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The ex ante competition regime for broadcasting

The forthcoming DCMS consultation

Connectivity, content and consumers

Despite Jeremy Hunt's promises of radical reform and deregulation akin to 'Big Bang' in the City, in summer 2013, DCMS instead published 'Connectivity, content and consumers: Britain's digital platform for growth' (the '3Cs' report). This followed a series of stakeholder seminars and clear feedback to government that radical change was not necessary. No Green Paper emerged and the 3Cs report hit the holiday season at the end of July. All the tricky business of cleaning up the internet has been handed back to service providers, the massive public investment programme into next generation broadband was paraded, and another spectrum strategy was announced.

One had to scour the report to identify any areas for concern. But they are there; two of them. First, media plurality (déjà vu), which DCMS recently consulted on (see www.ceg-europe.com for our perspectives). Second, the ex ante competition regime for broadcasting where DCMS appears to have been influenced by the argument (made in representations to the House of Lords inquiry into convergence) that convergence implies that broadcasting and telecoms may need to be subject to the same regulatory regime. Ahead of the forthcoming DCMS consultation on the issues, this paper highlights some of the important areas that are likely to give rise to vigorous debate.

'Convergence' has become a familiar term to describe the technological and market changes that have taken place in media and telecommunications markets.

The development of the internet protocol allows for digitisation of services and enables different services such as data, video or voice to be delivered over any network. In today's dynamic market, the traditional lines between formerly discrete sectors of media or communications markets have become blurred; they can no longer be maintained as rigid demarcations.

The implications of convergence are many and varied and include: (a) a transition from historic scarcity in distribution to relative abundance;[1] (b) increased use of distribution networks; and (c) the emergence of new and potentially complex industry structures. Against this background, DCMS has entered the fray with a proposed consultation that may lead to a radical overhaul of the regulatory landscape.

Ex ante vs. ex post intervention

Convergence and innovation may raise issues for competition and market structures, and how markets are defined and assessed in competition law and regulation.

This in turn raises the perennial question of whether regulation should be 'ex ante' (i.e. intervention before there is observable harm on the basis that the market may not deliver efficient outcomes if left to itself) or 'ex- post' (i.e. on the basis of evidence of actual or likely harm or violations of relevant laws, including competition law). Mario Monti makes the case for the continuation of ex ante regulation in a speech on telecoms markets:

"*We have by now firmly moved to an approach which envisages that regulation is essentially economic regulation… based on the perspective that intervention on the market is necessary and beneficial only when it offers the solution to certain sorts of market power, and in particular to market failures which derive from formerly monopolistic market structures… As long as problems such as unjustified impeded access to basic networks exist, ex ante regulation remains necessary*."[2]

Ex ante regulation is thus used when there is a lack of effective competition owing to structural problems that make development of normal market dynamics impossible:

- High or insurmountable barriers to entry
- Asymmetric cost structures
- Control over bottleneck facilities

These features may give rise to:

- Exclusionary abuses (price squeeze, discrimination, raising rivals' costs, refusal to interconnect, predatory pricing, etc.)
- Exploitative abuses (excessive pricing, application of unfair trade conditions, etc.)

A key distinguishing feature of sectors in which ex ante regulation is appropriate is that they involve non-contestable ownership of largely non-replicable infrastructure assets. Thus ex ante regulation tends to be applied in network industries such as telecoms, rail, gas, electricity, and water. Indeed, Joaquin Alumnia cites the telecoms sector as a good example of ex ante regulation and competition working hand in hand:

"*It is typically the sort of industry where ex ante regulation has been a necessary complement to competition enforcement, because there are enduring economic bottlenecks, namely non-replicable legacy facilities. So regulation of access to networks has been necessary to allow market entry."*[3]

The line between sector regulation and competition law tends to correspond, broadly, to the 'ex ante' and 'ex post' labels:

- Sector regulation is generally 'ex ante' enabling 'regulators' to control the activities of natural or unnatural monopolies. Once markets have been opened up to competition, market forces come into play. It is maintained that competition law can then be applied to intervene if – and only if – there have been observable restrictions on competition or evidence of likely violations of law ('ex post').
- Sector regulators tend to have an on-going relationship with regulated companies and benefit from detailed sector information derived from carrying out their continued supervisory functions. Competition authorities rely generally on complaints and

[1] We acknowledge that capacity issues remain in some distribution networks.
[2] http://ec.europa.eu/competition/speeches/text/sp2003_015_en.pdf
[3] See: http://europa.eu/rapid/press-release_SPEECH-10-121_en.htm

obtain information in the context of specific enforcement actions.
- Sector regulators impose and monitor detailed behavioural remedies. Competition authorities, if the distinction is maintained, typically elect for structural-based remedies addressing specific activities.
- Sector regulators tend to have regulatory duties to fulfil a broad range of policy objectives. These may include industrial policy objectives as well as consumer welfare objectives. Competition authorities have a narrower remit, typically to promote consumer welfare or total welfare.

