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TELECOMMUNICATIONS REGULATION AND COMPETITION LAW

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INTRODUCTION

Telecommunications regulation in the UK is to undergo significant change when the Communications Bill, which was published on 02 May 2002, is enacted into English legislation prior to the end of July 2003.

The Bill sets out the Government's plans to overhaul and simplify the legal framework for the media industry. This talk will focus on the changes to be introduced and their implications for the UK telecoms market. It will however touch on the changes to media ownership rules, which are introduced by the Communications Bill, as that aspect of the Bill has already been addressed in Paddy Grafton-Green's earlier talk. I will round up the talk by looking at how the UK regulatory approach contrasts and compares with that adopted in the US, and whether the lessons learnt from the US experience are applicable to the UK telecoms market.

WHY THE NEED FOR CHANGE?

The impetus for a Communications Bill in the UK was triggered by a combination of the following:

- the need to comply with a raft of new EU Electronic Communications Directives;
- the desire to streamline the various regulatory bodies in the UK;
- the perceived failure of the UK telecoms market to develop as a truly competitive market under the existing regulatory regime; and
- the fast pace of technological change which demands a new regulatory approach.

At the moment, the primary legislation regulating telecommunications in the UK is the Telecommunications Act 1984. No matter how well drafted a piece of legislation is – and the Telecommunications Act was very well drafted – the pace of technological development over the last 18 years has meant that new legislation is essential. As will be seen, the Communications Bill will liberalise the telecoms regulatory environment by enabling the removal of unnecessary regulation as and when competition has developed to an extent that permits the natural rules of competition and market pressures to apply. It will also encourage increased investment and competition in the communications industry whilst continuing to protect consumers' interests.

EU Electronic Communications Directives

The need to transpose a series of EU Electronic Communications Directives into English law by 25 July 2003, has largely informed the way the Communications Bill has been drafted. Those

Directives are the Framework Directive, the Access and Interconnection Directive, the Authorisation Directive and the Universal Services Directive.

The aim of the Directives is to implement a technologically-neutral regulatory system across Europe that will address the perceived convergence of the telecoms , IT, media and broadcast industries. In order to provide as much flexibility as possible in implementing the new regime, the Directives incorporate certain competition law principles into what was a sector-specific regulatory regime. In particular, the Framework Directive provides that the concept of "significant market power", which triggers ex ante regulatory obligations for operators, should be redefined in line with the competition law concept of "dominance". This, at least, recognises the dynamic and developing nature of the market and I will address this in more detail later.

Failure of the existing regulatory regime to create a truly competitive environment

Whilst the existing regulatory environment has done much to open up telecoms markets across Europe to competitive forces, it is generally accepted that it has not gone far enough. Like many markets and particularly those which are driven by fast-moving technological change, factors which were of prime importance 10 years ago are no longer relevant or applicable.

The UK telecoms market has transformed from an era when BT enjoyed a monopoly to today when a variety of markets have emerged in addition to the traditional fixed line market. BT does, however, still occupy a dominant position in many markets, and it has been alleged that, on occasion, it has used its position to hinder the development of a fully competitive market, for example by being obstructive in opening up the local loop to other operators. The Communications Bill will go some way to rectify that imbalance and to ensure a level playing field for all operators.

Technological change requires a new regulatory approach

In addition, the convergence of technologies in the communications sector has not been reflected in the existing regulatory structure. The five existing regulators (OFTEL, the ITC, the Radiocommunications Agency, the Radio Authority and the Broadcasting Standards Commission) do not co-ordinate responses to issues which cross their respective jurisdictions.

The Communications Bill aims to remedy these deficiencies as well as to implement the EU Directives into English law.

PRINCIPAL CHANGES MADE BY THE COMMUNICATIONS BILL

1. Establishment of a single regulator: OFCOM

It is appropriate, given the level of convergence in the communications sector, that the Communications Bill establishes one regulator, the "Office of Communications" or "OFCOM", to regulate the whole industry. OFCOM will have a huge task to discharge as it will be assuming the work of the existing five regulators, albeit under different legislation.

It is hoped that OFCOM, as a single regulator, will be able to ensure a coherent, integrated and balanced approach to regulation rather than the disparate approaches which can emerge from various regulators and that its creation will ensure the quality of decision-making whilst improving administrative efficiency and reducing costs.

