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LATIN AMERICAN COMPETITION FORUM

-- Session I: Competition Principles in Essential Facilities --

Contribution from Brazil

8-9 September 2010, San José (Costa Rica)

The attached document from Brazil is circulated to the Latin American Competition Forum FOR DISCUSSION under session I of its forthcoming meeting to be held in Costa Rica on 8-9 September 2010.

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LATIN AMERICAN COMPETITION FORUM

8-9 September, San José (Costa Rica)

Session I: Competition Principles in Essential Facilities

-- ESSENTIAL FACILITY DOCTRINE IN BRAZILIAN TELECOMMUNICATIONS SECTOR¹ --

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1. Introduction

1. Brazil has experienced a vast transformation in telecommunications since mid 1990's when the State drop back and permitted free enterprise in the sector. Before this structural change a State owned Company ("Telebrás") was the sole entrepreneur for constitutional² as well as institutional reasons.

2. It is not easy to affirm whether the characteristics of local telephone provision, that involve natural monopoly features, were decisive for Brazilian former constitutional choice of granting a legal monopoly to the government.

3. Despite this difficult question, the fact is that in Brazil telecommunications remained a legal monopoly until 1995 and in this context the federal government supplied telecommunication services by means of a public enterprise created to exert the monopoly privilege granted by the Constitution.

¹ This is a draft version; please do not quote without permission from the author. The views expressed here are the author's alone and do not necessarily reflect the views of the Brazilian Competition Tribunal or other antitrust authorities of the Brazilian Competition Policy System.

² Brazilian 1988 Federal Constitution stated in its Article 21, XI, that telecommunications services had to be performed by state owned companies.

4. Telecomunicações Brasileiras S.A. (hence “Telebrás”) certainly played a central role in the creation of telecommunications infrastructure in Brazil since it was founded in 1972. The fact that it was vertically integrated and encompassed local telephone companies throughout the country made it easier to tackle with a large range of problems normally inherent to telecommunications.
5. For example, how should be settled the relations between the company owner of infrastructure and other firms which depend on this infrastructure to sell their service to customers? In a vertically integrated State monopoly this sort of conflict is nonexistent. Not merely for the reason that this institutional arrangement is more likely to prevent conflicts, but because they have to be solved within the firm.
6. That is why decision making on price of access to infrastructure and established networks will not be negotiated on the marketplace where monopoly prevails; instead they are decided as an intra-firm matter. Therefore cross-subsidies in telecommunications are easier to be created and managed when only a single firm owns the whole business in several integrated markets.
7. The company may have a program of subsidies to extent the network by selling telephone devices and line connections under its average price. Although it seems at first an irrational behaviour, for prices have to reflect at least costs of production and return to capital investments in production, indeed it may prove rational if the company who sells telephone or links customers to its network will also sell local and long distance calls. In this circumstance losing money in the customer’s joining the network may be compensated by charging higher prices in subsequent services.
8. There are at least two conditions for this strategy to succeed. The first one is that network effects are greater when more people join the network³. It means that the utility a user may extract from networks he joined is greater when more people join in⁴.
9. That is why the user may be willing to pay subsidies to enhance the size of the network and make it more useful to herself even if it means greater prices to fund subsidies for those who would not join if access prices were higher.
10. The other *sine qua non* condition is that the company has to be owner of the network and either exclude or charge those willing to sell services through the network. Network effects and exclusivity make cross-subsidies possible, for higher prices generate greater user utility.
11. Thus cream skimming, for instance, is an important issue in telecommunications. For the firm investing in networks is frequently concerned about not letting other firms use the network without paying for its use.

³ For further information on this issue, see George L. Priest, “Rethinking Antitrust Law in Age of Network Industries”, Yale Law School, John M. Olin Center for Studies in Law, Economics and Public Policy, Research Paper n.º 352, 2007. Generally, on network effects see Michael Katz, Carl Shapiro, “Network Externalities, Competition, and Compatibility”, *The American Economic Review*, Vol. 75, No. 3. (Jun., 1985), pp. 424-440; Michael Katz, Carl Shapiro, “Systems competition and network effects”, *Journal of Economic Perspectives*, Vol. 08, No. 02, 1994, pp. 93-115; Mark A. Lemley, David McGowan, “Legal Implications of Network Economic Effects”, *California Law Review*, Vol. 86, 1998.

⁴ More precisely, the value of a telecommunications network is proportional to the square of the number of connected users of the system. This statement is known as Metcalfe’s Law ($n^2 - n$). For further information, see Carl Shapiro, Hal Varian, *Information Rules: A Strategic Guide to the Network Economy*, Harvard Business Press, 1999.