Sector regulation and competition can combine to achieve the optimum balance between preventing the creation or entrenchment of market power and not undermining companies' incentives to invest and innovate.

First, some sort of temporary market power may be needed to achieve efficiencies connected with investment and innovation. Second, it is apparent that markets may not always be left to their own to address the challenges presented by technological development if consumers find it costly to switch to new products and services.

This situation may give rise to complex balancing that does not always have a clear-cut policy solution. The implication is that it is vital that regulators limit themselves to intervention 'ex ante' only where this is demonstrated to be necessary to prevent the foreclosure of entry, competition and innovation.

The current ex ante broadcasting competition rules have their origin in the 1990 Broadcasting Act

At that time there was a limited number of TV channels broadcasting in the UK, including four terrestrial channels (Channel 5 did not launch until 1997). Sky launched in February 1989 with 3 channels and BSB launched in April 1990 with five channels. BSkyB was formed in November 1990 (the merger of BSB and Sky). In 1990, ITV had a viewing share of 44%.

Moreover, at the time the broadcasting framework was established, competition law in the UK bore little resemblance to what it is today. Today there has been a shift from a form-based approach to one that is more underpinned by economic principles. Viewed in this historical context, it is perhaps understandable that the framework was predicated on a more form-based approach that is characteristic of ex ante regimes.

The ex ante conditions were subsequently specified in Section 316 of the Communications Act 2003 and allow Ofcom to impose on broadcast licence holders conditions that Ofcom considers appropriate for securing:

"*fair and effective competition in the provision of licensed services or of connected services*."[4]

In contrast the ex ante telecoms regime is governed by the EU regulatory framework

The framework covers fixed and wireless telecoms, internet, broadcasting and transmission services and identifies specific markets to which ex ante regulation is to be applied.

The regime is characterised by strict rules such as designation of relevant markets, the conducting of regular market reviews, and granting the power to impose remedies on players with significant market power ('SMP') in order to promote competition. The regime was designed to address the specific characteristics of legacy telecoms networks owned and run by incumbents, typically former state monopolies.

We observe that the list of relevant markets subject to ex ante regulation is not fixed. For example, during 2003-2007 the number of markets on the EC list (i.e. likely to require ex-ante regulation) fell from 18 to 7.

[4] We observe that licensed broadcasters are additionally subject to other forms of regulation (e.g. broadcast codes on taste and decency, impartiality, and restrictions on permitted advertising minutage). Public service broadcasters are subject to additional restrictions including hours broadcast of specific genres, independent production quotas and specification of the location of production.

Recent expert advice published by the Commission in September 2013 recommended that fewer markets should be included on the Commission's list than under current EU rules, and that no new markets should be added.[5]

Against this background, the UK debate on the proper scope for ex ante regulation is rather timely.

Convergence is at the core of the EU telecoms regulatory framework [6]

"*The convergence of the telecommunications, media and information technology sectors means all transmission networks and services should be covered by a single regulatory framework*."

But the EC acknowledges the need to distinguish transmission and 'media content'; media content is outside the telecoms regulatory framework

Media content is instead regulated by audiovisual media services rules.

"*It is necessary to separate the regulation of transmission from the regulation of content. This framework does not therefore cover the content of services delivered over electronic communications networks using electronic communications services, such as broadcasting content, financial services and certain information society services*."

In respect of relevant content regulation, the Commission states:

"*Audiovisual policy and content regulation are undertaken in pursuit of general interest objectives, such as freedom of expression, media pluralism, impartiality, cultural and linguistic diversity, social inclusion, consumer protection and the protection of minors*."

This context is important. It serves as a reminder of the main basis for the different regulatory treatment for electronic communications networks and services under the EU Framework which has stopped short of regulating content.

The House of Lords' ('HoL') convergence inquiry appears to have paved the way for DCMS's focus on the effectiveness of Ofcom's current broadcast-specific competition powers

"During this inquiry, we heard calls for more effective "ex ante" (literally—before the event) broadcast-specific competition powers to be given to Ofcom. In essence, Ofcom's existing media competition powers, it was argued, should be strengthened to match its powers in telecoms markets."

