



Bundesnetzagentur

Price regulation and exclusionary pricing practices

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Outline

- Brief introduction of BNetzA
- General regulatory principles + institutional set-up
- Telecommunications price regulation
- Energy price regulation
- Postal price regulation
- Conclusions



- 1998: Regulierungsbehoerde fuer Telekommunikation & Post (RegTP)
 - regulation of two sectors: telecommunications and postal services
- New responsibilities:
 - electricity, gas (both 2005) and railway (2006) regulation
 - RegTP renamed Bundesnetzagentur (BNetzA) in 2005, Headquarters in Bonn
- BNetzA's task:
 - market and network regulation in the 5 network industries in order to develop and promote *sustainable competition* in these sectors based on sector specific regulatory laws





Regulatory principles (1)

- **Competition** as a means to create economic welfare and in particular consumer benefit (lower prices, better quality and more choice)
- **Regulation** as a means to promote sustainable competition via opening markets in network industries and creating a level playing field
- **Network industries** are characterised by market entry barriers resulting from substantial economies of scale and scope requiring regulation to overcome market entry barriers
- **Competition** is the best driver for efficient investment and consumer benefits, but in network industries it can only be achieved with strict access and price control **regulation** applied ex-ante, thus competition and regulation are not opposed to each other, but reinforcing each other



Regulatory principles (2)

- **Regulatory instruments** must go beyond general competition law by imposing specific obligations on the dominant operator such as:
 - the obligation to grant access to **essential facilities** at **non-discriminatory conditions** in order to create a level playing field (equal access);
 - **ex-ante price control** (cost-oriented access prices)
- Keep market entry open by removing all legal barriers to entry and prevent the establishment of new ones
- Prevent price/margin squeezing with regulation on the access / wholesale level and ex-ante margin squeeze tests
- special control of abuse of market power (anti-competitive beh.)
- **Prevent foreclosure and leverage with ex-post price control** (to stop short anti-competitive behaviour, e.g. exclusionary practices)



Regulatory Principles: Telecommunications

- Close link to general competition law as the 2002 European electronic communications networks and services framework (reviewed 2009) incorporated competition law principles with regard to the definition of the relevant market and finding of significant market power (= dominance) as competition law oversight will replace sector-specific regulation once market forces start to work and competition is self-sustaining
- However, for the time being, competition in the most important wholesale telecoms markets is not yet self-sustaining but still reliant on regulation, while regulation of retail markets is relaxed or lifted completely



Institutional Set up in Germany

- **Umbrella approach**, which means:
- The Federal Cartel Office (BKartA) as the NCA has a co-ordinating function regarding the definition of the relevant market and the market analysis by BNetzA, merger control remains in the responsibility of BKartA
- BNetzA must get **agreement** for its definition of the relevant market as well as the determination of an operator with significant market power (SMP)
- The same threshold for dominance holds in all sectors of the economy to guarantee a close link between regulation and general competition law
- BKartA has the right to comment on BNetzA's remedies draft decisions and vice versa (for all sectors)



Implementation in Germany

- Provisions of Directives transposed with the German Telecommunications Act 2004:
- Power to carry out market reviews
- Take utmost account of the market recommendation defining markets susceptible to ex-ante regulation (i.e. passed the 3-criteria-test)
- Discretion to choose appropriate and proportionate remedy
- German particularity: differentiation between ex-ante (cost orientation) and ex-post rates (abuse criteria) rates regulation:
 - section 30: determines ex-ante and ex-post delineation,
 - section 31: defines ex-ante cost-standard as the cost of efficient service provision (= LRICs plus appropriate mark-up for common costs incl. reasonable rate of return on capital employed (as before))
 - section 28: defines the ex-post standard: abusive criteria taken from the general competition law



Rates Regulation Procedure (1)

- Ex ante: prior approval of rates (section 30)
- Cost standard: cost of an efficient operator (sect. 31)
- BNetzA has 3 methods to calculate rates (sect. 35):
 - cost accounting (top-down),
 - benchmarking („reality check“),
 - analytical cost model (bottom-up)
- Cost documents submitted are the incurred costs = fully allocated historical costs (FAC/HCA)
- Efficient costs are defined as long run incremental current costs (LRIC/CCA)
- Approved rate = efficient costs, not all incurred costs are accepted, inefficient costs will be deducted (over-capacity, over-staffing, too high wages / common costs)