12. Otherwise there would last no incentives for firms to build an infrastructure that is expensive but would be freely used by others. Investment would not pay in this hypothetical situation, therefore individuals and firms would not use their money in a venture that is costly but allows other's use for no cost.

13. Public officials dealing with telecoms are normally aware of these circumstances and the very idea of having a government monopoly in telecom was an institutional arrangement to cope with typical problems they noticed in the sector. As long as one single public company provides local telephone, distance calls, builds infrastructure and charge customers for their use of the network, cross subsidies can work smoothly.

14. This choice was taken not only in Brazil but by a great number of governments⁵. By doing so intentions were both to expand the size of telecommunications networks – a central concern in developing countries – and also foster the inclusion of more citizens into this network in localities where it was already available.

15. To a great extent these policies that involve provision of new infrastructure have to be funded either with public funds or by some sort of public-private partnerships. Brazil adopted in the framing of its 1988's Constitution to provide telecommunications to its citizen by means of state owned enterprises which acted as holder of State's monopoly for the sector.

16. The Ministry of Communications enacted regulations for the sector, but the Telebrás holding company acted as an executive branch of government policy, being also the holder of monopoly in providing local telephone services all over Brazil through its 27 subsidiaries and moreover maintaining a long distance telephone company ("Embratel"⁶) that also was a monopolist for long distance calls.

17. Monopoly is frequently regarded as an antitrust violation in a large range of markets. Having a monopolist position or struggle to attain and maintain it through illegal means is punished by antitrust authorities in several jurisdictions.

18. However, in telecommunications sector, this sentence shall face a few objections. Abuse of dominance is always a problem, but having a 100% market share in a certain relevant market may be a consequence of a market structure that does not support competitors. The point that has to be highlighted here is that a monopoly in a telecommunications relevant market can be a consequence of regulatory choices and thus does not constitute *per se* an antitrust violation⁷.

19. Although the aim of this paper is not merely to expose Brazilian experience in providing and regulating telecommunications, much of it will have to deal with the national regulations and the transformations the sector underwent during an age that may called, though inexactly, deregulation and the structure that emerged from this.

20. We argue deregulation does not define properly the situation in Brazil during the 1990's because deregulation presupposes a prior regulation. Surely regulation does not have to correspond only and always

⁵ The U.S. Federal Government and Federal Communications Commission ("FCC") permitted AT&T to act as almost a private monopoly until 1982, when a suit was filed by the Department of Justice Antitrust Division and an agreement was reached before the District Court for the District of Columbia. According to this agreement, AT & T was broken up into seven new operating companies.

⁶ This company was privatised during the 1990's. Before that it was a state owned enterprise.

⁷ See Herbert Hovenkamp, *Federal Antitrust Policy: The law of competition and its practice*. St. Paul, MN: West Group, 1999, p. 707-8.

to regulation made through regulatory agencies or other independent bodies with quasi-normative and adjudicative powers.

21. But the very idea of regulation and the debates arising from it are directly linked with the conception of regulatory agencies. That is why we shall argue here that Brazilian model of State intervention was originally based on State owned companies and decision-making process in centralised bodies, a great deal of them under immediate Presidential supervision.

22. Before the Constitutional reform that allowed private enterprise in telecommunications two actors were central in Brazil: Telebrás (a holding company of regional also State owned telephone companies) and the Ministry of Communications, which issued rules governing the sector. After state monopoly was attenuated within Brazilian constitution in 1995, the State was allowed henceforth either to directly provide telecommunications or delegate it to private companies through administrative contracts.

23. This new configuration of the sector was thought to function with an autonomous administrative body that would enact regulations, supervise its application and enforce it in case of misconduct or non achievements of regulatory goals. In this sense the agency was designed to play two main goals: *design regulatory standards and rules* and *impose them in the public interest*.

24. Surely problems arise when attaining the public interest is the aim of any sort of administrative body. Certainly it does not depend much on the nature of the ownership, for it may be either a public or private organisation. It does not depend either solely on its institutional position within a firm or a government.

25. The challenge is that public interest configures a blurred concept that does not provide clear answers to those that have to take decisions about organisational structure. Notwithstanding it is fundamental to create some sort of commitment from the government with the public good, even if we are not able to define public good *ex ante*. That was the task of Brazilian reformers, how to widen telecommunications infrastructure and direct it to it to the public interest?

