
The New EU Regulatory Framework for Electronic Communications: Market Definition

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Overview

- Principles of Competition Law
- The concept of a “Dominant Position”
- Market definition in competition policy and the New Framework
 - The Hypothetical Monopolist Test
 - Is Market Definition really necessary?
 - Conclusions

Principles of Competition Law

- The New EU Regulatory Framework for Electronic Communications is informed by the principles of competition law – “ex ante regulation”
- Article 8 of the Framework Directive 2002/21/EC states *inter alia* “ensuring that there is no distortion or restriction of competition”
- Distortion or the restriction of competition is associated with ‘market power’
- The methodological framework for assessing ‘market power’ is based on the concept of a ‘dominant position’
- Relevant documentation: The Framework Directive, “The Guidelines” on Market Analysis and SMP (article 15(2) FD), and the Commission Recommendation on Relevant Product and Service Markets (in draft)

What is meant by a dominant position?

- The economic understanding of a dominant position is taken in the context of a 'relevant' market to mean the ability for one or more undertakings to influence economic variables (prices, outputs, etc.) that have a material effect on welfare – which means that competitive constraints are relatively weak (maybe due to entry barriers, tacit collusion, etc.). Exercising market power.
- Article 14 of the Framework Directive: “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.” (as established in *United Brands* 1978 (Case 27/76 1978, CMLR 429))

Defining markets – the why

- The Framework Directive establishes policy objectives that are consistent with the promotion of effective competition (article 8)
 - The transition from the existing regime set up in 1998 to the New Framework necessitates the identification of Significant Market Power (SMP) – that is, dominance
 - Market definition is primarily an analytical tool to help identify in a systematic way the competitive constraints that an undertaking faces. Its purpose is to identify the competitive features that constrain one or more undertakings' economic behaviour in a market. The greater the effects of competitive constraints, the less likely it is that market power is significant.

Market definition in competition policy

- The definition of markets in competition policy, sometimes referred to as defining *relevant markets*, is an integral party of the application of competition law when assessing the likely effects of a merger, agreement, or behaviour, on the competitive process.
- In many cases, but not all, market definition is seen as a ‘first step’ in an investigation
 - However, some economists take a view that market definition is unnecessary in competition policy

Market definition in competition policy

Market definition in abuse
of dominance case

Define Market

Is one or more
undertaking
dominant?

Is there an
abuse?

Remedies?

