Non-Discrimination: The Second Best Form of Competition

- ***BEREC's consultation on high level principles of non-discrimination seeks to ensure that vertically integrated firms do not have an unfair advantage***
- ***An operationalized non-discrimination regime can be based on structural or behavioural remedies***
- ***Properly implement, non-discrimination is the second based way to effective competition***

BEREC's high level principles on issues of non-discrimination, set out in its recent consultation[1], seek to ensure, *inter alia,* that dominant firms do not have an "unfair and unmatchable advantage". The non-discrimination obligation is, according to BEREC, a very important tool to ensure that vertically integrated firms do not use their dominant position in the upstream market to limit competition in downstream markets. We would certainly agree. In a market where competitors are dependent on the incumbent owner of an essential facility to compete with that incumbent, an effective non-discrimination regime is necessary to deliver the benefits of competition: albeit in the second best way – the best way being competitors entirely independent of each other, as in most non-utility markets.

[1] BEREC's Review of the Common Positions on wholesale unbundled access, wholesale broadband access and wholesale leased lines: Stage 1 High Level Principles on issues of non-discrimination

It's not just in theory

The theoretical incentive for vertically integrated firms to discriminate has been known for some time. But, firms have also been found to do so in practice, and to have behaved in ways the theory predicted. Compare the following: first an academic article by Mandy and Sappington[2], and secondly the European Commission findings in the 2011 Telecom Poland Case[3], which is subject to appeal.

Mandy and Sappington define discrimination (they call it sabotage) as:

(1) providing inferior service to competitors,
(2) delaying competitors' attempts to implement new and improved services,
(3) withholding crucial information from competitors and

[2] Mandy, D.M and Sappington, D.E.M. (2007) 'Incentives for sabotage in vertically related industries' *Journal of Regulatory Economics*, 31, pp 235 – 260

[3] Case COMP/39.525 - Telekomunikacja Polska. English language summary published in Official Journal 9th November 2011

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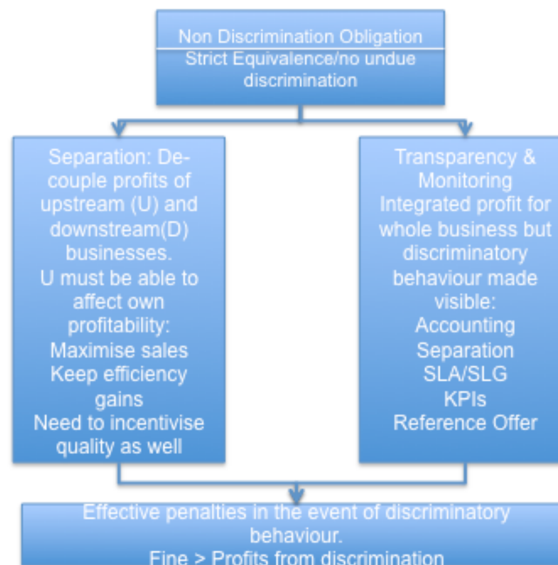
(4) structuring services and standards to favour the operations of their own downstream affiliates at the expense of rivals.

The Commission described Telecom Poland's behaviour as:

- Proposing unreasonable conditions governing Alternative Operators' access to wholesale broadband products;
- Delaying the negotiation process;
- Limiting access to its network;
- Limiting access to subscriber lines;
- Refusing to provide.

Remarkably similar!

The graphic in the next column sets out a process of operationalizing non-discrimination. It begins with a definition of non-discrimination and then sets out alternative approaches to removing the incentive to discriminate, before imposing sanctions should discriminatory behaviour be found.



Defining Non-Discrimination

To ensure firms do not discriminate, the first stage is to define what we mean by non-discrimination. The standard definition is "equivalent conditions in equivalent circumstances". However, when it conducted its Strategic Review of Telecommunications in 2004, the UK regulator, Ofcom, found this definition provided scope for difference in treatment that was not in itself discriminatory, but when taken together placed competitors at a disadvantage: known as "cumulative materiality". In other words, the non-discrimination obligation as applied in the UK was too weak. It therefore introduced "Equivalence of Input" (EOI), which required BT to treat its own retail businesses and those of its competitors in "exactly the same" manner.

EOI may or may not be appropriate for every country: some countries may have definitions of non-discrimination that are sufficient. However, when operationalizing non-discrimination the appropriate standard should be defined, adopted and clearly communicated to the market.

Structural and Behavioural Remedies

The next stage is to decide what type of remedy to impose: structural or behavioural. A

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structural remedy requires the separation of the monopoly upstream business from the competitive downstream business. "Separation" here means complete ownership separation, not a halfway house such as legal or functional separation. Such separation removes the incentive to discriminate as, in theory, the rational, independent upstream firm will treat all its downstream customers the same. There seems little appetite for full separation in European telecoms, though the approach has been adopted in the UK gas industry and in telecoms in Australia and New Zealand (where Telecom New Zealand separated on December 1st 2011).

The alternative to full separation is a set of behavioural obligations that ensure full transparency of the vertically integrated firm's behaviour. The standard toolkit includes, but should not be limited to: accounting separation, service level agreements/guarantees, key performance indicators and reference offers. An essential element of this package is publication, in a timely manner, of data that allows comparison of how the vertically integrated firm services its own downstream entity and its competitors. Publishing aggregated data, or only external data, does not provide the transparency necessary to deter discrimination.

Functional separation, now an exceptional remedy available to NRAs, increases transparency and so supports the ability of stakeholders to monitor the behaviour of the SMP firm.

Effective Sanctions

The final element is a set of effective sanctions that, *ex post,* punish discrimination. Financial sanctions need to be high enough to wipe out any profit made from discrimination, so they need to be greater than profit. The ineffectiveness of sanctions under the 2002 Directives was recognised in the 2009 revisions and so, under the revised Framework Directive (Article 21A), National Regulatory Authorities are supposed to impose fines that are "appropriate, effective, proportionate and dissuasive" (emphasis added).

Ten percent of turnover seems widely accepted as a dissuasive level of fine. However, it is also important that firms that receive fines should not be able to behave so strategically that they can delay and delay the payment of the fine until it becomes meaningless, subject to the necessities of justice.

An effective non-discrimination regime involves a clear definition and either structural or behavioural remedies and effective sanctions. It can only be the second best form of competition, but it can deliver benefits to consumers.

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