26. That is certainly why a brand new form of State intervention emerged after the Eighth Amendment of the Brazilian Constitution and the creation of the National Agency of Telecommunications (hence, “ANATEL”)⁸.

27. In contrast with the American experience of regulatory agencies, the Brazilian venture into regulation was a byproduct of privatisation, the State left the direct provision of goods and services and assumed a prevailing regulatory function.

28. The Telebrás system – as it was called – consisted of a holding company and other companies in which the Federal government had almost unlimited decision-making power. It means that the Federal government both issued regulations – through the Ministry of Communications – and was supposed to follow them.

29. Surely it is not reasonable to accept that interest groups had no role to play in this decision making process and that no conflicts would come up between the Ministry of Communications and State owned Companies. Indeed decisions were reached within one branch of the government, the executive,

⁸ The Telecommunications General Act (Act No. 9,472, 16 July, 1997), in Portuguese, known as “LGT”, created the National Agency of Telecommunications (ANATEL), an independent regulatory body for telecommunications sector.

nevertheless state companies and central government had different interests and frequently those differences became important enough to be solved by the Attorney General.

30. Along the process though the legislative branch and in a certain degree even the judiciary had roles to play. It was surely not an insulated decision making procedure since many agents with conflicting interests could act along it.

31. After the privatisation of state companies, the former mechanisms of dispute resolution and decision making lost their capability. Now that companies were private and the Federal government could no longer directly intervene in commercial decisions a new form of intervention arose to guarantee the attainment of public interest. The regulatory agency took up this function previously held by the Ministry⁹.

32. At the other side of the regulatory process there is not a state owned enterprise, but a private company that has to comply with regulatory standards, but is not part of the government. In this new institutional arrangement the State has to cope with the problem of making private firms work for the public interest, what frequently involve less profits or at least splitting profits with the user of the regulated public utility.

33. Another problem arising from this setting regards competition issues. Before privatisation the State himself was entrepreneur, thus there was almost no competition in the telecommunications sector and nevertheless it was not seen as a problem.

34. Firstly because the State although monopolist faced specific “checks and balances” like Congress supervision and public opinion. These checks and balances are weaker in a private firm in comparison to a public firm. The solution for this, at least in Brazil, was designed one year before the enactment of the Eighth Amendment to the Brazilian Constitution: the establishment of a modern system of competition law¹⁰.

35. Competition law was seen as a necessary institution to check the increase of private power during privatisation. Given that the presence of the State in a wide range of economic activities was usual and old, it would take a while to the regulatory framework learn how to deal with private economic power and learn how to establish adequate checks and balances to prevent abuse of dominance in relevant markets.

36. In a sector where natural monopolies are a reality and a policy challenge, introducing competition law and policy was a central concern.

2. Applying Essential Facilities Doctrine

37. The Brazilian Council for Economic Defense¹¹ already had the opportunity to apply the so called essential facilities doctrine in telecommunications. Even if regulators tried to design a environment that would forbid collusion and other anticompetitive practices, the reality is that in a complex and dynamic setting such as telecommunications agents may adopt practices for harming or excluding competitors despite regulatory rules.

⁹ The Ministry of Communications still exists in Brazil and plays a role even after the creation of the regulatory agency, certainly smaller than before the privatisation.

¹⁰ The Amendment was enacted in 1995. By its turn, the new antitrust system appeared in 1994, enacted by Competition Act, of June 11th 1994.

¹¹ The Brazilian Competition Policy System (“BCPS”) is composed by the Secretariat for Economic Monitoring (SEAE) of the Ministry of Finance, the Secretariat of Economic Law (SDE) of the Ministry of Justice, and the Council for Economic Defense (CADE), an independent tribunal. SEAE and SDE have analytical and investigative functions, while CADE is an administrative tribunal. CADE’s decisions can only be reviewed by the Courts.

38. A central concern in markets where a former vertical company was replaced by independent companies is how to manage commercial relations that were previously made within one single firm. Frequently the choice between going to the market to obtain necessary assets or producing it internally depends on the price and risk of acquiring scarce inputs or even the risk of paying high prices for them¹².

39. The firms that emerged after privatisation in Brazil could no longer choose to produce their own inputs, since the idea was to unbundle the sector by separating the several services and introduce competition where it was possible¹³.

