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LATIN AMERICAN COMPETITION FORUM

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

Contribution from Argentina

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

The attached document from Argentina 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.

Contact: Mrs. Hélène Chadzyska, Administrator, LACF Programme Manager.
Tel.: +33 (01) 45 24 91 05; Fax: +33 (01) 1 45 24 96 95; E-mail: helene.chadzyska@oecd.org

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Session I: Competition Principles in Essential Facilities

-- CONTRIBUTION FROM ARGENTINA --

Diego Povo. Alberto Delgobbo. Guillermo Pérez Vacchini.

I. Introduction

1. This document describes Argentina's experience in implementing competition policy in selected sectors where essential facilities are present. It explains the approach that has been taken to these facilities both from the point of view of sectoral regulation and as regards enforcing competition law and regulations. The sectors in question are gas, electricity and telecommunications.

2. As the following text explains, the links between competition authorities and regulators in these sectors varies. Significant differences in this respect occur – in particular, between, on the one hand, gas and electricity, and on the other, telecommunications – and are important in understanding what Argentina's competition policy is and has been in these sectors.

1. The structural features and regulatory framework of the gas sector

3. Law 24.076 of 1992 governs the transportation and distribution of natural gas, activities that are considered to be a national public service. The guiding regulatory principles structuring the sector are: (1) regulation of transportation rate schedules; (2) open access; (3) indicators of market transparency; and (4) limits on vertical integration.

4. As regards **regulating transportation and distribution rates**, the law requires that transportation and distribution entities operating economically and prudently have the opportunity to generate revenue sufficient to cover all reasonable operating costs incurred in providing service, as well as taxes, amortisations and a reasonable profit.

5. Maximum rates for service are set by the sectoral regulator (ENARGAS) in conformity with the rules and guidelines set by the regulatory framework and the conditions of the operator's license. Note that natural gas prices do not affect transportation rate schedules.

6. The regulatory framework addresses the question of **open access** in detail, prohibiting all transportation providers from allocating their systems' capacity in a discriminatory fashion. Under the principle of free access, transportation and distribution entities are to be prevented from engaging in action that involves unfair competition or abuse of a dominant position. They must provide open access to their transportation capacity, and cannot favour particular users with advantages or preferential treatment.

7. Under the law, transportation and distribution entities are required to provide third parties with non-discriminatory access to their own systems' transport capacity to the extent that this capacity has not already been committed to supplying demand that has been contracted for, and the access must be provided under conditions agreed on by the parties and pursuant to the principles set forth in the law and regulations.

8. ENARGAS uses the **transparency indicator** to ensure that transportation entities disseminate daily information on the operational state of their systems via electronic mass media.

9. The purpose of this indicator is to ensure the availability of knowledge concerning transactions carried out during the previous day. It makes information available on who has transport capacity, on daily movements, and on the remaining capacity in each natural gas pipeline or transportation system.

10. Another very important factor addressed in the regulatory framework is its **limitations on vertical integration**, which are designed to keep the industry divided into competitive, regulated segments.

11. In this connection, the law provides that no producer, warehouse, distributor or consumer that contracts directly with the producer, or any group of such entities or firm controlled by or controlling such entities, may hold a controlling share, as defined by Article 33 of the Commercial Firms Act (Ley de Sociedades Comerciales), in a firm authorised to provide transportation services.

2. Electrical transport and distribution

12. Under law 24.065, electrical transport and distribution constitute a public service. The most important aspects of the regulatory framework governing electrical transport and distribution involve the principle of open access, the remuneration of transportation entities, rates, price setting methods, and limits on vertical integration.

13. In a regulatory scheme involving vertical separation, such as that shaping the electrical industry in Argentina, it is very important to enforce the principle of free access to transportation systems. Non-discriminatory access to transportation services is fundamental in ensuring that the transparency of the market is not diminished by discretionary arrangements that make it difficult for new participants to enter the market and develop, or that create obstacles to competition in the generation segment of the market.

14. In addition to free access, given the monopolistic nature of transportation services, the regulatory framework has given the sector's regulator (ENRE) the authority to cap rates for these services in order to prevent abuse of dominant market positions by transportation entities.