In concluding the inquiry, the HoL recommended further consideration of:

- the scope of Ofcom's media-specific competition powers - should they apply only to broadcast licensees, or more widely (as Ofcom suggested)?
- the nature of those powers - the extent to which they should be extended to the promotion of competition;
- when those powers can be used - in particular, can greater certainty be given to the sector by making it clearer when Ofcom can (and cannot) use ex ante powers of this nature?

The HoL did express, however, that use of the powers would be subject to a high hurdle and that the use of ex ante powers would be justified only in markets:

- characterised by high and non-transitory barriers to entry;
- where market structure does not tend over time towards effective competition;
- where competition law by itself is not sufficient to deal with market failures identified.

[5] See: https://ec.europa.eu/digital-agenda/en/news/future-electronic-communications-markets-subject-ex-ante-regulation

[6] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:108:0033:0050:EN:PDF

The convergence inquiry heard polar views on the ex ante competition rules for media content [7]

Ofcom and others argued that the ability to intervene in media content markets is severely limited. Indeed, Ofcom posited that the legislation in its current form lacks clarity.

Amongst others, Ofcom stated that

"*It is important that the competition regime should be capable of keeping pace with the changing competitive landscape. Without clarity on the application of Ofcom's ex ante competition powers, there is a strong risk that in future we will be unable to take effective action in cases where we anticipate that changes in the market could hamper competition*."[8]

BT argued:

"*To align this [telecoms] regime to the media sectors would simply involve copying the powers that Ofcom has for telecommunications and applying them to media: the powers to define markets, identify market failures (including, but not limited to, market power), and the design of remedies to promote effective competition and provide a consistent level of protection for consumers*."

In sharp contrast, two economics professors took a different position. Professor Valletti argued that:

"As an economist, I would say that content to me seems to have less of the nature of a persistent bottleneck like some infrastructure. In that sense, just from the economics alone, I would say, therefore, it would be better to subject it ex post to competition policy instead of having a regulator and doing things before they happen."

Professor Cave stated:

"*Well, I know it is very dangerous to say that you would eat your hat if anything happens, but I would be inclined to make that claim that I would eat my hat if the European Commission decided to include the content markets as susceptible to ex ante regulation to a greater degree than it is now. … content issues can be sorted out by competition policy.*"

Other stakeholders also disagreed with the notion of strengthening ex ante powers. For example Sky argued:

"*Providing Ofcom with the additional powers that it seeks to intervene in the sector is unnecessary and risks having a significant negative impact at a time when UK media companies face substantial threats from global competitors."*

We anticipate that similar arguments will re-emerge in responses to the forthcoming DCMS consultation

In its '3Cs' paper, DCMS raises a preliminary list of issues for consideration and poses the following key question:

"is there a risk of unfairness or market distortion if firms are more – or less – regulated because they are subject to one form of regulation rather than another?"

The issues that DCMS wishes to explore in the consultation comprise:

Objective of the regime: convergence may suggest that there is benefit in greater alignment of the duty to "ensure fair and effective competition" with Ofcom's principal duty to further the interests of consumers, "where appropriate by promoting competition", as is explicitly the case for the ex-ante telecoms regime.

[7] Extensive detailed oral and written submissions were provided by several stakeholders. Here we provide some brief overviews.

[8] This approach contrasts with views expressed in "*Competition issues in television and broadcasting*", Contribution from Mr Allan Fels (DAF/COMP/GF (2013)6): "*the speed and unpredictability of technological change makes it vital competition authorities recognise the risks of 'getting it wrong': in the sense of mistaking transient commercial success for market power; or, conversely, in over-estimating the corrective efficacy of entry and of new competition. Striking the balance between these errors will undoubtedly be challenging for competition regulators, and at times frustrating for market participants, in developed and developing countries alike*."

Types of services which the regime applies to**:** currently powers apply only to licensed services and perhaps clarification of the definition of 'connected' services in the existing provisions is required.

Features which the regime should consider**:** DCMS posits that greater certainty may be provided by identifying the types of features which require attention. Examples suggested by DCMS include: high concentration levels and SMP (e.g. in access to premium content); market failure (e.g. a lack of interoperability and issues in co-ordinating technological standards); and whether aspects of policy/regulation may create barriers to entry or have other unintended consequences.

Available remedies under the regime: greater certainty may be provided by setting out a specified list of remedies available under the regime.

Time limits for action under the regime: greater effectiveness and more timely intervention may be facilitated by introducing time limits into the regime.