40. Professor José Gómez-Ibañez adequately describes this situation as follows:

*“After vertical separation, the other firms in the industry must buy critical services, once supplied by a sister division in the old integrated company, from the bottleneck provider.”*¹⁴

41. Companies therefore could no longer choose the intra-firm solution and had to go to the market to acquire needed inputs. The problem is that competition in upstream markets may not be available if a natural monopolist owns the infrastructure of, e.g., local wire infrastructure. In other words it is highly possible that a company has to compete in its own market and at the same time faces a monopoly in upstream markets.

42. Regulation is normally the answer to deal with such integrated markets where vertical integration is no longer allowed. A regulatory agency has to enact and enforce rules that shall restrict the possibility the monopolist has to abuse of its dominant position.

43. Although this may be controversial the fact is that regulation established the upstream market shall remain to be a monopoly and regulatory barriers to entry are created so that the existing company does not face competition. Such a regulatory choice however has to be followed by other measures such as rules governing the relations between monopolist and the competing firms in integrated markets. Rules prohibiting price discrimination, for example, are essential to prevent opportunistic behaviour after these so called unbundling processes.

44. Unbundling is indeed seen as a manner of introducing competition in markets where regulation had a leading role. As is widely acknowledged, problems of natural monopoly may be solved through the creation of open access or by the creation of vertically integrated companies.

45. The rationality of both measures implies that the common asset has to be attainable by other companies that need that asset to run their business. Unbundling may entail a tough question regarding the new configuration of relations between the holder of an essential asset and the other companies that need that asset and have to negotiate contracts with the sole provider of that input.

46. Regulation thus is even more necessary after unbundling in order to exclude discriminatory practices or unjustified increase of profits by the company that has the needed input. If those relations were

¹² See Ronald H. Coase, “The Nature of the Firm”, *Economica*, New Series, Vol. 4, No. 16. (Nov., 1937), pp. 386-405.

¹³ In this regard, Article 71 of Telecommunications General Act establishes that the National Telecommunications Agency may establish restrictions, limits or conditions to concessions to provide telecommunications services, aiming to provide effective competition in the market.

¹⁴ See José A. Gómez-Ibañez. *Regulating Infrastructure: Monopoly, contracts and discretion*. Cambridge, Massachusetts: Harvard University Press, 2003, p. 249.

easily solved when a State owned enterprise dominated the entire business, the contrasting argument is that without competition firms tend to produce less at higher prices, particularly if it is a public company.

47. Introducing competition in markets where it is feasible was a major concern of institutional reforms during the 1990's in Brazil. Some parts of industries with characteristics of natural monopoly remained with a single firm.

48. But as we said above unbundling has to be accompanied by rules to guarantee that the company who owns an essential facility will not abuse of its property rights and for that reason will be obliged to fairly transact with others who depend of that facility.

49. It is though quite simple to enunciate that such measures are necessary and extremely difficult to enact regulations and enforce them efficiently so as to exclude opportunistic behaviour. As was already stated Brazil has experienced this new setting since the Constitution was amended in 1995 to permit telecommunication services to be provided by private companies.

50. After that the long distance and local telephone companies were sold to private companies and the market went through an extensive reform whose aim was to introduce competition even in fields where infrastructure duplication is too costly.

51. Long distance calls are traditionally regarded as a market in which competition is possible. Nevertheless even the long distance company depends on the local company which has the infrastructure to reach the final customer and connect him to the person he wants to call.

52. This issue is frequent in telecommunications and therefore regulators pay a great deal of attention to solve problems of interconnection among the several networks that link customers along the whole national network¹⁵.

53. Before privatisation and unbundling it was unnecessary to enact regulations on the interaction between the several chains of telecommunications services because all transactions would no longer take place within a single firm. Unbundled firms will though behave differently and if they have the opportunity of extracting more profits from firms that depend on their services, they will probably do it.

54. If a certain firm controls an infrastructure that cannot be efficiently duplicated, then the regulatory agency has to cope with this problem. Normally agencies create rules of open access and make some kind of price cap regulation¹⁶. These two groups of rules intend to create a market for access to local

¹⁵ As summarised by Melamed: "In a nutshell, AT&T had monopolies in both local and long distance telephone service in most of the country. Other firms were beginning to compete with it in the provision of long distance service; but their ability to do so depended on having access to AT&T's local telephone network, so that their long distance customers could reach the people they wanted to call. In various ways, AT&T refused or impeded the new firms' access to its network and, thus, to its local telephone customers". (See Douglas Melamed, "Network Industries and Antitrust", Antitrust Division of the U.S. Department of Justice, The Eighteenth Annual Symposium on Law and Public Policy: Competition, Free Markets and the Law, 1999).