Market definition in a
merger case

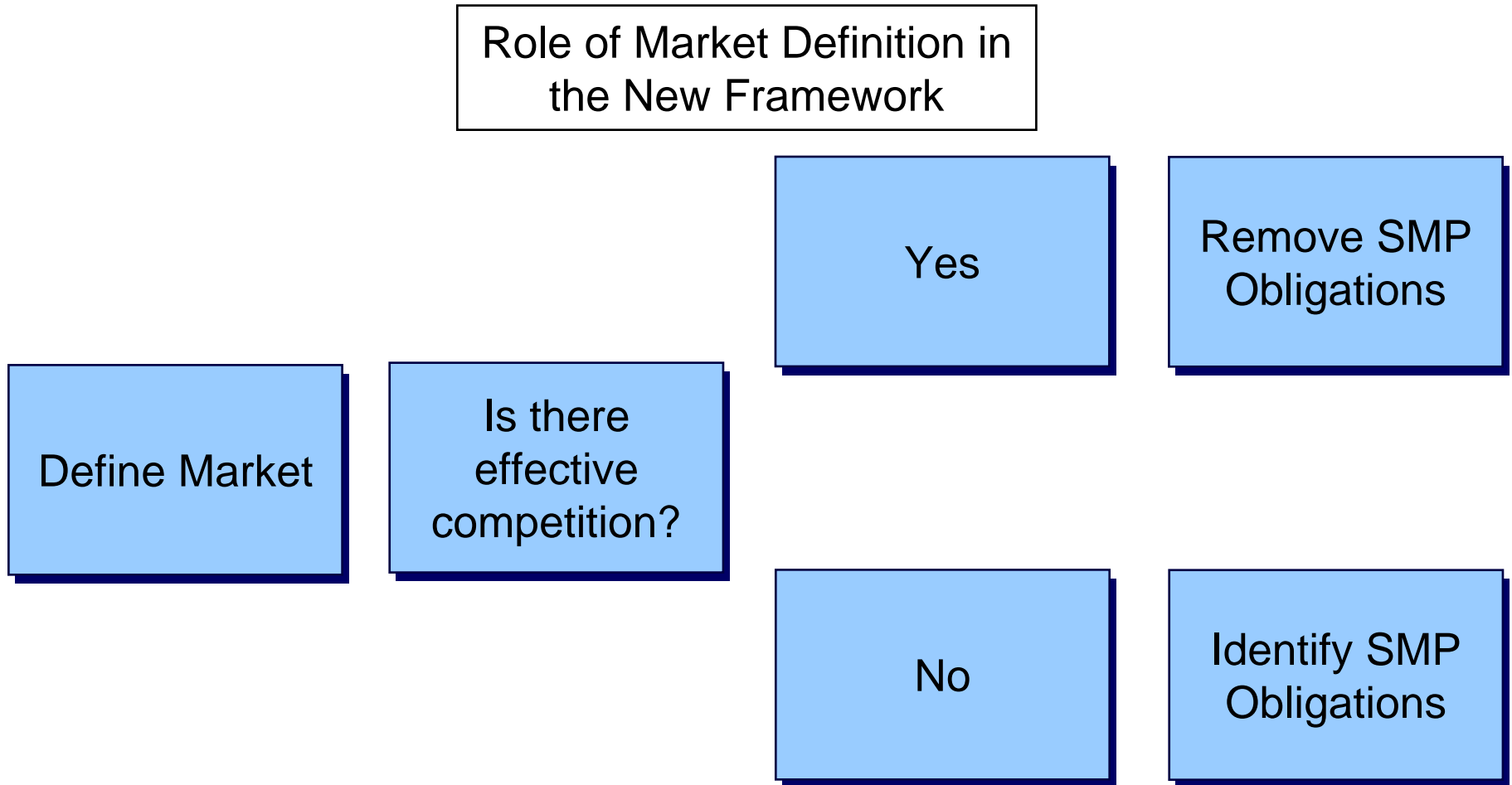
Define Market

Does merger
create or
strengthen
dominance?

Does it
compromise
economic
welfare?

Decision

Market definition in the New Framework



Economics and market definition

- There are three broad dimensions to a market:
 - ◆ Spatial or geography
 - ◆ Product characteristics
 - ◆ Time or temporal
- The above are crucial elements in market definition

Economics and Market Definition

- Scheffman and Spiller (1987) *Jnl of Law and Economics*:

“[...] a classically defined market is that area and set of products within which prices are linked to one another by supply- or demand-side arbitrage and in which those prices can be treated independently of prices of goods not in the market”

This description is very wide, though may be precise in terms of economics, and is of little practical use

- Kaserman and Zeisel (1996) *The Antitrust Bulletin*:

“[...] there is no unique market definition that is appropriate for all purposes. Where one is concerned with the potential exercise of market power, an antitrust market concept may be appropriate. Where one is interested in modelling market equilibrium, however, an economic market concept is required.”

EC Notice on Market Definition 1997

http://europa.eu.int/comm/competition/antitrust/relevma_en.html

“Market definition is a tool to identify and define the boundaries of competition between firms.”

“Firms are subject to three main sources of competitive constraints: demand substitutability, supply substitutability and potential competition.”

It goes on to say that market definition makes it possible to calculate market shares in order to convey information useful for the assessment of market power.

The Hypothetical Monopolist Test

Introduced in the 1982 US Department of Justice Horizontal Merger Guidelines, quotation from the slightly revised 1984 Guidelines:

“A market is defined as a product or group of products and a geographical area in which it is sold such that a hypothetical, profit maximising firm, not subject to price regulation, that was the only present and future seller of those products in that area would impose a ‘small but significant and non-transitory’ increase in price above prevailing or likely future levels.”

The Hypothetical Monopolist Test

Sometimes known as the *SSNIP* test

Small but Significant and Non-transitory Increase in Price

The test is a thought experiment – abstracts from “within-market” rivalry and assess scope for competition “between markets”

A relevant market is defined when a hypothetical monopolist could increase its profits by imposing a SSNIP (sometimes specified as a 5-10% increase for at least one year, EC Notice specifies a permanent change)

From Narrow to Broad

- Is there a market for wholesale call termination on mobile networks? The Commission has posed two questions: What is the appropriate relevant market in respect of call termination on mobile networks? Should an appropriately defined relevant market be identified for the purposes of this Recommendation?
- Mobile termination at the level of a network has been examined in the Recommendation – and the Commission is minded to define the market as each mobile network operator
- In arriving at this conclusion the Commission has applied informally (or qualitatively) the hypothetical monopolist test

Issues with the Hypothetical Monopolist Test

■ *The Cellophane Fallacy*

- ◆ Arose in Du Pont case 1956 in US and concerns situation where the candidate market is already a monopoly – in which case the test could lead to the amalgamation of products/services into the relevant market that do not provide an effective competitive constraint. The Commission would need to assess competitive prices if it believed market power were already being exercised.
- How can a firm with a market share below 100% in a relevant market (defined according to the HM Test) be designated as having significant market power (SMP), where SMP is understood to mean market power?
 - In principle this should not occur, but in practice there is in effect fudging – defining firms as having SMP where market shares are below 100% is purely practical

Is Market Definition really necessary?

- One argument posits that in certain cases market definition confers no benefit to competition policy analysis and the correct decision can be achieved without this step

- Stigler and Sherwin (1985) *Jnl of Law and Economics*:

“Why the factual inquiry necessary under this 5 per cent [hypothetical monopolist] approach – coupled with quantification of market shares and judgement concerning the level and changes in concentration – is any easier than asking directly whether the merger will result in an increased price (the question that is, after all, the one to be answered) is beyond us.”

Should this matter for the New Framework?

Is market definition really necessary?

More recently Steve Salop (1999) has advocated the so-called *first-principles* approach

“[market power and market definition] Should not be analysed in a vacuum or in a threshold test divorced from the conduct and allegations about its effects. Instead, market power should be measured as the power to profitably raise price above the competitive benchmark price, which is the price that would prevail in the absence of the alleged anticompetitive restraint. The competitive benchmark may be the current price, the perfectly competitive price or some other in-between price, depending on the particular allegations of anticompetitive effect being asserted.”

Conclusions

Concluding Remarks

- Application of competition law principles ought to provide for greater consistency across the EU
- The concept of a 'dominant position' is central to the New Framework
- Although Market Definition is important, The Guidelines emphasise market analysis to be used in determining SMP
 - Economic analysis will play a crucial part during the transition phase
- Controversy about market definition likely to occur in mobile and possibly broadband/narrowband internet access