European University Institute

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

FSR COMMS & MEDIA
Florence School of Regulation

FLORENCE COMPETITION PROGRAMME
law & economics

Issue 2018/18
September 2018

POLICY BRIEF

EU Competition Law vs *Sector Regulation in Shaping the Digital Single Market. Back to the Future?*

Workshop jointly organised by the Florence Competition Programme (FCP), the Florence School of Regulation Communications and Media (FSR C&M) and Bird & Bird LLP

Authors: Pier Luigi Parcu, Director of the FCP and the FSR C&M; Silvia Solidoro, Research Associate; Chiara Carrozza, Research Fellow

Abstract

On 28 June, 2018, the Florence Competition Programme (FCP) and the Communications and Media Area of the Florence School of Regulation (FSR C&M) of the Robert Schuman Centre for Advanced Studies (RSCAS), jointly organised with Bird & Bird LLP, a workshop in Brussels. The title of the event was 'EU Competition Law vs Sector Regulation in Shaping the Digital Single Market. Back to the Future?'. The workshop aimed to discuss the interaction of competition policy and sector-specific regulation in the context of the Digital Single Market (DSM) Strategy that was adopted by the European Commission in May 2015. It included two panels, which dealt, respectively, with the concerns expressed by regulators on geo-blocking and the revision of the European Commission's Guidelines on Significant Market Power (SMP) in the electronic communications sector. The event gathered representatives from National Competition Authorities (NCAs), the European Commission, academia, industry, as well as law and economic consulting firms. The diversity of views ensured a lively debate. This Policy Brief summarises the main points that were raised during the discussion and seeks to stimulate further debate.

Panel I - The Geo-blocking Regulation and Antitrust Enforcement

The Geo-blocking Regulation,[1] which entered into force on the 22nd March, 2018, will apply from 3rd December, 2018, to all of the traders who actively offer their goods or services to EU end-users in the European Union, regardless of whether the trader is established in the EU or in a third country. The new rules prohibit direct and indirect discrimination based on the customers' nationality, place of residence or establishment, including the automatic rerouting of customers.

First, during the workshop, participants remarked that the Regulation forms part of the EU's wider DSM strategy. It offers a concrete example of what the consumers' benefits associated with the creation of an internal market would be. The removal of unjustified geo-blocking, and of other forms of discrimination, applied by traders to artificially segment the market represents the *leitmotif* of the newly enacted framework. The Commission's regulatory efforts to enhance online shopping and cross-border trade through the use of competition law is reflected in the core provisions which ban unilateral conduct by any dealer, even in the absence of market power. Article 3 of the Regulation states that traders cannot block or limit a customer's access to the trader's online interface. By virtue of Article 4, the application of different general conditions of access to goods or services for reasons related to the customer's nationality, place of residence or establishment, is prohibited in all cases when customers try to acquire (a) goods; (b) electronically supplied services, with the important exception of copyright-protected works or matters, and (c) non-electronically supplied services. Article 5 sets out the non-discrimination principle for reasons that are related to payment transactions.

Furthermore, Article 6 establishes an important distinction between active sales (i.e., when retailers are actively targeting customers) and passive sales (i.e., when sales are made in response to unsolicited orders). Restrictions falling outside the scope of the Geo-Blocking Regulation which are covered by the Vertical Block Exemption 330/2010, are not affected. However, passive sales restrictions that lead to a violation of the Geo-Blocking Regulation are automatically void under Article 6(2). Speakers at the seminar stressed that the exclusion of the copyright-protected works from the scope of the Regulation was the subject of intense debate before the European Parliament. In this respect, in the statement annexed to the Regulation, the European Commission has explicitly mentioned that in the future whether a new legislative proposal will have to be enacted will be assessed, following the results of the evaluation of the first two years.

One strand of the debate thus dealt with the presentation of the main findings of a recent study, conducted by Oxera Consulting LLP in May 2016,[2] to outline the reasons justifying the exclusion of copyrighted works from the scope of the application of the Geo-blocking Regulation. The study holds that the audiovisual (AV) industry has developed on the basis of a differentiation by geography that currently makes it possible to reflect the different consumers' content valuations, which are driven by cultural differences, tastes and preferences, as well as the different costs that are associated with serving each market. The study presents empirical evidence in support of the argument that imposing a greater cross-border access to audiovisual content and services would expose consumers to significant losses in quality, diversity and access to content in the short run, and would produce several adverse effects, detrimental to the AV sector as a whole, in the medium to long term.

