

# **Contribution of Orange to BEREC Report on Oligopoly analysis and regulation**

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- Name of the organization responding to the questionnaire: Orange
- Brief description of the role of the organization: Orange is one of the world's leading telecommunications operators with sales of 39.445 billion euros in 2014 and has 159,000 employees worldwide at September 30, 2014, including 99,800 employees in France. Present in 30 countries, the Group served 240 million customers worldwide as of 30 September 2014, including 182 million mobile customers and 16 million broadband internet customers. Under the Orange Business Services brand, Orange is also one of the world leaders in providing telecommunication services to multinational companies.

Orange is listed on NYSE Euronext Paris (ORA) and on the New York Stock Exchange (ORAN).

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## EXECUTIVE SUMMARY

According to BEREC report, the European electronic communications sector sees the emergence of oligopolistic markets as a result of fixed-mobile or mobile-mobile mergers, and the move from a monopoly to a duopoly in growing proportion of fixed access markets. BEREC acknowledges that oligopolistic market structures can naturally result from market forces, that they can achieve effective competition and not be a concern for regulators. But according to BEREC, they may also lead to competitive concerns either due to joint dominance based on tacit collusion, or to non-competitive outcome due to unilateral effects in the absence of dominance (so called “tight oligopoly” concept introduced in the BEREC report). For BEREC, when an NRA is convinced that if an oligopoly generates competitive concerns, the current framework does not provide easy solutions for regulatory intervention. That is why BEREC proposes concerning joint dominance to clarify the SMP guidelines and allow NRA to use theoretical rather than empirical evidence to justify tacit collusion. BEREC also asks that the future regulatory framework provides NRAs with a solution for ex-ante intervention in the case of tight oligopoly, including absent single or joint dominance.

BEREC report can be assessed both on opportunity, considering the actual economic situation of the telecom industry, and on its structural merits, considering in principle the justification of regulatory intervention.

From an opportunity point of view, Orange considers that BEREC concern on the potential growth of market power in the EU telecom market is inconsistent with facts and figures, notably the decreasing trend of revenues and profits that the European telecom industry has been experiencing for years, despite growing volumes. Such trends are incompatible with the hypothesis of growing market power. On the contrary, market trends observed by BEREC have very clear and pro-competitive sources:

- Emergence of strong fixed alternative infrastructures,
- Fixed-mobile convergence as a consequence of fixed mobile complementarity for data usage,
- Mobile-mobile mergers to render market structures more sustainable and supportive of investments in new infrastructures.

A possible extension of regulation would divert investors from European telecom, in contradiction with the priority given by EU telecom policy to investment.

Addressing the structural merits of BEREC proposals:

- For joint dominance, BEREC dangerously distinguishes between the conviction of an NRA that a joint dominance may occur and its ability to meet the corresponding standard of proof. Orange considers that a demanding standard of proof reflects the unlikelihood of joint dominance and should not be questioned, neither lowered, for instance by using theoretical instead of empirical evidence. If an NRA cannot provide the required standard of proof, it means that there is no joint dominance.

- The “tight oligopoly” concept introduced by BEREC is not defined in the economic literature. Consequently identifying a tight oligopoly is discretionary. As there is no robust theory of efficient regulatory intervention in a “tight oligopoly”, the outcome of such intervention would be unpredictable, with no guarantee or even presumption that it would do more good than harm or lead to a viable organisation of the market. Reference to the “Significant Impediment of Effective Competition” (SIEC) test recommended in European Merger Guidelines does not justify triggering ex ante regulation based on a “tight oligopoly” identification: SIEC is a relative test of competition intensity, not an absolute test. In particular, it does not allow addressing all competitive concerns in the market under scrutiny, only those specific to the merger itself. Intervention based on the concept of “tight oligopoly” would open a new chapter of public regulation, for behaviours which would not constitute breaches of competition law. As nothing is sector specific in BEREC analysis of “tight oligopolies” such new form of regulation, if justifies, should to apply to all sectors of the economy. Dedicating such regulatory treatment to the telecom sector alone would be a sure way to divert investors from European telecom markets, when investment is the best medicine to cure any competition impairment.

Besides, BEREC regulatory analysis is flawed: supposing a competitive concern arises from a “tight oligopoly”, BEREC report suggests addressing its consequences rather than its causes. Moreover, its evaluation of regulatory tools already available to NRAs is very incomplete, as its scope is limited to market analysis provisions, ignoring most of the levers available to NRAs in the different Directives of the Framework. For instance, if “tight oligopolies” are characterised by high switching costs, NRAs can use powers available in the Universal Service Directive to obtain low switching costs, through number portability, transparency requirements, limitation of the duration of consumers’ contracts and net neutrality provisions guaranteeing access to OTTs’ independent services. “Tight oligopolies” are also supposed to be characterised by high entry barriers which NRAs may address by mandating when appropriate, obligations to share physical fixed access infrastructures. And each characteristic of “tight oligopoly” identified in BEREC report can be properly address using NRAs powers already available in the Framework Directives, generally outside market analysis.