¹⁶ In Brazil, the Telecommunications General Act regulated interconnection in generic terms, like in most of the countries, leaving to the discretion of the regulatory independent agency more detailed provisions. ANATEL issued the General Ruling Toward Interconnection [in Portuguese, Regulamento Geral de Interconexão], enacted by Resolution ANATEL No. 410, of July 11th 2005, which provides in more detail the regulatory provisions of interconnection, setting rules against anticompetitive practices within the interconnection agreements and quality. The basic rules assigned to the payment of interconnection tariffs are established in the "Ruling on the Payments for the Use of Telecom Networks" [in Portuguese, Regulamento de Remuneração pelo Uso de Redes de Prestadoras do Serviço Telefônico Fixo Comutado], enacted by Resolution ANATEL No. 458, of February 2007.

networks when other firms compete in related markets but have necessarily to connect with networks they do not own and are not willing to build.

55. Antitrust has an important role to play in the relations between firms in telecommunications and these related markets. Although regulation aims to promote competition in the sector, regulators may be misleading about their choices or even about the consequences of their choices to competition. Companies try frequently to see their preferences embodied in regulatory decisions and if they succeed regulation will not reflect competition policy concerns. When it happens regulation may be brought for antitrust review.

56. The Brazilian Council for Economic Defense discussed in the early 2000's a case involving two firms, Telefónica Empresas and Embratel¹⁷, that were disputing a public contract for the provision of Data Transfer Services (DTS).

57. Brazilian rules of public contracts oblige bidders to disclose their price and offer's quality¹⁸. In this particular case the price offered by Telefónica Empresas was much lower than the price offered by Embratel and even lower than access price Embratel had to pay for TELESP, the holder of local network. For this reason, Embratel regarded TELESP's behaviour as price discriminating and also claimed that its practices lead to a raise its rival's costs strategy.

58. If Embratel wanted to provide Data Transfer Services the company would necessarily have to pay for the use of TELESP's network. The problem in this case was that TELESP and Telefónica Empresas were both part of a single economic group.

59. Charging Embratel higher prices than Telefónica Empresas was considered unlawful by Embratel, which filed a complaint before the National Agency of Telecommunications and the Antitrust Authority claiming injunctive measures. Since a public contract depends on the prices offered during the bid if price discrimination was not prevented by an injunction Embratel would not be able to compete fairly with Telefónica Empresas for the contract.

60. Embratel considered prices charged by TELESP constituted both a regulatory as well as an antitrust violation, on these grounds the company filed both complaints. Eventually though only the antitrust authority gave an injunction to Embratel to prohibit TELESP of adopting price discrimination practices.

61. The Commissioner responsible for the case, Cleveland Prates Teixeira, issued the injunction and warranted his decision on the grounds of essential facilities doctrine used in the *MCI v. AT&T* case¹⁹.

62. The case involving telecommunications companies in Brazil was particularly interesting because implied an assessment of the regulatory arrangements for Data Transfer Services in which TELESP owned an essential facility for the provision of the service²⁰.

¹⁷ At this time Embratel was already a private company.

¹⁸ In Brazil, mandatory bidding procedures are established by 1988 Brazilian Constitution. Its Article 37, XXI, states that public bidding procedures must be followed in all public sector contracts of construction projects, services, acquisitions and property transfers, in order to ensure equal conditions to all participants, resulting in the best value for public resources. Bidding proceedings are governed primarily by The Public Procurement Act (Law No. 8,666, of June 21th 1993) and its amendments. It establishes a great variety of principles that must be observed in these proceedings, such as free competition, publicity, strict observance of the terms of the tender notification, objective judgment and compulsory awarding.

¹⁹ *MCI Communications Corp. v. AT & T*, 708 F.2d 1081, 1132-1133 (7th Cir.), cert. denied, 464 U.S. 891, 104 S.Ct. 234 (1983).

63. In other words, without TELESP Embratel could not run its business and depending on the price TELESP charged for the access to its facility Embratel's business would be more or less successful.

64. It is quite clear that Embratel's complaints on prices charged by TELESP could be frequent, since buyers normally complain about the prices they pay for the services they get. The company was indeed unable to gather consistent proofs of overprices since there was no other company offering the product, except TELESP, there existed no ground for comparison.

65. For this reason Embratel could informally complain but could not prove overprice really existed. The National Agency of Telecommunications could not act as well since TELESP was respecting price cap regulation and was not charging over this price. But things changed when bidding companies disclosed the prices for which they would provide Data Transfer Services to a public company²¹.