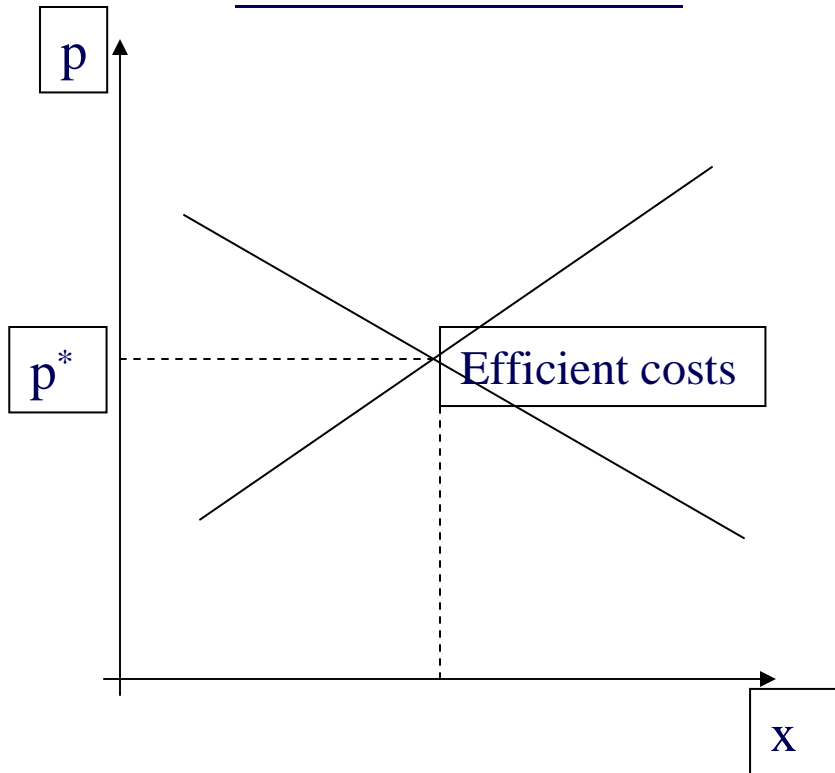
Rates Regulation Procedure (2)

- Ex post: rates can be set by the SMP operator (section 38), but in case of complaints or indications of abuse, rates are checked against:
- Abuse of market power criteria (sect. 28 = sect. 19 General Competi. Act)
- Rates shall not be excessively high
- Rates shall not be predatorily low and affect competitors' chances considerably (through harmful cross-subsidization):
presumption: not lower than LRIC (similar approach in the Cion's 2008 Art. 82-Guidance paper), no common costs taken into account (lower barrier)
- Rates must comply with the margin squeeze test, i.e. allow an efficient company to make an appropriate rate of return in the downstream market
- Unfair bundling is not allowed (replicability test)
- Rates shall not be discriminatory
- 2 methods to check for anti-competitive pricing: benchmarking and cost-accounting, no cost-modelling

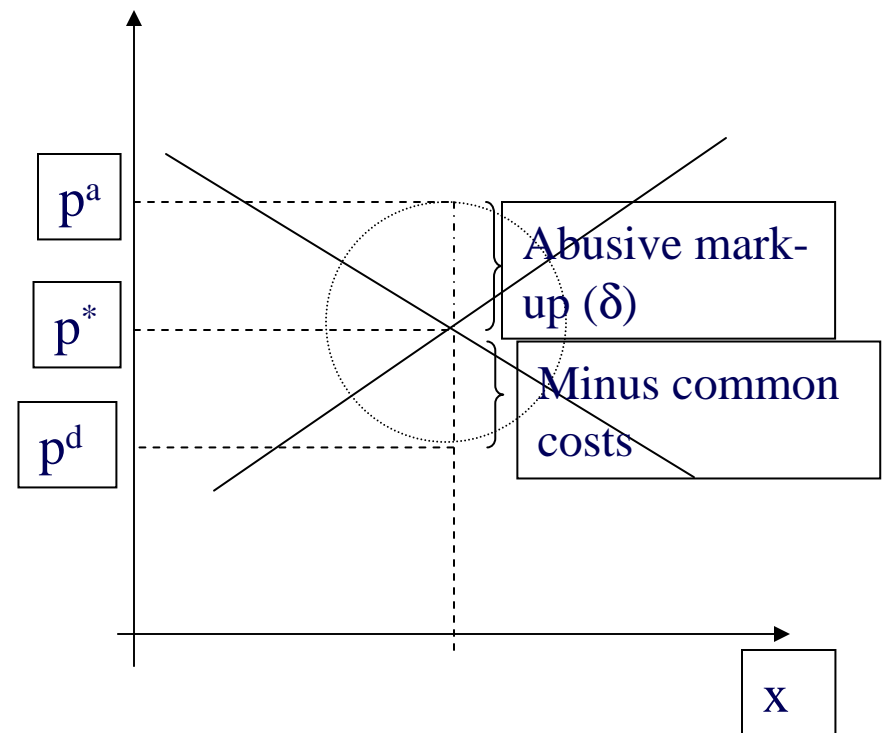


Comparison of ex-ante and ex-post regul.