So there is no need to add a new and ill-defined concept of tight oligopoly in the framework. Instead, there is a need to change the objectives of the framework in order to upgrade investment as a top priority. Fixed access regulation should be based on the principle of physical infrastructure sharing when proportionate to achieve the new framework objectives. And market analysis SMP regulation should only concern the cases where physical infrastructure sharing has already been mandated, irreversibly excluding mobile from its scope.

The present paper first summarises BEREC report on oligopoly ex ante regulation, and comments its proposals and secondly describes Orange views on the evolutions of access regulation which should be included in the forthcoming review of the regulatory framework.

## 1) BEREC report on oligopoly regulation

### 1.1. Summary of BEREC report

BEREC report observes that European telecommunications markets see structural changes such as:

- Increase deployment of cable technology, development of alternative fixed infrastructures,
- fixed-mobile mergers,
- mobile-mobile mergers,

and concludes that European telecom markets tend to show oligopolistic features. BEREC acknowledges that telecom markets may be naturally oligopolistic and that oligopolistic markets may behave efficiently. This assessment of efficiency takes into account that effective competition in telecom may be compatible with prices over marginal costs in order to cover fixed infrastructure and investment costs, and even accommodate for a degree of market power to support investments in improved technology generating technical progress.

However BEREC considers that oligopolies may lead to inefficient outcomes in two cases:

- First the case of “joint dominance” when telecom operators may tacitly collude to mitigate competition. This case is well identified in the framework but difficult to prove as the standard of proof for NRAs, the same than for competition authorities, is high. BEREC report ultimately does not ask for reducing the standard of proof but suggests (a) that SMP guidelines are made more detailed and precise on evidence to be used, building in particular on Air Tours case law (b) that in circumstances where a NRA considers that joint dominance may occur in case of deregulation due to the end of a single SMP situation, they should be allowed to substantiate the case based more on theoretical than empirical evidences.
- Second the so-called “tight oligopoly” in which case non-competitive outcome is the result of unilateral effects without tacit collusion. BEREC bases its analysis on the concept enshrined in the 2004 Merger Regulation which allows authorities to block a merger – or require remedies – in case of “Significant Impediment to Effective Competition” due to unilateral effects, absent dominance or tacit collusion. Such outcome can occur, following BEREC report, in case of high concentration, capacity constraints, low elasticity, little innovation, high switch costs, high entry barrier and

high differentiation. BEREC does not consider these criteria as cumulative, but agrees that “tight oligopoly” is all the less likely to occur, in case any of these conditions is not fulfilled. BEREC considers that in such a case, the current framework does not provide NRAs appropriate tools to intervene, although BEREC acknowledges that the design of an efficient intervention has yet to be defined.

## 1.2. Comments on BEREC report

Before commenting the substance of BEREC proposals, a more general remark on the objective of this exercise needs to be made...

### 1. 2. a - BEREC exercise should be aligned with the new EU objectives of the Digital Single Market strategy

BEREC reports a concern of a possible growth of market power in European telecom markets due to the development of a more oligopolistic market structure. This theoretical concern overlooks the reality of revenues and profits decrease in Europe for the past years, a trend which is not forecasted to change in the coming years. At the same time, volumes continue to grow. Such an observation is incompatible with a growth of market power which implies either growing profits, or decreasing outputs, or both. Market structures trends observed by BEREC have very clear and pro-competitive sources:

- emergence of strong fixed alternative infrastructures on fixed markets,
- fixed-mobile convergence as a consequence of the complementarity of fixed and mobile services for data usage,
- mobile-mobile (and fixed-mobile) mergers to render market structures more sustainable and supportive of investments in new infrastructures.

The Digital Single Market strategy has also clearly set investment as a priority objective of European telecom policy in the coming years. In this respect the balance of regulatory options should switch from prioritizing static efficiency, which has been the priority till now, to promoting dynamic efficiencies based on investments in technologies, as the priority of the coming years. In this respect, while BEREC several time highlights the necessity to give more weight to dynamic efficiency, which is welcome, its proposals to extend the limits of regulatory intervention on network infrastructure would be a very serious concern for all potential investors which may consider to finance European network investments.