The above shopping list suggests that DCMS has given serious consideration to a possible new, detailed and prescriptive ex ante regime for broadcasting. What may be of further concern are some of DCMS's references to the sector displaying features of concentration:

"*for example: the vast majority of homes primarily watch TV over the three main platforms (Freeview, Sky and Virgin Media)*."

We ask, how many competing and sustainable platforms does DCMS consider there could be? Moreover there's no mention of other competitors such as Freesat or IPTV or more recent entrants providing OTT services.

DCMS also states, bizarrely, that:

"…*many of the key features of the broadcasting sector which led to the introduction of an ex-ante competition regime endure. For example despite the growth in video on-demand and new devices, viewing of traditional TV remains stable, with the average adult watching over four hours of TV a day. In addition, almost 75% of that viewing continues to be attributable to Public Service Broadcasters (the BBC, ITV, Channel 4 and Channel 5)*."

We do not see how such consumer outcomes give cause for concern given the plethora of choice available.

How important is convergence?

Convergence blurs the lines between historically distinct networks, services and devices and a reasonable question to ask is, what are the implications of convergence for ex ante competition rules for broadcasting? Convergence per se does not imply that broadcasting and telecoms should be subject to the same ex ante regulatory regime.

The rationale underpinning the telecoms regulatory regime is one of injecting competition, rebalancing prices, reducing costs and setting cost orientated prices so as to transform old state monopolies into vibrant, competitive and innovative markets.

Moreover, there is a distinction between the content and the pipes. The former cannot be divorced from public interest issues which include, amongst others, culture and media plurality.[9]

Some will argue that there should be no policy interventions in media content – akin to the publishing world – as the market will deliver what the consumer wants. In such a world there is no rationale for ex ante competition powers.

Even if one accepts that public policy requires local (European) content to be produced and available on-screen, by a combination of commercial and public institutions, this does not automatically dovetail to a regime of increased ex ante competition powers in 'broadcasting'.

[9] The 'pipes' of course may raise public interest issues such as affordability and access.

DCMS refers to the importance of the broadcasting regulatory regime being as effective as the telecoms regime, stating that:

"*This is especially important in converging markets – if firms regulated under the telecommunication regime are more or less effectively regulated than those under the broadcasting regime, then the converged market may be distorted*."

We ask, *how* may the converged market be distorted? A closer inspection of this argument reveals its complexities. The comparator between negotiated prices and regulated prices may be too simplistic in circumstances where there is a sound reason to believe that the regulated operator may increase prices above competitive levels in the absence of regulation.

For example, in a bundled offering, it may be open to the supplier to match a competitor's retail prices across the bundle even if its wholesale input costs differ. It does not necessarily follow that there is competitive distortion if one supplier's input prices are regulated and the other's are not. Asymmetric regulation across telecoms and broadcasting per se does not imply possible market distortions.

In our view convergence enables policy makers to stand back and re-appraise the rationale for existing regulation/whether new regulation may be required. As per the quotation from Allan Fels (footnote 7), convergence, if anything, implies that regulators should be cautious when intervening in markets.

Presumably DCMS will explore several options for future regulation

DCMS will have to decide whether the current policy with regard to regulation of converging media and telecoms markets needs to change.

The HoL discussions relayed above give a flavour of the likely issues to be raised by the consultation paper. The key issue appears to be whether broadcasting should be regulated like telecoms.

To propose a significant departure from the current regulatory regime should of course be underpinned by robust evidence of market distortions/failures rather than assertion.

At a high level, the main categories of possible policy responses appear to be: (1) do nothing; (2) extend ex ante regulation to broadcasting as per the current telecoms regime; and (3) relax telecoms regulation.

Ultimately DCMS will need to compile a regulatory impact assessment that compares the policy options against the base case in terms of costs and benefits. The results of this exercise should be the cornerstone of any new policy proposals.

At this stage it is too early to second-guess the detailed content of the DCMS consultation paper and the policy options that will be tabled. We thus provide a brief discussion of some of the issues under each of the options we considered.

Option 1: *Status quo*

If there is no change to current regulation of broadcasting or telecoms this prompts a comparison between the effect of this on competition, investment and innovation between converging networks and services.

In this situation, a provider of electronic communications networks or services that is subject to SMP conditions has to continue to meet any *ex ante* conditions including g any access obligations to which it is subject. Now, let us suppose that operator is considering upgrading its facilities. It may factor into the business decision the need to remain competitive with other services and, also, the reality that it may need to grant access as a corollary of the SMP conditions.

