Innovative Trade Rules with Anti-Competitive Effects?

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This article analyses how policies to increase market access can sometimes backfire and how principles that require companies to deal with their competitors can potentially obstruct the development of innovative services.

Some readers will be aware of a long-running debate about whether competition rules should go global and, most recently, whether responsibility for their enforcement should rest with the World Trade Organization (WTO). At the heart of the debate are European trade representatives who want such rules and American antitrust officials who do not, or who urge caution in their definition and application. The main disagreement concerns the propriety of imposing multilateral trade rules over competition law enforcement. While antitrust opposition shows no signs of abating, trade negotiators have gone ahead and negotiated ‘competition’ rules in other areas of the WTO framework in order to control state enterprises and monopolies and certain aspects of the exercise of intellectual property rights and to provide access to the telecommunications networks.

It is in the fast-moving telecoms sector that world trade laws have been innovating most in order to adopt ‘competition’ principles. Moreover, having worked so hard to devise competition rules for that sector, there is a strong trade-led movement to apply them to many other sectors as part of the built-in round of negotiations under the General Agreement on Trade in Services (GATS) agenda. Unfortunately, as this article will explain, these trade policy innovations are in fact *mutating* competition policy principles, with likely harm to competition, innovation and the efficient operation of markets.

The underlying principles of a liberal trade policy are sound. Increased trade law discipline over protectionist activity lowers trade barriers and allows foreign competitors to enter new markets and introduce new products and different ideas. The important caveat, however, is that this entry should not take place at any cost. Trade barriers are broken down to increase the diversity, competitiveness and efficiency of the marketplace. In the process, market forces should not be distorted to help particular competitors to enter a particular market. To do so would be to allow the heavy ‘helping hand’ of government regulation to replace, or subvert, the hard work and effort of competing to earn one’s place on the playing field.

This article looks at how a policy movement towards mandating ever-increasing market access actually plays out in practice and how it can even backfire. In particular, it addresses how ‘pr-competitive regulatory principles’ – that require companies to deal with their competitors – can impede, delay or even prevent the development and introduction of innovative services.

Innovative trade rules

In the WTO legal order, the GATS introduces trade rules that oblige governments to provide foreign competitors and their services with national treatment and market access across a range of sectors. IN the telecoms sector, access to networks is absolutely crucial. Telecoms is a service sector in itself, as well as a distribution channel for the telephony signals on which the business (e-commerce) of the internet is conducted. GATS disciplines can help to provide access to public telecoms networks, but do not apply to newly - privatized operators. As a result, the supply of such services may be negated or obstructed by dominant firms denying access to their networks. Moreover, having governments simply agree to restrain their companies form discriminating against foreign competitors does not ensure that their domestic telecoms market will become or stay competitive: a right of general entry has to be provided. This was created in the *Reference Paper on Pro-Competitive Regulatory Principles* agreed in 1997. Its purpose is to provide telecoms service suppliers around the world with non-discriminatory access to their larger rivals' networks. The *Reference Paper* introduces pro-competitive regulatory principles with two main objectives. First, to *maintain* competition by requiring governments to maintain appropriate measures to prevent major suppliers from engaging in anti-competitive practices that frustrate market entry generally (ie not just foreign entry). More importantly, however, the principles aim to *promote* competition by ensuring that an incumbent operator provides new entrants which access to its networks. Governments are obliged to ensure that their major supplier allows its competitors to interconnect to its own telecoms transport network on non-discriminatory terms and conditions and in a timely manner.[1] The accrual meaning and scope of these vague but important terms and obligations will have to be determined during dispute settlement.

WTO telecoms challenges

The first telecoms cases are already bubbling up towards the WTO. In August 2000, the United States requested WTO consultations over the difficulties that AT&T and MCI were having in accessing Mexico's market. The US provider, Sprint, had partnered with Mexico's major supplier of telecoms, Telmex, to deliver mobile telecoms services in the United States and Mexico. AT&T and MCI had to settle for deals with lesser Mexican players. Perhaps feeling thwarted, they called on the office of the US Trade Representative (USTR) to make their case to the WTO, alleging inadequate regulation of Telmex by the Mexican Government. The USTR alleged that Mexico had not lived up to its commitments under the *Telecoms Reference Paper* to prevent its domestic carriers actively from engaging in anticompetitive practices. Under this pressure, in early September 2000, the Mexican telecoms regulator COFETEL issued a set of 'Asymmetric Regulations for Telmex' which ordered it to provide its long-distance competitors with access to its network at no greater charge than its own cost of providing that access. The United States then dropped its WTO complaint.

Note, however, that Mexico has a very robust competition law, designed in conjunction with the US and Canadian competition authorities, as well as a strong record of enforcement. Nevertheless, AT&T or MCI (or the USTR) made no public request for an

investigation by the Mexican competition authority. Why should they though? Their allegations would have had to stand up to a rigorous market analysis and a legal standard (that competition had to have been proved to have been lessened substantially) before the Mexican Government would intervene. The complainants stood a much better chance if their complaint was reviewed by Geneva-based trade officials charged with interpreting the new pro-competitive rules of the *Reference Paper*. Harm to competition would no longer be the relevant threshold; the desire to *promote* competition through increased foreign entry would be the trade policy standard.

As the Mexican case was settled though bilateral 'negotiation', WTO dispute settlement panels have not yet had an opportunity to explain what the *Reference Paper's* pro-competitive regulatory principles actually mean. Severe problems of interpretation are going to arise in any dispute settlement proceeding. The term 'major supplier' offers no guidance at all and appears much broader than the rigorous competition policy tests for 'dominance' or 'monopolization'. The same applies to the definition of 'essential facilities'. US and European competition policies appear to be moving towards a model in which the owner of an essential facility is only ordered to provide its competitors with access to the facility if it has unjustifiably denied its competitors such access and it is not possible, or at least not economically feasible, for them to develop a competing facility.[2]

There is no indication at all that trade officials charged with interpreting the new competition rules at the WTO will pay any heed to such a rigorous competition law test. This is particularly so given some rather disturbing developments within the merger control subset of European competition policy in the telecoms sector.