### 1. 2. b - Structural merits of BEREC proposals

This section will address BEREC proposals first on optimal outcome of oligopolistic markets, second on joint dominance and third on so-called “tight oligopolies”.

*Oligopolistic markets may operate in ways that tend towards effective competition and that, therefore, are not necessarily problematic.*

As rightly mentioned BEREC, any analysis of the need for regulatory intervention should take into account not only static efficiency (as short-term competition), but also dynamic efficiency, a term which encompasses the potential impact on incentives for investment and development of new products and services (Page 10).

Orange also shares what is stated page 12 “Moreover, in oligopolistic markets, even a degree of market power that results in profits above such a normal level (“super-normal” profits) might result in a market outcome that is optimal from a welfare perspective. Allowing firms to exert some degree of market power or, more precisely, the expectation of future super-normal profits may increase dynamic efficiency by stimulating innovation and risky investments. These, in turn, might deliver benefits such as lower production costs or product innovation in the long-run that compensate for allocative inefficiencies (higher prices) in the short-run. By eliminating any prospect of super-normal profits, there could be a risk of limiting innovation and investment incentives.”

It should also be added that in the framework of the Communication of the European Commission about the Digital Single market, it has been emphasized the need for creating the right conditions leading to universal high-speed coverage: setting the right framework conditions to mobilize private investment, securing financing and addressing the lack of investment notably in rural areas.

Consequently, the time has come to move away from the current regulatory drawbacks and the temptation of extending it.

#### *Joint dominance.*

On joint dominance, there are only few observations to make as BEREC report ultimately does not ask to depart from existing standard of proof and list of criteria of the current framework. However, some parts of the report, for instance in section 6.2, seem to imply that a different standard of proof could be used. It should be clearly reassessed that the required standard of proof effectively prevents NRAs from adopting inefficient regulations damaging the economy; it should not be questioned.

The BEREC conclusion that, when the outcome of a market analysis is to move from single SMP regulation to joint dominance, providing empirical evidence might not be possible is questionable. Even though a situation under SMP regulation may not directly allow the observation of tacit collusion, the mechanisms which are supposed to lead to joint dominance after the deregulation of the SMP operator should already be present in the market and as such can be empirically evaluated.

Finally, it should be reminded that tacit collusion is very unlikely to be observed in the telecom markets. On mobile, because there are no less than three MNOs in nearly all European countries and that tacit collusion is nearly hardly impossible to maintain with three or more players, first of all because above two players there is no certainty about who deviates which makes retaliation scenario inefficient. In this respect existing regulatory precedent of regulation under joint dominance do not appear particularly

convincing. On fixed, because even if competition is limited to one telco and one cable network, the technical and economical characteristics of the respective infrastructures are very different and do not exhibit the level of symmetry required for tacit collusion.

*So-called “tight oligopoly” is not a relevant concept for future regulation*

The reasoning of BEREC to introduce the concept of “tight oligopoly” as the reason of future regulatory intervention is flawed. It assumes that under certain circumstances (high concentration, entry barriers, capacity limits, high switching costs, high differentiation, low growth, low innovation, low demand elasticity which in fact have to be cumulative for the predicted outcome to occur) and absent dominance, an oligopoly may not lead to effective competition, in the sense given by BEREC to this expression, due to unilateral effects. BEREC assumes that these circumstances are exogenously given to the market, and that NRAs should intervene on the consequences of such a situation.

This is a wrong approach; in such circumstances, the right regulation would be in Orange view to tackle the roots of the problem and not the consequences. Contrary to what BEREC report states, NRAs (in some case with the support of other regulatory authorities) have all the necessary levers in the Directives of the Regulatory Framework to act:

- To reduce switching costs to the minimum, provisions of the Universal Service Directive on portability, on transparency, on the limits of contractual commitments are efficient tools.
- Entry barriers and capacity limits depend on regulatory decisions concerning spectrum allocations between operators (pursuant to the Authorization Directive) or sharing of infrastructure costs (sector specific obligations detailed in Art.12 FWD or cross sector Directive for the reduction of the cost of broadband).
- Excessive differentiation via access to exclusive contents may be addressed through content regulation or competition law.
- General access and interconnection obligations (article 5 of the Access Directive), Net Neutrality obligations are there to guarantee a high level of innovation at service level, demand growth, elasticity, requirements to innovate in order to improve capacity and cost efficiency at network level. This refers also to the FCC’s idea that “Internet openness drives a ‘virtuous cycle’ in which innovations at the edges of the network enhance consumer demand, leading to expanded investments in broadband infrastructure that, in turn, spark new innovations at the edge
- The electronic communications industry is characterized by a very high rate of technological changes. The high level of investment needed to permanently incorporate technological change is a major explanatory factor of market



concentration. The level of profits needed to sustain the continuous pace of investments which incorporate the technological change into infrastructures and services can only be achieved through concentrated market structures. Such market structures support private investment which enables the diffusion of technological progress into the global economy and society alike and is by far the major driver of unit price reductions in the telecommunications industry. This virtuous system should be supported by regulatory and competition policies.