In addition, participants focused on the various efforts undertaken by the European Commission in the fight

1. Regulation (EU) 2018/302 of the European Parliament and the Council of 28th February, 2018, on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market and amending Regulations (EC) No 2006/2004 and (EU) 2017/2394 and Directive 2009/22/EC. OJ L 60I, 2.3.2018, pp. 1–15.

2. Oxera, The impact of cross-border access to audiovisual content on EU consumers, May 2016, available at: https://www.oxera.com/wp-content/uploads/media/oxera_library/downloads/2016-05-13-Cross-border-report-(final).pdf.

against geo-blocking practices, which have been on the European legislator's radar for a while. In fact, in parallel to its legislative initiatives, the Commission has also challenged geo-blocking measures under the EU competition rules (Articles 101 and 102 TFEU). It has also launched a number of individual antitrust investigations, which are still pending before DG Competition.[3] However, it was noted that, although competition rules are flexible, they are case-centered and not exactly suitable for enforcing general legal principles. By contrast, sector-specific regulation offers more legal certainty but because of its rigidity, it presents the disadvantage of becoming outdated more rapidly. Through the enactment of the Geo-blocking Regulation, the European legislator seems to have found a compromise, since the adopted set of rules appears to be minimal, which leaves room for future legislative initiatives, even at the national level, if needed. In the near future, it should be assessed whether this may be understood as part of a new trend, established by the Commission, in the effort to bridge the gap between competition law and regulation in digital markets.

More broadly, in order to better explain the strong interplay between competition and regulation, some recent cases were discussed during the seminar. These were cases in which competition law has been used to signal significant market failures while, at the same time, opening up the path to more articulated regulatory intervention. In a decision concerning the pharmaceutical manufacturer Pfizer and its distributor Flynn Pharma Limited, the UK Competition and Markets Authority (CMA) found both companies guilty of abusing their dominant positions in the narrowly defined market for phenytoin sodium capsules by excessively increasing their prices.[4] Participants thus agreed on the fact that, while the European community's disapproval of geo-blocking practices is clearly reflected in the ban on unilateral conduct that is contained in the core provisions of the Regulation, it is not possible to predict, whether, and to what extent, this might pave the way for further regulatory actions.

The speakers argued that, in competition law, the notion of 'price discrimination' refers to the practice of selling the same product to different customers at different prices, even though the production/distribution costs of the product are the same.[5] It was underlined that, according to a consolidated economic literature, prohibiting price discrimination does not necessarily produce the result of increasing consumers' welfare. In fact, requiring producers/distributors to sell a product at the same price in all Member States may harm customers in lower income countries, who often end up paying more than consumers in wealthier Member States in comparison.

Furthermore, it was argued that one of the most controversial aspects of the Regulation lies in its adoption of a non-dynamic perspective, given its focus on increasing the choices for consumers, without taking the impact on market structure into due consideration. In this respect, participants submitted the idea that the Regulation might be the source of new market failures in the near future: if smaller providers were pushed out of the market due to compliance with the Regulation's requirements, fewer larger providers would be in the position to compete amongst each other; and thus the more concentrated structure of the market might favor anti-competitive practices.

This session was concluded by stating that, beyond considering the adoption of the Geo-blocking Regulation to be appropriate, timely or satisfactory,

3. Antitrust investigations have been launched in the consumer electronics, video game, hotel industry, clothing, and licensed merchandise sectors, as well as into the licensing and distribution practices of movie studios. Some of these enforcement actions target copyrighted content, and thus may reach beyond the Regulation's scope.

4. However, it must be noted that on 7th June, 2018, the Competition Appeal Tribunal (CAT) quashed the CMA's decision holding that a purely excessive pricing decision had been undertaken with no serious allegation regarding misconduct. In fact, according to the Tribunal, excessive pricing cases, should remain rare. Overall, the authorities should be wary of taking up the price regulators' tasks, unless this is 'soundly based on proper evidence and analysis'. *Flynn Pharma Ltd and Flynn Pharma* (Holdings) *Ltd v Competition and Markets Authority* & *Pfizer Inc. and Pfizer Limited v Competition and Markets Authority*, [2018] CAT 11, text of the judgment available at: http://www.catribunal.org.uk/files/1275-1276_Flynn_Judgment_CAT_11_070618.pdf.

5. Richard A Posner, Antitrust Law, 2d ed., Chicago, 2001.

it is now time for all the EU Member States to enforce it through a process that is likely to require significant effort.