Ex-ante-Standard



Ex-post-Standard





Effective control of anti-competitive behaviour is necessary

- Competitive market structures start to stabilize (with different business models) and competitive pressure brings retail prices down
- No ex-ante regulation of retail markets required any more, but to prevent remonopolization through dumping and unfair bundling by the SMP operator, an ex-post (or competition law type) regulation is needed to stop anti-competitive behaviour, which is
- Foreseen in section 28 of the Telecoms Act:
no abuse; no dumping; no unfair bundling
- BNetzA published a Guidance paper on the application of the margin squeeze test
- And: effective wholesale regulation required with ex-ante price regulation acc. to economic rationality: simulate price prevailing in a competitive market: according to the cost of an efficient operator and to prevent margin squeeze (ensure replicability)



Danger of market dominance abuse under new market structures? (1)

- Consolidation of the communications-market should not be allowed to lead to restriction of competition or to the development of oligopolies
- Convergent markets due to technological convergence as an effect of next generation networks which are multi-service networks: as a consequence we see media markets and traditional telecommunications service markets converge
- Convergence of fixed and mobile services with potentially changing market boundaries: impact on the market definition
- More and more bundles ("triple play": Phone, Internet, TV and others) are offered, containing regulated and unregulated products;
- New pricing models: e.g. flatrates are offered more and more
- Single-supplier bundle products can be consumer-friendly and in line with the market, but at the same time specialized providers must be able to compete and put together bundled products: access-rights may not be undermined



Danger of market dominance abuse under new market structures? (2)

- Consumers must keep the right to choose, whether they purchase bundled or single products from one or more suppliers, flat rates or usage-based tariffs
- Protect consumers to allow them to benefit from convergence (e.g. transparency requirements)
- Convergence is a driver for new services, new players and a higher market dynamic, but there are **chances and risks for competition: leverage of market power** from traditional markets to be prevented
- Regulation is necessary to keep markets open and guarantee a level playing field, the principle of **technological neutrality** is of key importance in a convergent environment
- **Price regulation** likely to shift for retail offers to ex-post tests while wholesale services (access) continues to be regulated ex-ante: prevent unfair bundling and predation as well as margin squeeze



ERG-Report 2009 on the Application of margin squeeze tests to bundles (1)

- **Bundling is challenging current regulatory practices - in particular where ex ante margin squeeze (MS) obligations exist on some retail market.**
- **Convergence will make the analysis of MS on bundles more relevant.**
- **MS at wholesale-retail level, not between wholesale services.**
- **Ex ante MS tests. Ex post practice is expressly excluded of the scope of the report.**
- **MS applied to bundles. Practice on individual services as a starting point for analysis.**
- **Anticompetitive horizontal effects of bundling is only considered with reference to MS tests.**



ERG-Report 2009 on the Application of margin squeeze tests to bundles (2)

- **Provides information on current practices of European NRAs, describing their methodologies to assess MS in an ex ante framework.**
- **Describes the current regulatory framework in relation to MS.**
- **Identifies when is MS more likely and when an ex ante MS assessment is needed.**
- **Discusses the pros and cons of MS assessment methodologies in relation to bundling**
- **Discussion will continue and be developed further**