66. This information showed, for example, that Telefónica Empresas was offering a price to final customer lower than TELESP was charging Embratel solely to use the network. In other words Embratel could not compete with Telefónica Empresas because the cost structure Embratel faced was much higher than the one Telefónica Empresas faced.

67. At first one could think that Telefónica Empresas was much more efficient than Embratel and for this reason could offer lower prices. In a free and competitive market this would be true.

68. In telecommunication's regulated market this statement simply does not apply, mainly because Embratel could only pay for the use of one network, which was the same that Telefónica Empresas would have to use. How then was it possible for Telefónica Empresas to charge such a lower price?

69. The answer is quite simple according to information available in the process. Telefónica Empresas was linked to TELESP, they had both the same owner, despite being independent companies.

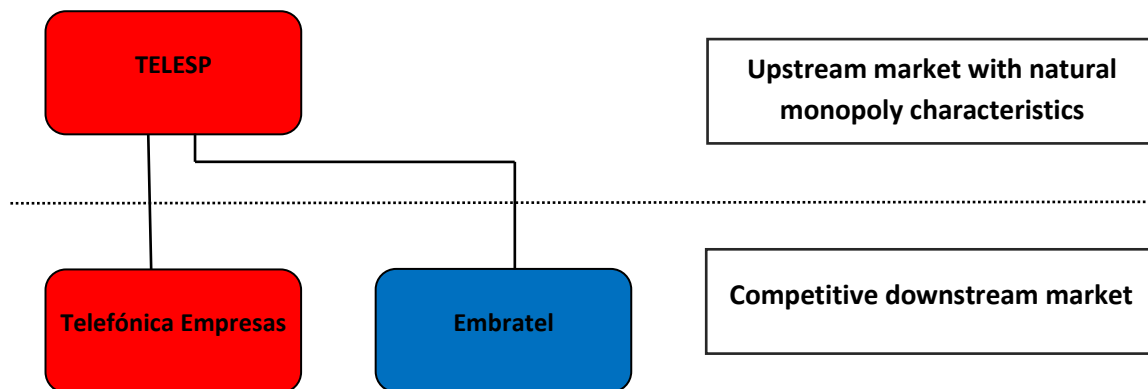
70. Embratel was another company and had another owner. Since both needed the same facilities that only TELESP could provide, this latter company had many incentives to grant lower prices to Telefónica Empresas and thus guarantee that this one offers lower prices and thus earn contracts of Data Transfer Services.

71. The problem in this case is that this behaviour unlawfully favours Telefónica Empresas and makes regulator's desired competition impossible. Embratel's price will always be higher than the price Telefónica Empresas gets simply because TELESP wants Telefónica Empresas to have lower prices and receives as many public contacts as it is possible.

²⁰ See Request for a Writ of Prevention [in Portuguese, Pedido de Medida Preventiva] no. 08700.003174/2002-19 in Administrative Proceeding [in Portuguese, Processo Administrativo] no. 53500.005770/2002, Plaintiff Empresa Brasileira de Telecomunicações S/A – EMBRATEL, and Defendant Telecomunicações de São Paulo S/A – TELESP.

²¹ The PRODAM is the Information Technology Company of the City of São Paulo, Brazil. As stated in footnote no. 17, above, according to Brazilian laws these companies have to follow the Public Procurement Act to buy products and services. Publicity has to be observed and bids have to be disclosed at the end of the procedure (Article 3º, §3º, of Law No. 8,666, of 1993).

72. This strategy is commonly called raising rivals costs or price squeeze²² and is feasible when a rival in a downstream market has to necessarily buy inputs from a company at the upstream and this monopolist company is vertically integrated with a downstream competing firm. The figure below illustrates this situation.



73. As was already stated above, in this particular case Embratel argued TELESP controlled an essential facility that could not be efficiently duplicated and therefore TELESP could not refuse to deal with Embratel nor could it discriminate prices.

74. The Essential Facilities Doctrine was originally stated in a U.S. Supreme Court decision involving rail companies in 1912²³. The case handled by the court had as plaintiff railroad companies that wanted to make use of a bridge and as defendant the owner of the bridge who wanted to bar the use of his asset.

75. The case brought before the Brazilian Competition Tribunal could be compared to this one involving railroad companies since both deal with some sort of infrastructure whose duplication is inefficient.