Panel II - Collective Dominance and SMP Guidelines in Electronic Communications

During the second session of the workshop, participants pointed out that SMP Guidelines represent a vital tool for the performance of the telecoms National Regulatory Authorities' (NRAs) forward-looking analysis in the electronic communications sector in the EU. Being directly referenced in the EU Regulatory Framework, the Guidelines can be regarded as the main basis of the NRAs' approach to defining the relevant products and geographical markets, as well as for the assessment of the existence of Significant Market Power (SMP).

Given this framework, the main issue, that has been explored from both an economic and legal perspective since the first enactment of the text of the Guidelines in 2002,[6] has dealt with the applicability of the concept of joint or collective SMP when tacit coordination arising from an oligopoly situation is at stake. Whereas NCAs can rely on Article 102 TFEU to sanction collective dominance, *ex-ante* regulation seems to have suffered from remarkable enforcement gaps, which have encouraged the European Commission to undertake a substantial revision of the Guidelines.

The new text reflects the peculiarities of the telecommunications sector, which has witnessed the deployment of Next Generation Access (NGA) networks, the advent of Over-the-top (OTT) players, competition from cable networks, technological convergence, and a wave of mergers and acquisitions, in the last few years, making it particularly conducive to collusion. However, at the beginning of the negotiation process relating to the revised Guidelines, different solutions, not necessarily mutually exclusive amongst each other, were put on the table.

The most interesting and fully comprehensive proposal encompassed the exact determination of the concept of joint SMP, which has been taken into full consideration by the legislator when adopting the new version of the Guidelines. In this respect, the study carried out by the German consulting firm, WIK, for the European Commission,[7] made it clear that the NRAs' prospective analysis represents a sophisticated task, which may encounter several different challenges in oligopolistic markets. On the one hand, behavioral factors may influence market outcomes, and thus require careful consideration when the assessment is conducted. On the other hand, structural elements, such as SMP-based regulation, may obscure the economic indicators at the wholesale and retail levels, requiring the application of the so-called 'Modified Greenfield Approach' to test whether tacit coordination is the likely outcome in the absence of such regulation.[8] This illustrates well the extent to which the assessment of joint SMP may be complex. Overall, there was agreement on the fact that NRAs' analysis should be based on a combination of both structural and behavioral elements.

In one strand of the debate, the main question remaining open was whether the clarification of the concept of joint SMP can be deemed consistent with EU competition legal principles as well as its case law. It was noted that the final version of the Guidelines, published on, April 26 2018,[9] has been conceived so as to ensure that this objective was met, since the most important updates that have occurred

6. Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165, 11.7.2002, p. 6–31.

7. WIK Consult, Review of the Significant Market Power (SMP) Guidelines, A study prepared for the European Commission, 2017, available at: https://www.wik.org/fileadmin/Studien/2018/2018_SMP_Guidelines.pdf.

8. In this case, the forward-looking *ex-ante* SMP assessment must control for the effects of pre-existing regulation, while taking into account regulation in related markets, in order to correctly identify the counterfactuals and the theories of harm that need to be remedied using regulatory tools.

9. Communication from the Commission, Guidelines on market analysis and the assessment of significant market power under the EU regulatory framework for electronic communications networks and services, OJ C 159, 7.5.2018, p. 1–15.

in the field are taken into utmost consideration. Another strand of the debate argued that, in the future, it remains to be seen whether this approach will ensure a fully, and satisfactory, methodological guidance for regulators.[10]

The economic basics of joint dominance were thus debated during the seminar. It was remarked that the economic literature predominantly uses the expression 'tacit collusion', even though it does not involve any 'collusion' in the legal sense; the expression 'tacit coordination' would thus be more appropriate. The framework for analysing these types of conduct is provided by the 'repeated game theory'. According to game theory, frequent dynamic interactions allow firms to sustain supra-competitive prices. When interacting with each other, in fact, firms may be able to keep higher prices by tacitly agreeing that any deviation from the collusive path would trigger some retaliation.