15. ENRE sets maximum rates for each type of client (distributors, large users, etc.). This does not prevent transportation providers from agreeing with a user to charge rates lower than this, provided that similar users in the same geographical area are not charged different amounts for the same service.

16. The regulatory framework also establishes a structural division of the industry that prevents agents active in each segment of the industry from holding majority interests in firms that are active in more than one segment.

17. Thus, for example, transportation providers (whether individually or as majority owners and/or holders of stock packages through which they control the firm holding the transportation concession) cannot purchase or sell electrical energy. Nor can a generator, distributor, large user, or a firm controlled by or controlling any of these be the owner or majority shareholder of a transportation firm or of the firm that controls it.

3. Regulatory framework and competition in the telecommunications sector

3.1. Introduction

18. Following ten years of monopoly provision of some telecommunications services by the incumbent firms in their areas of coverage, Decree 764/2000 deregulated the sector and opened it to competition, making it possible for new operators to enter the market.

19. The regulations currently in force are contained in Decree 764/2000, the annexes of which cover Licensing Regime (Annex I), National Interconnection Regulations (Annex II), and Universal Service (Annex III). The National Interconnection Regulations (RNI) are important in defining access conditions for new entrants to incumbents' networks and facilities.¹

20. Chapters IV and V of the RNI deal with the technical and economic aspects of interconnection. Here, the regulatory body establishes the technical conditions that must be met by telecommunications networks to permit interconnection by different operators. It also defines the network elements that are considered to be essential facilities.

21. Close examination of the decree reveals a distinction between the economic conditions for interconnection established for network elements in general, and for those that are considered essential facilities.

22. The former can be freely set, and in the case of "intervention by the enforcement authority, the prices of the network elements and functions not identified as essential facilities will be a function of the cost of efficient provision of service."²

23. Under the decree, prices of essential facilities were to be set by a Working Group, which was to issue them "within 90 days from the date of its formation".³ However, the group was in fact not formed.

24. Although the concept of interconnection employed in the RNI was broad and did not distinguish between services,⁴ its actual enforcement was subsumed under the regulations of the Transitory Provisions

¹ The firms in question are Telefónica de España and Telecom, which starting in 1990 were allowed to provide telephone service that had previously been provided by the state enterprise ENTEL (Empresa Nacional de Telecomunicaciones).

² Decree 764/2000, Annex II, National Interconnection Regulations, Article 26.2.

³ Decree 764/2000, Annex II, National Interconnection Regulations, Articles 39.1 and 39.2.

(Chapter VIII), which state that “until the prices of the essential facilities indicated in Article 18 of the present regulations are established, the following reference values will hold” for the interconnection conditions applicable to fixed switched telephone services.

25. The result of the enforcement of the sector’s regulations, shaped by the economic context at the time when the regulations become effective, influenced the sector’s competitive structure through price regulation and through the interconnection conditions defined for the different network elements, namely: (a) those elements considered essential facilities, with regulation of prices and conditions for local telephone services (the prices of which were determined on a “transitory” basis⁵ in the case of local traffic, call origin and termination, and colocation; (b) the last mile or local loop, which, although considered an essential facility, was not assigned the price that would permit its total disaggregation; and (c) the rest of the network elements belonging to operators with dominant or significant power that were not considered essential facilities, on which price and interconnection regulations have had virtually no effect (these elements include a number of network elements involved in providing infrastructure services such as wholesale Internet access, leasing of links, etc.).⁶

26. Beyond its specific regulations, Decree 764/00 mandates that operators with dominant power must offer other unintegrated operators wholesale services under the same commercial conditions that they themselves enjoy.

3.2. *Networks structure and competition*

27. A fairly clear distinction can be made regarding levels of networks,⁷ which include trunk networks and local access networks. The former support major capacity and function to join large switches that carry aggregated traffic between areas. The latter support low transmission capacities and function to connect the switches with consumers.⁸

28. The possible scope of competition between networks depends on the level of the networks involved. The amount of competition between networks is a function of the costs of constructing the networks, and by the flow of traffic, which is generally a function of an area’s population density and socioeconomic variables. As a result, where transmission media with equal transmission capacity and costs are involved, greater traffic will lead to lower cost for entering the market, and thus a greater number of

⁴ Article 2 of the RNI, which deals with the “scope” of the regulations, states that “*The present regulations include the economic, technical and legal mechanisms on the basis of which providers make interconnection agreements to provide their clients and/or users access to other providers’ services and clients and/or users*”.