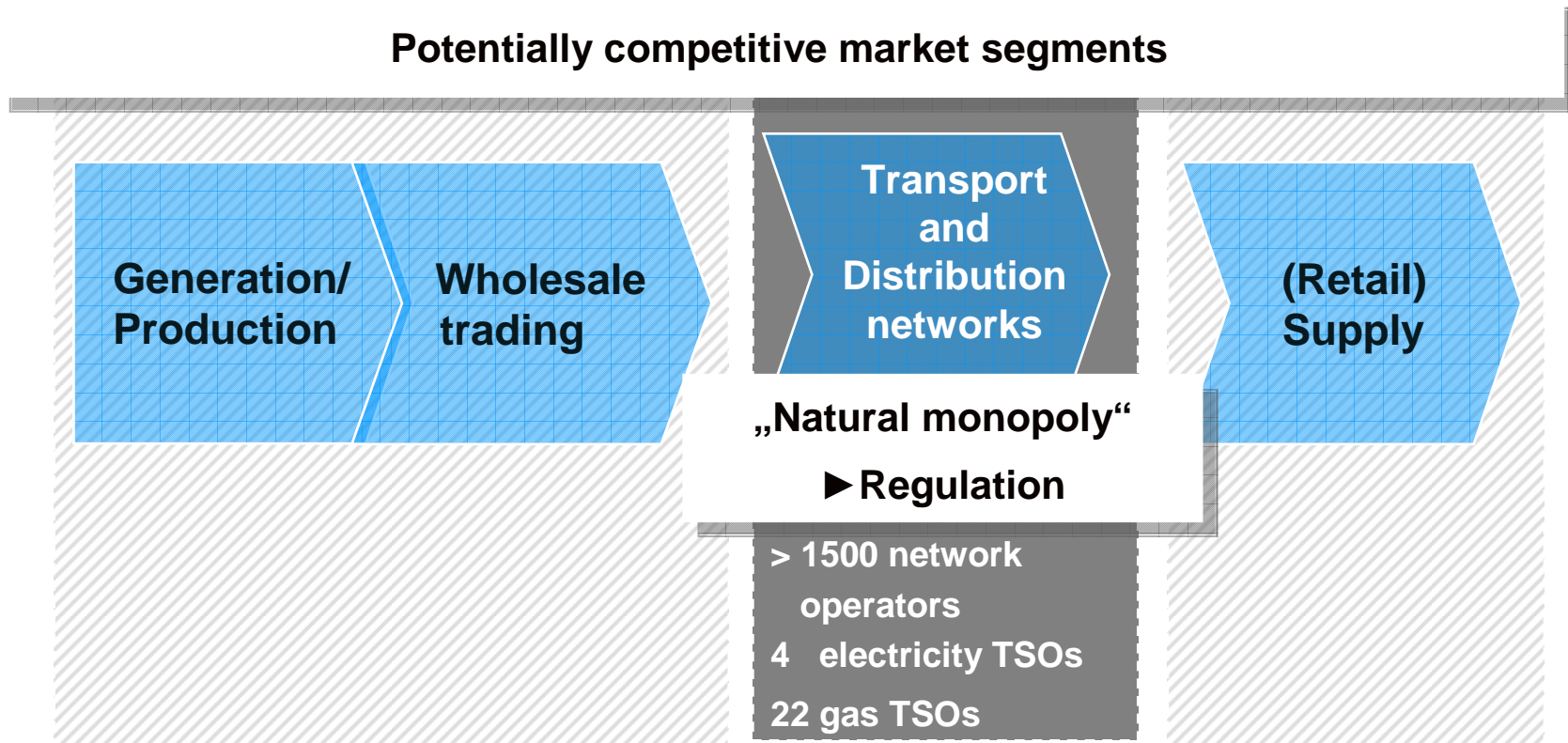
Price control measures incl. risk assessment

- In order to finance investment in NGA roll-out new pricing models are suggested by incumbents (contract duration, up-front payments and volume discounts) have to be checked to ensure non-discrimination and prevent margin squeeze foreclosing the market to competitors (“penetration pricing”).
 - Tension between financing needs while operators are at the same time offering flatrates to consumers to penetrate the market faster.
 - To incentivise efficient investment a reasonable rate of return has to be calculated including a risk-premium adequately reflecting the risks, however the risk remains with the operator. Existing methodologies are still applicable.
 - Regulators can facilitate investment planning by providing regulatory predictability and stability through announcement of regulatory strategy and determination of the length of the regulatory period balancing certainty and flexibility thus reducing risk.
- ➔ NRAs should continue to ensure non-discrimination and prevent leverage of SMP to enable a competitive NGA roll-out with joint projects where appropriate.