According to economists, three criteria that need to be satisfied would exist in order for a finding of collective dominance to be established in competition law. First, firms should have the ability and the incentives to arrive at a coordinated outcome - the focal point - even when collusive equilibria may be difficult to achieve, especially when there is no communication channel among the firms. Market transparency is thus key to allowing firms to be aware of the way in which the others' market conduct is evolving. Second, firms should have the ability and incentives to sustain the coordinated outcome in order to make the conduct stable internally. To that end, retaliation needs to be sustainable: it must entail, for the deviating firms, a very significant loss of profit if compared to the profit that it would be possible to obtain by adhering to the collusive behavior. In particular, retaliation should be effective in preventing firms from deviating (Ivaldi et al., 2003). Third, 'collusion' needs to be stable 'externally': this happens when there are no potential or actual market constraints (e.g., non-collusive firms, potential entrants or consumers) destabilising the outcome of the collusive behavior.

These three criteria also represent the cumulative conditions of the preferred legal test that is used to establish that joint SMP may flow from an oligopolistic environment that is based on the EU Court of Justice's case law, and, in particular, the *Airtours*[11] leading case (2002). The new Guidelines, rather than imposing a mechanical verification of each of the criteria taken in isolation, recommend that NRAs consider the whole mechanism of hypothetical tacit coordination, following the more recent *Impala* case, which has been explicitly referenced in the new text of the Guidelines.[12] Participants thus submitted the idea that no major change in substance has been produced, despite the Guidelines being much more articulated on this point. Another strand of the debate argued that, in addition to telecommunications, other sectors are witnessing a process of deep consolidation that may revamp the application of collective dominance.

A further point raised during this part of the discussion dealt with the interplay between regulation and competition law: participants agreed that an NRA's decision establishing collective dominance should not necessarily lead to an antitrust assessment on joint dominance, which would have even more complex features if compared with an *ex-ante* prospective analysis.

It was concluded that the approach followed by the European legislator is likely to lead to the creation of a more diversified approach to regulation across the EU Member States, and that the need for a further amendment of the legal text of the Guidelines may arise again in the near future.

10. As regards the other proposals, it was observed that while the legislator has decided to embrace the proposal concerning the extension of the scope of symmetric regulation, the idea of including some provisions that are devoted to tight oligopolies, as per BEREC's opinion delivered on 16th March, 2018, was finally discarded.

11. Case T-342/99 *Airtours v Commission* EU:T:2002:146.

12. Case C-413/06 *P Bertelsmann and Sony Corporation of America v Impala* [2008] ECR I-4951.

QM-AX-18-018-EN-N

Florence Competition Programme &
Florence School of Regulation Communications and Media
Robert Schuman Centre for Advanced Studies
European University Institute
Villa Raimondi, 121/111
Via Boccaccio, I-50133, Florence, Italy

Contact:
email: fcp@eui.eu fsr.comsmedia@eui.eu website: https://www.eui.eu/Projects/ENTRANCE http://fsr.eui.eu/communications-media/ phone: +39 055.4685803

Robert Schuman Centre for Advanced Studies

The Robert Schuman Centre for Advanced Studies, created in 1992 and directed by Professor Brigid Laffan, aims to develop inter-disciplinary and comparative research on the major issues facing the process of European integration, European societies and Europe's place in 21st century global politics. The Centre is home to a large post-doctoral programme and hosts major research programmes, projects and data sets, in addition to a range of working groups and ad hoc initiatives. The research agenda is organised around a set of core themes and is continuously evolving, reflecting the changing agenda of European integration, the expanding membership of the European Union, developments in Europe's neighbourhood and the wider world.

Florence School of Regulation Communications and Media

The Florence School of Regulation (FSR) is a programme of the Robert Schuman Centre for Advanced Studies at the European University Institute, which was established as a center of excellence for independent discussion and dissemination of knowledge regarding European regulation and policy. For over a decade, the school has provided advanced professional training while organising a wide range of events which brings together the leading representatives of academia, private companies and regulators. The Communications & Media (C&M) area, in particular, aims to provide state-of-the art training for practitioners, to carry out analytical and empirical research, and to promote informed discussions on key policy issues in the electronic communications and media regulation sectors.

Florence Competition Programme

The Florence Competition Programme (FCP) in Law & Economics is a programme of the Robert Schuman Centre for Advanced Studies at the European University Institute, which focuses on competition law and economics. FCP acts as a hub where European and international competition enforcers and other stakeholders can exchange ideas, share best-practices, debate emerging policy issues and enhance their networks. In addition, since 2011, the Robert Schuman Centre for Advanced Studies organises a training for national judges in competition law and economics co-financed by DG Competition of the European Commission - ENTraNCE for Judges.

doi:10.2870/619203
ISBN:978-92-9084-618-5
ISSN:2467-4540