A survey of OFCOM's duties set out in the Communications Bill reveals that OFCOM is obliged to be a light touch regulator that promotes consumer interests, and encourages optimal use of radio spectrum whilst promoting competition in the communications sector. To ensure that it does not lag behind industry developments, OFCOM must regularly review its functions to identify any

areas where regulation is no longer necessary or appropriate and must publish an annual statement setting out its plans to meet this requirement.

Interestingly, OFCOM will have an express power to prioritise its duties and, in direct contrast to other regulators in the UK such as the gas and electricity regulators, OFCOM will have no primary duty to protect the interests of end-users. This is a result of OFCOM's duties in respect of broadcasting regulation, which is not a primarily economic function, although it will be interesting to see how OFCOM actually approaches this issue in practice.

2. OFCOM's competition powers

OFCOM is to have concurrent powers with the Office of Fair Trading to exercise the powers under the Competition Act 1998 and to address monopolies using the powers under the Fair Trading Act 1973. These powers are already available to OFTEL but the Bill bestows a wider ambit of competition powers on OFCOM than is currently enjoyed by OFTEL under the Telecommunications Act.

Whilst OFTEL has competition powers in relation to "*commercial activities connected with telecommunications*", the Bill gives OFCOM concurrent powers in relation to a range of "*communication matters*" regardless of whether the means of transmission is over electronic communications networks or by broadcast. This results from one regulator assuming the duties of the five existing regulators as well as the need to address converging technologies.

3. Regulation of spectrum

As mobile telephony has developed as a parallel market to fixed line telephony, so the importance of radio spectrum has increased and, as a scarce resource, it needs to be carefully protected and put to optimal use. The Communications Bill recognises the significance of spectrum by clarifying the regulatory regimes for telecommunications use of spectrum and acknowledges that further change may be required in the future by the introduction of the principle of spectrum trading and by giving OFCOM the powers to introduce and regulate spectrum trading. Under the Communications Bill, OFCOM is granted a power to make regulations to authorise spectrum 'licence holders' to transfer their rights and obligations to another person; that change will permit the development of a secondary market in licences.

A new concept of 'Recognised Spectrum and Access' ("RSA") is also introduced which confers formal recognition on those services not currently subject to licensing e.g. satellite downlinks. Such pre-emptive drafting will save time in the future as the Secretary of State will be able to use secondary legislation to extend licensing to satellite spectrum rather than introduce it through the more lengthy process of primary legislation.

4. Telecoms licensing regime changed

The overhaul of the telecommunications licensing regime in the Communications Bill is likely to be the most significant development for new entrants to the UK telecommunications market. No longer will aspirant telcos be required to apply for a licence before offering communications services to the public, as licences under Section 7 of the Telecommunications Act 1984 will be abolished and replaced by a simple regulatory regime for licensing communications networks, services and associated facilities by way of general authorisations. These general authorisations will merely require the service provider to notify OFCOM that it is running networks and/or providing services and to comply with applicable obligations. Regulation is further reduced as the conditions which may be imposed on general authorisations are more limited than those applied under the existing licensing regime. At the moment, over 400 individual telecoms licences have been granted in the UK, and these will all be revoked under the new legislation.

The change to the licensing of telecoms operators will effectively mean that no company can be refused the right to set up as an operator in the UK electronic communications sector and that only scarce resources such as radio spectrum and telephone numbers can be rationed.

It will also move the UK towards the US model of standard rules of general application where compliance obligations will be found in the legislation rather than in individual licences granted to particular companies.

5. Concept of 'Significant Market Power' is redefined

One of the most significant changes to be introduced by the Communications Bill is probably the re-defining of what is meant by "Significant Market Power" or "SMP". SMP is currently determined under the existing Open Network Provision framework, principally by the percentage market share which an operator enjoys (25% is the usual threshold of a market at which a market player is deemed to have SMP), in one of a small number of pre-defined markets. The new model of SMP, which is redefined in the Framework Directive, is, as already noted, aligned to the competition law concept of dominance and including the concept of joint dominance.

Changes to how SMP is assessed

Under the old approach, a party was deemed to have SMP if it had a 25% market share in one of the specified markets (for example, in the UK OFTEL determined that BT had SMP in the markets for fixed public telephone networks, fixed public telephone markets, and leased line services). Individual regulatory authorities could, however, when determining SMP, also take into account an operator's ability to influence market conditions; its turnover relative to the size of the market; its control over access to end-users; its access to finance; and its prior experience in the market. This concept of SMP was clearly broader than the concept of dominance under Article 82 of the EC Treaty, and deliberately so. In order to stimulate competition in nascent telecoms markets ex-ante regulation of former monopolists and duopolists was considered essential.