Mandating access

The *Telecoms Reference Paper* is designed to provide 'non-discriminatory access'. This term was the subject of fierce debate in the European Commission's decision in *Vodafone/Mannesmann* in April 2000.

The Commission's main concern with the merger was its creation of a pan-European mobile operator with a 'footprint' of 10 networks in 15 European Member States. This coverage would allow Vodafone to substitute international roaming agreements between national mobile providers with its own integrated service. Vodafone could then provide its mobile customers with one reduced roaming tariff for all of Europe: a most innovative and long-awaited service offering cheaper calls as well the incentive to make more use of mobile phones, particularly for roaming, thereby increasing the growth of the mobile telecoms market as well. The problem was that none of Vodafone's competitors could replicated such an offering. However, at the time of the decision, neither could Vodafone! Put simply, demand for such a service was growing but it could not yet be supplied: therefore there was no 'market' for one-rate roaming. Nevertheless, the Commission made it a relevant emerging product market. As odd as that might sound, one of the Commission's mandates is to be concerned about the creation of a dominant position. Assuming that the merged entity would instantaneously become dominant when it had the technology in place, Commission officials extracted form Vodafone an undertaking

that it would provide competitors with 'non-discriminatory access' to its network for three years on the launch of its reduced-rate roaming service.

While competition lawyers will readily identify the kinds of analytical problems that the Commission's decision raised, the terms of this access undertaking itself were particularly troubling. The undertaking given by Vodafone was negotiated in an extremely high-pressure situation in order to clear the largest deal in corporate history. This was a completely different environment from a judicial proceeding which would require a finding that a company that was (1) dominant in a market; and (2) had control over a facility that was essential for competition to exist, which could not be economically replicated and to which the incumbent had unreasonably refused its competitors access, before it was required to help its competitors to succeed. Not even one of these elements was proven before non-discriminatory access was required in *Vodafone/Mannesmann*.

There are at least three further levels of absurdity with this sort of mandatory 'non-discriminatory access' undertaking.

Chilling innovation by the incumbent

Subject to a non-discriminatory access provision, an incumbent is free to offer lower charges so long as it is prepared to extend the discount to its competitors. That threat undermines its incentive to introduce the lower prices in the first place. This is because not all customers that it might normally attract would sign up and because competitors would have access to the incumbent's rates and, thus, would be able to offer the same service without making any of the technological investment or acquisitions that the incumbent made. As a result, the incumbent has much less of an incentive to make the offering in first place.

Chilling innovation by competitors

The Commission said that it put a three-year time limit on the non-discriminatory access commitment 'so as to give competitors the incentive to compete with the merged entity in building alternative networks'. The irony is that the original merger would have been enough to spur attempts to replicate the new incumbent's footprint.

Competitors would have had to actually do something (more than complain to the regulator) and either merge or develop a competitive response. However, a non-discriminatory access provision removes the incentive for any competitors to do that. On a deeper level, a disturbing new policy rationale appears to be under development: imitation appears to have greater value than innovation and true competition.

Distortion of competition

The final absurdity is that while the incumbent's competitors may still lack the incentive, they remain free to try to develop their own new service without sharing it with anyone;

the incumbent cannot. This is not to suggest that a new entrant should become subject to the same kinds of restrictions that have been imposed on an incumbent but to suggest again that the access provision can be inappropriate in the first place. The impropriety in the commercial world of handicapping the successful to help those who have done nothing should be readily apparent.

Conclusion

If left unchecked by disciplined market analysis, pro-competitive regulatory principles that mandate non-discriminatory access are more akin to 'new competitor' – friendly regulations than true competition policy. Some trade representatives have been most frank about this: they call it 'the need for re-regulation'. They claim that the way to think about competition in international trade is by promoting competition without invoking competition law disciplines. The aim is to encourage new entrants by ensuring that incumbents help them to get in. This adds competition to a market but lacks an eye for the protection of the competitive incentives that underpin markets. There is little incentive to invest in providing a service if you are only to be ordered to share it with your competitors once you have reached a vaguely defined level of success. It would seems to be far better (and wiser) if we could temper the imposition of any such pro-competitive regulation with a form of Hippocratic oath for the regulators: do no harm.

Governments should not intervene in a market unless they have analyzed it, can show that there is a real risk of harm if they do not intervene and that this harm is greater than any harm their own intervention may entail. In particular, they should ensure that their own intervention will not undermine the incentives that underpin normal and healthy competition. Regulators around the world should forgo action if a firm achieves 'dominance' through legitimate competitive conduct and superior skill, foresight and industry and thereby succeeds in (or comes close to) creating a distribution channel or network that others may view as essential for their own survival. Regulators should ask themselves whether providing access to that 'facility' is essential for competition to exist. If others can invent around that facility or develop one of their own, by definition, competitions is possible and then access should not be required. At the end of eh day, the focus should be on competition and the competitive process, not on the complaints or demands of a few competitors.

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[1] A 'major supplier' is defined as one with the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market by control over 'essential facilities' or simply the use of its position in the market. 'Essential facilities' are defined broadly as those parts of a public telecoms transport network that are exclusively or predominantly provided by a single or a limited number of suppliers and which cannot reasonably be economically or technically replicated.

[2] *MCI Communications Corp v AT&T,* 464 US 891 (1983); *Oscar Bronner v MediaPrint Zeitungs et al* [1994]4 CMLR 112.