²² See Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law*, 767b, 3d ed. 2008; Herbert Hovenkamp, "Unilateral Refusals to Deal, Vertical Integration, And The Essential Facility Doctrine", University of Iowa Legal Studies Research Paper, Number 08-31, July, 2008; Steven C. Salop, "Refusals To Deal And Price Squeezes By An Unregulated, Vertically Integrated Monopolist", *Antitrust Law Journal*, Vol. 76, Issue 03, 2010; Herbert Hovenkamp, Erik Hovenkamp, "The Viability of Antitrust Price Squeeze Claims", University of Iowa Legal Studies Research Paper, Number 08-33, March, 2009. In U.S. jurisprudence, see *LinkLine Communic., Inc. v. SBC California, Inc.*, 503 F.3d 876 (9th Cir. 2007), cert. granted, 128 S.Ct. 2957 (June 23, 2008).

²³ *United States v. Terminal Railroad Association*, 224 U.S. 383, 32 S.Ct. 507 (1912). For further development of essential facilities doctrine in United States throughout 20th century, see also *Associated Press v. United States*, 326 U.S. 1, 65 S.Ct. 1416 (1945); *Otter Tail Power Co. v. United States*, 410 U.S. 366, 93 S.Ct. 1022 (1973); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 105 S.Ct. 2847 (1985).

76. It is not reasonable to think that facing a refusal to deal, railroad companies would start to build another bridge just beside the one owned by the businessman refusing to grant passage rights. In this case therefore the refusal to deal was deemed unjustified because the consequences of permitting unjustified refusal to deal entail high social costs²⁴.

77. The problem though remains in the sense that many times what happens is not simply unjustified refusal to deal, but merely unjustified price discrimination between firms. In our telecommunications case the local network plays the same role bridge plays in the Supreme Court case. The difference remains in the fact that TELESP and Telefónica Empresas were both jointly owned and Embratel was an outsider or – better defined – an entrant.

78. As an entrant Embratel depended on the inputs only TELESP could provide, but TELESP had significant economic incentives to discriminate prices and thus benefit Telefónica Empresas so that this latter earns a wider market share by offering lower prices than its competitor.

79. Undoubtedly this is the rational strategy TELESP and Telefónica Empresas would adopt if there was no other rules governing the sector and they could follow their own interests. This market structure though was foreseen by Brazilian regulatory framework as potentially problematic; therefore rules were framed to prevent abuse of dominance by the holder of essential facilities²⁵.

80. This measure is crucial to guarantee an effective market in upstream since without them the wealth-maximising strategy of vertically integrated firms will certainly be to exclude competitors. Competition though was the very reason why Brazilian legislators chose to unbundle the sector²⁶.

81. It would be an irrationality to privatise a public vertically integrated company (Telebrás) in order to introduce competition and foster investment and then some years after that allow a private company to replace the former public monopoly by a private monopolist. This was clearly not the intention of 1990's telecommunications reformers.

82. Despite these evidences, the defendant responded before CADE that in this particular case price discrimination does not violate antitrust law since price distinctions was not due to intentions of market foreclosure or exclusion of competitors, but merely reflected distinct prices to the provision of services. It is thus implicit that costs of transacting with firms jointly owned are lower than those of transacting on the market.

83. Despite the arguments brought by the defendant, it is reasonable to consider that lower costs of provision intra-firm are directly related to the control of essential facilities. As states Professor Herbert Hovenkamp:

*“What all these structures [qualifying for essential facilities] have in common is that those who have control over or access to them may have significant cost advantages over those who do not.”*²⁷

²⁴ For further discussion on this issue, see Spencer Weber Waller, William Tasch, “Harmonizing Essential Facilities”, *Antitrust Law Journal*, Vol. 76, Issue 03, 2010.

²⁵ See Article 129, Telecommunications General Act (Act no. 9,472, 16 July, 1997).

²⁶ See Article 155, Telecommunications General Act (Act No. 9,472, 16 July, 1997).

²⁷ See Herbert Hovenkamp. *Federal Antitrust Policy: The law of competition and its practice*. St. Paul, MN: West Group, 1999, p. 307.

84. Still according to H. Hovenkamp “structures and plants or other valuable productive assets that were created as part of a regulatory regime, whether or not they are properly monopolies”²⁸ are deemed by the courts to qualify as essential facilities.

85. Unequivocally this is the case of telecommunications in Brazil and particularly the case involving TELESP group and Embratel. The former had control over an upstream structure that Embratel necessarily needed.

86. TELESP however was part of larger group that also compete in downstream markets and for this reason could effectively raise the costs of Embratel and consequently make competition between Embratel and Telefónica Empresas unlikely.