Under the new approach, an undertaking has SMP:

> '*if, either individually or jointly with others, it enjoys … a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers'.* [Article 14(2), Framework Directive]

Obviously, the intention is to apply the same criteria ex ante as competition authorities apply ex post to the analysis of effective competition in any given market.

The new method of assessing SMP involves a full analysis of competition and market power which includes, inter alia, reviewing the vertical integration of an undertaking, market share in a relevant market, supply-side competition and barriers to entry. Article 15 of the Framework Directive provides for the Commission to adopt a Recommendation on Relevant Product and Service Markets addressed to Member States. The Commission, in the Recommendation, is required to identify those product and service markets in which the imposition of regulatory obligations in a form of specific measures addressed to undertakings having SMP may be justified.

National Regulatory Authorities ("NRA") must then analyse the product and service markets identified in the Recommendation, following the procedures outlined in the EC Guidelines, '*Guidelines on market analysis and the calculation of significant market power*'. If OFCOM, as the UK's NRA, concludes that there is no effective competition within a market, it must impose obligations on operators designated as having SMP within that particular market. OFCOM can also define markets which are different to those identified in the Commission's Recommendation provided that the Commission consents to OFCOM's independent market definition.

Under the new regime, a determination by OFCOM that an operator has SMP in a particular market, is effectively a determination that that market is not competitive. Since SMP equates to the concept of dominance under competition law, a finding of SMP implies that one or more undertakings have the ability to operate with completed disregard for the competitive process. This goes beyond the former concept of SMP which required a 25% market share which might mean something less than dominance. Given that the usual threshold under EU law for market dominance to arise is 40%, it may be expected that under the new regime fewer operators will be deemed to have SMP.

Equally, of course, if OFCOM concludes that a market is effectively competitive, it may not impose or maintain any ex ante regulatory obligations on operators within that market, and must remove any existing obligations on operators formerly deemed to have SMP. Indeed, Recital 27 of the Framework Directive stresses that ex-ante regulatory obligations should be imposed only where there is not effective competition and where national and community law remedies are insufficient to address the problem.

Right of appeal against OFCOM's decisions

I should also point out that operators will, for the first time, have a full right of appeal on the merits against a decision taken by OFCOM. Appeals against decisions of OFCOM including a determination of SMP will lie with the Competition Appeals Tribunal and then to the Court of Appeal. This full right of appeal could mean that OFCOM's overall influence is weakened. It is certainly likely to have an effect on the way that decisions are reached and recorded.

Potential impact

The change to how SMP is defined raises the threshold for regulatory interventions by NRAs and is deliberately flexible so that regulation can be withdrawn as markets become competitive.

It is likely that fewer undertakings will be determined as having SMP, as factors other than simple market share will be considered in the making of a determination of SMP.

However, the fact that a range of considerations must be taken into account before a determination of SMP is made, might prompt regulatory uncertainty as operators will be unable to accurately assess whether they might be deemed to have SMP as the factors which could have influence a determination are so wide.

There is also considerable scope for uncertainty surrounding the concept of collective dominance. The mobile market is prone to collective dominance by virtue of the fact that few licences are issued. The concept of collective dominance has recently been considered by the European Court of Justice in the context of EC Merger Control, which also applies a dominance test. The Court laid down three criteria which must be satisfied for collective dominance to be found. These are:

1. that there must be sufficient market transparency for each member of the oligopoly to know how the other members are behaving in order to monitor whether they are adopting a common policy;

2. that an incentive exists for the members of the oligopoly not to depart from the common policy; and

3. that the oligopoly must be able to withstand challenge by other competitors (existing competitors and potential entrants) and customers.

Whilst this case has helped to bring some clarity, the concept of collective dominance will continue to give rise to uncertainty for undertakings in concentrated markets.

Concern has been raised as to whether OFCOM has sufficient guidance and relevant experience to evaluate collective dominance and also whether the lack of EC guidance on this issue will result in various NRAs across Europe applying different criteria when assessing collective dominance.

Potential for controversy

As noted already, operators will endeavour to avoid being designated as having SMP as onerous obligations will be imposed on SMP operators by the NRA e.g. providers shown to have SMP in any relevant market will be subject to appropriate obligations to protect competition such as price controls or mandated access. Conversely, operators that do not have SMP, will not be regulated.