The “High degree of concentration” is mentioned the first criteria in the report “to identify oligopolistic markets leading to sub-competitive results in the absence of collective dominance”, page 50. Such a criteria has to be used with great carefulness. As indicated by BEREC itself in its report, telecoms markets have indeed intrinsic characteristics that lead to a small number of players but this does not necessarily mean that there is a lack of competition. Such concentrated feature is mainly due to economies of scale but, as importantly, network externalities and fast technical changes. Moreover, recent economic researches have proven that classical concentration indicators such as HHI do overestimate market power in industries with high level of investments<sup>1</sup>.

The different points presented above show that contrary to what BEREC report pretends, the regulatory framework provides NRAs with all the instruments necessary to intervene upstream in order to guarantee that the oligopolistic market will deliver effective competition. These instruments are available in the Framework, however not within the market analysis process to which BEREC has limited its analysis. These instruments are the right lever for regulatory intervention would such circumstances be observed, as they act on the source of possible inefficiencies and therefore drive the market towards an efficient outcome. In particular, the ability given by the framework in the article 12 of the framework directive to mandate, when appropriate, rules to share physical fixed access infrastructures costs, gives the opportunity to lower entry barriers for efficient undertakings willing to invest in fixed infrastructures.

A contrario, attempting to introduce new provisions in the market analysis process to accommodate for NRAs’ will to impose ex ante regulatory remedies derived from SMP regulation on so called “tight oligopoly” would be profoundly inappropriate:

- First, the best medicine to cure a dysfunctional market is to attract investment, whereas the prospect of a new cycle of regulatory intervention of potentially unlimited reach and triggered by fuzzy criteria would for sure inhibit investment.
- Second it would generate an inefficient outcome, as the primary sources of inefficiency would not be addressed, and as there is no satisfactory robust economic foundation to support an efficient regulation intervention in such an unclearly defined situation.

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<sup>1</sup> Measuring Market Power in Presence of Investment in New Technologies- Georges Vivien Hounghonon +-  
23rd July 2015



- Third, it makes a biased analysis of the Significant Impediment of Effective Competition (SIEC) criterion in merger control:
  - this criterion does not justify intervention against any competition concern, contrary to the BEREC proposal, as merger control is strictly limited to the concerns generated by the merger itself,
  - in the context of application of SIEC criterion, the market situation before the merger is assumed to be viable; on the contrary there is no guarantee nor presumption that the market situation generated by ex-ante intervention on a so-called “tight oligopoly” would be viable, neither that it would lead to more efficient outcome than the existing situation.
- Fourth, the possible static efficiency of further regulation on welfare could be overtaken by the negative dynamic impact on the incentive to invest in network infrastructure as the investor cannot expect to enjoy any competitive edge from such investment on the retail market.
- Fifth, as BEREC report considers telecom regulation is not any more attached to its origin, namely opening to competition former public monopolies, but has to evolve taking account of the structural characteristics of the industry. Then, if BEREC suggestions concerning tight oligopolies were to be followed, all sectors of the economy exhibiting tendencies towards oligopolistic market structure, and they are many, should a priori be subject to ex ante economic regulation by dedicated National Regulatory Authorities.

## 2) Orange proposals on the evolution of network access regulation in Europe

### 2.1 - The regulatory context:

The European Union pursues a high ambition in the deployment of broadband and very high broadband services and networks that are dynamic elements of the economic growth.

A key priority of the Digital Single Market Strategy is to establish a supportive investment climate for digital networks, research and innovative business. Setting the right framework conditions will help to mobilize private investment and generate investor confidence.

As a result, the main concern of competition and regulatory authorities and policy makers alike should be to achieve the optimal level of competition intensity allowing effective competition through investment, rather than the increase of the market player's number for the sake of reducing the degree of market concentration<sup>2</sup>.

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<sup>2</sup> BEREC draft report - foot note page 33 “For example, BEREC could envisage future revisions of the market for wholesale access and call origination on public mobile telephone networks in situations in which the number of players is reduced due to mergers and acquisitions or when the evolution of the market shows specific competition problems. “BEREC and NRA should avoid the temptation to reintroduce new Relevant Markets to the current list.