An operator that is not subject to such *ex ante* conditions would not have to factor in the same regulatory obligation. So, the issue in this scenario is whether the preservation of the status quo somehow distorts competition between converging or competing broadcasting or telecoms providers where the boundaries

between their activities are not as distinct as they once might have been? Interestingly, DCMS concedes that:

"we do not consider that full alignment between the telecoms and the broadcasting regimes would be appropriate".

DCMS then goes on to postulate that:

"we should ensure that any broadcasting regime is as effective as the telecoms regime."

The forthcoming consultation may articulate reasons to believe the current broadcasting regulatory regime may not be as effective as the telecoms regime. Yet, in the absence of any evidence or arguments on the inefficacy of the current regime, continuation of the prevailing regime has to be the starting point.

Option 2: *Extend regulation*

This option would be to broaden the current telecoms approach to all elements of broadcast value chain (we note that transmission is already covered as per the EU Framework). This approach would raise tensions with or run counter to the EU Framework which does not bite on media content. We do not discuss the economic and legal intricacies of this option: we merely state it is an extreme option which is at least hinted at in DCMS' consultation.

Option 3: *Relax or overhaul regulation*

The opposite end of the regulatory spectrum to Option 2 is to relax regulation by jettisoning the current ex ante approaches in telecoms (specifically electronic communications networks and services). This would have as its aim the creation of a regulatory level playing field between converging services. Again, this raises questions of compliance with EU law where operators are subject to SMP conditions.

But let's assume that some loosening of regulation is possible this would create a symmetrical regulatory regime from the point of principle. However, whether this is genuinely symmetrical regulation in terms of treating 'like as like' depends on a much more detailed inquiry on whether the services are genuinely comparable.

CONCLUSION

The DCMS consultation is likely to raise some important questions and the policy options are potentially radical. If there is to be a transition from ex post to ex ante interventions – or vice versa – all segments of the industry will want to contribute to the policy debate.

We do not believe that convergence per se provides a rationale for broadcasting and telecoms to be subject to symmetric regulation.

Ex ante and ex post regulation are complementary tools in the telecoms sector, and over time, the number of 'markets' subject to ex ante intervention has fallen. DCMS is now considering the possible option of increasing ex ante regulation in broadcasting. Discussions held thus far on these issues have been vigorous and no consensus has been reached.

DCMS may be wise to re-visit the Competition Commission's ('CC') investigation into movies on pay TV. During a period of 10 months, the CC reversed its preliminary decision that BSkyB was having an adverse effect on competition to the conclusion that BSkyB did not have such an advantage over its rivals when competing for pay-TV subscribers as to harm competition. The CC noted the increasing trend of audiovisual content being delivered over the internet, and that it had increased competition and consumer choice.

The ultimate conclusion reached by the CC demonstrates the reluctance of a regulatory authority to impose remedies in a rapidly changing and uncertain market place.

It is imperative that DCMS adopts a 'first principles' approach. It needs to identify clearly any problems (with appropriate robust supporting evidence) in the relevant markets, asking some basic questions – 'what' should now be regulated and why? Is it the case that absent effective ex ante regulation, broadcasting

does not exhibit/will not develop effective and sustainable competition? What are the costs and benefits of such intervention compared to the status quo? What are the risks to innovation and investment?

We end this paper with food for thought, a comment made by Ed Richards in a speech to the UCL Jevons Institute for Competition Law and Economics:

"…*a national regulator needs to use a balance of powers to address complex competition problems, and should not overstate or seek to hold ideologically pure technical positions above the interests of competition and consumers, which is what ultimately matters*." (See: http://media.ofcom.org.uk/2010/07/13/competition-law-and-the-communications-sector/)

NEXT STEPS

We await publication of the DCMS consultation. In the interim, if you would like to discuss the issues raised in this note and how we may assist you in responding to the consultation once published, do not hesitate to contact Alison Sprague at CEG (contact details below).

CONTEXT

This briefing has been prepared by Dr. Alison Sprague of CEG and competition lawyer Suzanne Rab.

Any opinions expressed in this communication are personal and are not attributable to Competition Economists Group.

See: http://www.ceg-global.com/uploads/PDFs/Client%20notes/CEG%20client%20note%20DCMS%20media%20plurality%20Oct%2013.pdf for our perspectives on the DCMS consultation on media plurality.

CONTACT

Dr. Alison Sprague

T / +44 (0)20 3440 5526
M / +44 (0)75 0784 0740
E / asprague@ceg-europe.com

Suzanne Rab

T / +44 (0)20 7551 7581
M / +44 (0)75 5704 6522
E / suzanne.rab@gmail.com