An SMP determination can be of limited duration because, when OFCOM finds that effective competition has developed in a relevant market, it is obliged to remove any previously existing SMP controls. The intention is that, by moving across to this form of light touch regulation, there will be a positive impetus on the operators to foster the emergence of a competitive market in whichever sector they operate.

Lighter Regulation

In one respect at least, the Bill does appear to increase regulation however as previously only the running of telecommunications systems was regulated. Now, electronic communications networks, services and associated facilities will be subject to regulation. There is, however, no intention to extend the regulation of content supplied over the Internet. This is welcome both for ISPs and mobile operators, particularly now that the latter are using GPRS or UMTS to enable customers to access the web via their mobile phones).

Comparison with how the communications market has developed in the US

US

As a UK lawyer, I can only give my impressions of the way telecommunications regulation and its impact on competition has developed in the US. Sixty-two years after the Communications Act of 1934 (premised on the view that telecommunications is a natural monopoly), and 12 years after the divestiture of the Bell operating companies from AT&T, the US introduced the Telecommunications Act 1996 ("TA"). This was to ensure that the seven Baby Bells open their networks to competitors. The TA has the same objectives as the Communications Bill does; namely to increase competition and to reduce regulation. Like the Communications Bill, it imposes obligations on the regulator, the Federal Communications Commission ("FCC"), and also the States to introduce competition into local telecommunication services and to facilitate more competition into markets which already have some. In redefining the responsibilities of the States and the FCC, it takes away from each State the ability to approve competition in local telecommunications, and also prohibits States from denying entry of any qualified entity into intrastate and interstate telecommunications services.

One example of the former point is that under the TA, the Baby Bells are permitted to provide long-distance services outside their regions immediately, but only inside their regions once they have completed a series of steps to remove entry barriers for local telephone competition. The FCC, not the State, must be satisfied that the Baby Bell's networks are both open to competition and that it is in the public interest to grant approval for in-region long distance services. This strikes me as rewarding a Baby Bell (with in-region long distance services) for opening up their local network, rather than compelling it to open up where it is uncompetitive, a different approach

than in the Communications Bill in the UK. It also appears to be a remarkably slow process- the first Baby Bell to be approved by the FCC to offer in-region long distance services was finally approved in 2000, four years after the TA.

It seems that, rather than stimulate new operators to enter the market and to encourage new competition, a combination of the reluctance of Baby Bells to compete and the very slow implementation of the TA triggered a consolidation in the US telecoms market as existing monopolies simply merged into larger entities. This has been exacerbated by associated legal wrangling- at one point in 1998, a federal judge in Texas ruled that the TA unconstitutionally discriminated against Baby Bells. I think it remains to be seen whether the TA has produced the competitiveness and consumer benefits its policy makers promised.

UK

Since 1990, the UK Government has progressively liberalised the telecoms market by making available licences to provide different types of telecommunications services and to operate different types of telecommunications systems. The UK government accepted that BT would need quite tough regulating during the period that new competitors were being fostered. Instead of going for an extremely detailed approach as is found in the USA, OFTEL created what has become the "RPI minus X" formula (where RPI stands for the Retail Price Inflation). Under this approach, OFTEL tells BT that its average prices must fall by a certain percentage below inflation. Such a formula forced BT to worry about its efficiency, but gave it the freedom to decide how best to meet the pricing targets set it. Thus, it has been cutting prices heavily in sectors where there is substantial competition (international services and the corporate market) while, on occasion, even raising them in areas which have called for heavy subsidies in the past (such as supplying lines to homes).

Conclusion

The Communications Bill will significantly alter how the communications sector is regulated in the UK as a new licensing regime is implemented, the regulatory structure is overhauled and the concept of Significant Market Power is re-defined. The creation of OFCOM, the new super-regulator for the whole industry sector should ensure that a consistent approach to regulation is forged and the increased competition powers bestowed on that one regulator may increase its interventionist role. However that interventionist role will be balanced out by the fact that operators will be able to challenge OFCOM's determinations of SMP. It will prove particularly interesting to see whether or not there will be a more consistent pan-European approach adopted by NRAs throughout the EU and, in particular, how each NRA assesses the issue of collective dominance. As has been outlined in this talk, the implementation of the EC Directives heralds a new approach to communications regulation in Europe and hopefully should enable fully competitive markets to be further developed in the electronic communications sector.