This change of focus should be explicitly reflected in a clear change in the objectives of the framework as expressed in the Art.8 of the Framework Directive.

## **2.2 - Competition issues:**

For fixed networks, the main driver for investment is infrastructure competition. As also acknowledged by BEREC, the market has strongly evolved since the Framework was designed and a large part of the EU now encounters at least two fixed network providers in the same area. In such a new context, infrastructure competition will be more efficient if it is not biased by an asymmetric regulation targeting one of the two competitors. Therefore, the current regime of asymmetric regulation designed and/or implemented in a way to focus on regulating the well-known previous incumbent has reached its limits; it has become a hinder to investment in new fixed infrastructures.

At the same time, a competition issue could arise if mobile-only network providers were excluded from the trend of fixed-mobile services convergence. The setting of an efficient level of competition has to take account of that fixed-mobile convergence and the provision of related services and bundles by integrated providers. Mobile-only network operators have to remain able to compete with integrated fixed-mobile service providers.

When a telco and a cable network are competing on the fixed market, the provisions of the regulatory framework to provide a fair and efficient access to wireline infrastructure to pure MNO are not fully satisfactory. As they are based on asymmetrical obligations of one market player they generate both a regulatory distortion between the telco and the cable networks and an inefficient access for the MNO if the unregulated infrastructure has a competitive advantage on the regulated one (which can already be the case in some Member States).

Joint SMP, as stated by BEREC, is complicated to demonstrate and rather rare, so does not constitute the right tool to address this question, also considering that such a situation should occur more and more in the EU.

As described below, the right way forward is, in Orange view, to rely more on provisions allowing public authorities to support, when appropriate, sharing of physical fixed access infrastructures.

## **2.3 - Proposal for a suitable future proof fixed network access regulation:**

Orange considers that the next regulatory framework should evolve in order to match with the current market features as previously described.

- Mobile markets are competitive; it would be wrong to re-introduce access regulation.

Mobile network markets have been competitive from the beginning and therefore should not be subject to access obligations. This has been confirmed by the EC already in its second version of the list on relevant markets. It would be a very negative signal sent to the industry and investors to start regulating access to mobile networks (on top of current spectrum licenses obligations) as BEREC seem to suggest in its report.

There is now strong econometrical evidence that the relation between the intensity of competition between mobile operators and the level of their investment is non-linear and exhibits a maximum for a certain value of profitability of network operators. All available elements converge to indicate that European mobile industry is currently operating in average with an excessive level of in-market fragmentation and an insufficient level of profitability to invest as much as it should to provide the best network technology and support the highest level of usage. The current trend of mergers from 4 to 3 in the mobile industry aims at delivering more sustainable market structures and expected profits at sufficient level to support and incentivise an optimal level of investments maximising consumer benefit. As such, this trend should not be hampered by regulatory authorities.

- Concerning wireline access infrastructure, where proportionate and notably to allow MNOs to provide competitive convergent offers, the most effective tool would be provisions supporting the sharing of fixed infrastructure when appropriate.

Such a regulatory tool would:

- o consist of a generic sharing obligation imposed to wireline infrastructures in a given area, when it is proportionate, that is when there are no more than two undertakings owning fixed infrastructure,
- o consist of a single access point per network per area (with a possible differentiation for residential and business needs) with possible obligations in terms of transparency and reasonable prices,
- o take into account geographic segmentation,
- o be submitted to a transparency and notification procedure, under the general harmonization competency of the Commission based on Article 19 of the Framework Directive,
- o possibly be completed, if appropriate for an efficient outcome, by stricter asymmetric remedies which could only reinforce the generic access obligation resulting from symmetric regulation.

Such a regime has already inspired some countries like Portugal or France, for the terminal segment of the fibre network (FTTH). This French regulation is based on article 12 of the Framework directive and Article 5 of the Access directive. This gives more tools than the only Article 8 of the regulatory framework, mentioned in the BEREC report page 58, to impose remedies on all undertakings that may contribute to existing or potential sub-competitive outcome.

Such a move would set up a future proof and pro-investment framework. It would avoid creating new concept of regulation, and corresponding uncertainties, while being aligned with the spirit of the framework to move progressively to less sector specific ex-ante regulation.

### **Conclusion:**

There is no need to add a new and ill-defined concept of tight oligopoly to address the current trends of convergence and fixed infrastructure networks deployments. There is instead a need to:

- change the objectives of the framework upgrading investment as a top priority,
- base fixed regulation on a principle of physical infrastructure sharing, when necessary and proportionate to achieve the new framework objectives,
- restrict market analysis SMP regulation to the cases where physical infrastructure sharing has already been mandated, irreversibly excluding mobile from its scope.