value given to some criteria is not evidence-based and rather applied mechanically.

For example, in wholesale markets for transport or leased lines the number of providers will for natural reasons be limited and the buyers will be very informed about conditions. In this market type, primary criteria for assessing SMP may for example be entry barriers or switching cost.

Besides these general comments on the scope of the WP we have identified some paragraphs needing further consideration.

## Specific paragraphs/issues

- Joint dominance §2

The WP explains that it will provide additional information on joint dominance. Besides the summary of the Airtours/First Choice case in § 25 we haven't found that information in the WP.

A lack of clarity appears also when the WP deals with criteria for joint dominance. In §30 the WP discusses demand elasticity as a criteria that may enforce collusion. In short the WP claims that if the elasticity is low there is a lack of incentives to reduce prices because the volume effect is low, hence joint dominance. However, if the elasticity is high the gains from coordinated activities are also high, also leading to joint dominance. So the theoretical discussion of the relationship between elasticity and joint dominance gives no guidance or common sense interpretation of the relevant criteria (Low elasticity of demand).

- Economies of scale (§14)

The WP identifies as one example of scale advantages that scale is '*allowing greater specialisation, and in turn higher productivity*'.

However, this ignores that scale/scope advantages – as the bundling advantages mentioned in §13 – may reduce flexibility. For the 'scale' company there may be larger costs in switching production lines and at the same time there is an increased dependency between products which may make it difficult to phase out products which on a stand alone basis would become obsolete. For example, the arrival of telephony based on IP may reduce some of the current scale advantages for PSTN based voice traffic.

- Excessive pricing §20

Under competition law the finding of excessive pricing is subject to high evidentiary standards. The test the ERG is eventually turning to does not reflect these requirements ("*compare the prices of the undertakings active in the market [...] to get an idea whether the company seems to price .. above cost*"). Such summary analysis would not provide valid indications for the existence of SMP as it disregards differences in costs and other factors such as quality which influence consumer decisions.

- Cost and barriers to switching (§22)

The WP finds that consumer surveys can be used to identify barriers to switching. This may provide some information in some cases, but exactly regarding switching barriers it is highly important that no conclusions are drawn from such surveys until a distinction is made between the real and the perceived barriers. In the ongoing market analysis we have already seen examples where consumer surveys were used in a rather naïve way to draw far reaching conclusions.

- Control of infrastructure (§9)

The ERG has put much emphasis on the 'ladder of investment' concept. Therefore we are surprised that at the same time the paragraph has been deleted which in the previous version of the WP was dealing with the balance between infrastructure and service competition. This was the only part of the first draft version of the WP that dealt with infrastructure competition as an objective to be pursued by the NRF. Such considerations should definitely be part of the WP as the objective to promote infrastructure based competition is now a main task within national law (as a first evaluation of most of the Member States which have already implemented the new framework shows):

*"47. Infrastructure based, sustainable competition. In doing an effective competition analysis NRAs will have to consider (particularly when this analysis is done for the first time within the new framework) whether existing competition would prevail and be self-sustainable even in the absence of regulatory intervention. While service and infrastructure competition are not contrary to each other (but complements), the*

*existence of infrastructure based competition may provide evidence for sustainability."*<sup>1</sup>

## **Conclusion**

The ERG already wrote a draft paper on the concept of SMP in May 2003, and it is not clear whether this paper has been really useful for NRAs during their market analyses. Today, more than a hundred notifications were sent to the Commission and it would be interesting to know if the NRAs carried out their market analyses by basing them exclusively on the Commission Guidelines or if the 2003 draft paper effectively gave them any helpful explanations.

Nevertheless, the analysis of the various notifications already sent shows that we are still far from a real harmonization and the European internal market remains fragmented. So, as far as the ERG members feel the need to complete the Commission Guidelines relative to the market analyses, it would be desirable that they produce a document which illustrates the methods implemented during the analyses carried out so far, analyze the deviations in the interpretation and agree on a common vision of the SMP concept. In any case, such a document should be endorsed by the European Commission.

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<sup>1</sup> Paragraph 47, ERG (03)09 rev. 2