3. The future of essential facilities in telecommunications

87. The case involving telecommunication companies for the provision of Data Transfer Services is pretty much interesting, for this was an important use of the Essential Facility Doctrine in Brazilian Antitrust Law. However telecommunication markets are subject to intense technological changes and competition depends directly on how relevant markets evolve.

88. An essential facility has to be necessary for the provision of services or production of goods in a certain relevant market, whether geographical or a product. If technology causes huge transformations in markets, it is reasonable to think that what is essential at certain time may become simply unnecessary for the production of services and goods afterwards.

89. For this reason, the analysis of essential facilities has to be dynamic and has to follow technological advancements. In markets such as railroad transportation it is possible that what was an essential facility at the beginning of the 20th century, the tracks, is still deemed essential to a railroad company.

90. In telecommunications market things may be quite different, mainly because wireless technologies and the introduction of wireless networks change significantly the role physical wire networks play.

91. In our case, for example, Embratel complaint it could not competitively provide Data Transfer Services in speeds under 2 Mbps because this low speed services depend on the local wire network TELESP controlled. For services above 2 Mbps Embratel disposed of its own wireless network and for this reason did not need to access local physical networks. It means that above 2 Mbps the facility TELESP controlled loses its essentiality, for competitors may find efficient substitutes²⁹.

²⁸ See Herbert Hovenkamp, *op.cit.*, p. 307.

²⁹ This issue is even more complex. As an illustration, an OECD report states that: “Price decreases and improved services have been the most marked in markets characterised by intense competition. Competition may be the product of regulatory intervention, as in the case of local loop unbundling, or may be the result of new infrastructure-based competition. In particular, competition between traditional wireline and wireless access providers is increasing in telecommunications markets. The two technologies may not be perfect substitutes but flat-rate data offers on mobile networks are beginning to compete with broadband connections to individual homes. The ultimate extent of such substitutability is unclear, as individual demands for bandwidth may outstrip capacity on wireless networks. However, certain data services may clearly be as competitive on mobile networks as fixed”. (See Organisation for Economic Co-operation and Development – OECD, Communications Outlook, 2007).

92. That is why it is important to highlight that rather than static relevant markets and essential facilities are dynamic in sectors where technological changes are frequent. Telecommunications exemplifies very well these kind of markets, because had the case to be decided in 2010 instead of the beginning of 2000's its outcome would be considerably different.

93. Today a company would not be willing to acquire internet speeds above 2 Mbps, therefore the possibilities of competition with wireless networks are much wider since these networks do not characterise at first glance as natural monopolies.

94. Wireless networks may be duplicated in certain cases at lower costs than physical wire networks and they also do not imply high sunk costs. Another relevant aspect is that a physical network is a specific and immobile asset; it may not be moved or transferred to places where it may be needed and where profits are higher.

95. In other words the decision of building such an asset is bound to the market it can reach after its construction; it may not move to seek better returns for the investment.

96. The new reality brought by wireless technologies shall certainly change antitrust analysis, especially because products tend to disappear and geographical relevant markets tend to become wider.

97. Nevertheless and despite different, the doctrine of essential facilities is a key element of antitrust analysis in a sector where regulation and regulatory policy create and deal with natural monopolies.

4. Conclusion: Designing pro competitive regulation

98. By its features, telecommunications sector is facing a striking transformation. In this regard, regulatory and antitrust agencies need to be adaptable to these changes, re-evaluating perennially the scope and efficiency of regulations in the market.

99. Nowadays, one of the greatest challenges facing infrastructure regulation is the phenomenon of the convergence of telecommunications. The development of new technologies, such as multiple-play services, which allows consumers to choose one provider for a combination of video, data, and voice, creating a daring framework for regulatory and antitrust agencies, has had a tremendous impact on communications.

100. Traditional elements of competition policy analysis, which policy makers are used to deal with, will need to be aligned and work together to fresh aspects introduced by an intense technological progress.

101. All these matters are currently under discussion in many countries throughout the world. However, many issues remain unfinished and need further development, especially considering the deep changes in the industrial information economy.

102. Taking into account the emergence of a *networked information economy*³⁰, currently developing substantial alternative platforms, it will be necessary the understanding how policy interventions need to be designed for this networked environment.

103. The relatively recent advent of competition policy in many developing countries, such as Brazil, demonstrates the even greater importance of the study of such topics for them.

³⁰ See Yochai Benkler, *The Wealth of Networks – How Social Production Transforms Markets and Freedom*, New Haven, Yale University Press, 2006, pp. 3-8.