The energy market value chain

Potentially competitive market segments





Energy price regulation

- BNetzA is responsible for setting the grid charges since 2005 (before that the BKartA „regulated“ ex-post the energy sector), but not for the retail prices
- BNetzA has introduced an incentive regulation scheme in 2009 allowing grid operators to retain the „extra profit“ when producing more efficiently than the productivity rate foresees (cost standard of an efficient operator)
- Since 2005, the share of the network charges in the total retail price of electricity for households was reduced from nearly 40% to 25%
- The BKartA is responsible for wholesale as well as retail price regulation, and must include network charges set by BNetzA as given; new powers in 2009 amendment of the General Competition Act, not yet applied
- Having competitive and regulated areas and no competence on the value chain as a whole, it is more difficult to bring all the benefits of regulation to consumers (although due to standardized switching procedures, switching increases)
- This is also one of the reason why (ownership) unbundling is strengthened with the 3rd Internal Energy Market Package of 2009



Postal Market Regulatory Tools

Sector-specific regulation of dominant providers comprises :

- Rates regulation: ex-ante and ex-post
- Control of anti-competitive practices
- Access to network of incumbent



Mechanisms to achieve the aims of the Postal Act (1)

➤ Rates Regulation (§ 19 Postal Act)

- All rates charged by a licensee in a market for postal services subject to licence shall require approval by the NRA, provided the licensee has a dominant position in the relevant market.
- Based on the cost of efficient service provision and may not contain surcharges, any discounts, discriminatory pricing unless a legal obligation or another justifiable reason can be evidenced, § 20 Postal Act.



Mechanisms to achieve the aims of the Postal Act (2)

➤ Forms and procedures for price control

The NRA shall approve rates ex-ante:

1. on the basis of the costs of efficient service provision apportioned to the particular service (Single-Price-Procedure) or
2. on the basis of productivity calculations it prescribes the average rate of change for the prices of a basket of combined services (Price-Cap-Procedure).

The NRA shall control rates **ex-post** (§ 25 Postal Act), which are not controlled ex-ante or where information becomes available that indicate abuse of market power



Mechanisms to achieve the aims of the Postal Act (3)

➤ **Special Control of Anti-Competitive Practices (§ 32 Postal Act) – ex post mechanism**

- The NRA shall call upon the company to discontinue the anti-competitive practices objected to.
- If not successful: NRA may impose certain practices or prohibit anti-competitive practices and declare contracts wholly or partially null and void.
- The decision hereby is subject to the “principle of proportionality”, which means it has to be the mildest form of effective intervention.



Ex-post price control decision 2010

- On July 15th 2010 BNetzA opened an ex-post proceeding against Deutsche Post AG for increasing the discounts for incidental services considerably to compensate for the change in VAT regulation (DPAG is no longer privileged), fear of hampering competition
- DPAG argued BNetzA cannot prescribe how the extra burden (for legacy costs and universal provision) is allocated between the regulated and the competitive areas.
- BNetzA checked against the standard of efficient costs: this was passed and even a part of the extra burden covered, albeit less than before
- Therefore BNetzA had to allow the increase of discounts, but announced that any extra burden not recovered in the competitive area cannot lead to an increase in the ex-ante regulated area (decision of 15 Sept 2010)



Mechanisms to achieve the aims of the Postal Act (4)

➤ **Access to Network (§ 28 Postal Act)**

Licensee with dominant position in a market for postal services subject to licence shall, given demand, provide parts of its overall conveyance offering separately, if this is economically reasonable.

➤ **Access to PO Box Facilities and to Information on Changes of Address (§ 29 Postal Act)**

Licensee with dominant position in a market for postal services subject to licence shall undertake, provided demand exists, to allow in this market other postal service providers, against payment of a fee, to convey postal items to the PO box facilities it operates unless this is not objectively justified.



Mechanisms to achieve the aims of the Postal Act Role (5)

➤ **Requirement to submit contracts (§ 30 Postal Act)**

All contracts on incidental services and all contracts on the shared use of PO box facilities or access to information on changes shall be submitted to the Regulatory Authority by the dominant provider within a period of one month of concluding the contract.

This transparency obligation ensures
non-discrimination



Conclusions

- Adjust SMP-regulation to make a considered choice of ex-ante/ex-post regulation to achieve objectives of promoting sustainable competition and incentivising investment in next generation network roll-out as well as dealing with new forms of competition on the retail level resulting from convergent markets, mainly bundling and flatrate offers
- Ensure consistency of regulatory measures in a very dynamic environment with more differentiated and more competitive (retail) markets
- While telecoms regulation uses mainly behavioural remedies, energy regulation is also applying structural remedies (ownership unbundling)
- Postal regulation still to follow the development of telecoms regulation as the market is not so dynamic, but very unbalanced; cost allocation principles between the competitive and the regulated area play an important role (risk of harmful cross-subsidization)
- Increased importance of regulatory predictability – in all sectors, i.e. take a longer time horizon into consideration for regulatory periods
- Sectorspecific regulation remains necessary for network industries, but relationship with competition law is changing



Thank you for your attention!

Vielen Dank für Ihre Aufmerksamkeit!