⁵ See RNI, Chapter VII.

⁶ In 2002, the peso was devalued, thus ending the convertibility regime (1 peso = 1 dollar) that had been in place for eleven years. The situation in the post-devaluation period, with frozen end rates for fixed telephony services, and interconnection prices that were inflation-adjustable rather than dollarised, was stifling for competitors entering the market. In long distance service, where for calls of up to 30 kilometres (classified as “clave 1”), the price-regulated cost of the essential facilities “local access and termination” and “local traffic” exceeded the value of the top end rate (even if the costs of leasing the long distance infrastructure are not taken into account).

⁷ In some articles on the question, the OECD notes this differentiation of the functions and capacities of the different segments of the network.

⁸ There are cases in which, because of the amount of traffic, this classification does not hold.

firms can be expected to enter. This situation is usually associated with greater competition. Accordingly, more providers can be expected in trunk network segments than in local access segments.⁹

29. An extreme case is household access networks, which link residences with telecommunications networks.¹⁰ Because of the characteristics of this network element, Decree 764/2000 considers it an essential facility.

3.3. *Interconnection: complementarity and substitutability between networks*

30. The existence of different infrastructure services providers ensures the existence of competitive interconnection offerings in the sector, since competition to capture new clients brings improved prices and interconnection conditions. However, this may not occur when competition is limited by bottlenecks or imperfect competition due to economic merger of competitors.

31. Bottlenecks are due to the presence of assets that cannot easily be replaced by alternative infrastructure and/or services. The local loop or “last mile” of a public telephone network can be an example of this.

32. Effective regulation that makes access at this level available is important for the sector’s competitive development, since it allows for greater competition in the provision of telecommunications services by unintegrated operators (whether or not they have infrastructure in the local area). It also fosters investment in infrastructure in general by ensuring access to a network element that is used to initiate and/or terminate communications.

33. On the other hand, the existence of an entity that executes antitrust policy by analysing market concentration and mergers can prevent the proliferation of disadvantageous competitive conditions in markets where current technological development permits competition to unfold without specific regulation.

3.4. *Disaggregation of the last mile: disaggregated provision of wholesale platforms for residential Internet services*

34. To obtain connectivity to the public Internet network, ISPs purchase wholesale access to the Internet. They can acquire international traffic capacity from operators such as Telecom, Telefónica, Telmex or Global Crossing, or they can connect directly to an international access point, and then connect with other operators at that level. The incumbent firms have competing national networks that cannot be replicated by other operators, and thus they are the only backbone providers with the capacity to provide connectivity to the nation’s Internet network.¹¹

⁹ An exception to this occurs in local areas with very high population density and with corporate clients, where a greater number of suppliers may be active in the market.

¹⁰ Physical means of residential access can be wired or wireless. Wired methods include copper pair (xDSL), fibre optic (FTTH, FTTB, and FTTC) and CATV (HFC) coaxial network cable. Wireless methods include cellular networks, radio links such as WLL, WiMAX, LMDS, and MMDS, and satellite links.

¹¹ Domestic traffic, on the other hand moved without charge between the different operators through the NAP (national access point) belonging to CABASE (the Cámara Argentina de Base de Datos, or Argentine Chamber of Databases) until 2004, when the incumbent firms withdrew and began to offer commercial access to the wholesale Internet network.

35. Hence, an ISP without its own infrastructure must lease the links (local and/or long-distance) and access to the Internet network (national and international traffic), in addition to the copper pair.

36. Finally, it should be noted that the dominant power of incumbent operators is relevant not only to local access, but also to the other wholesale services that ISPs must lease under the various types of commercial arrangements mentioned above, namely, transport and access networks for linkage to the public Internet network (national and international).

37. It is precisely these network elements whose interconnection is not covered by any effective regulation of prices and conditions in Decree 764/2000.¹²

38. Analysis of the evolution of the retail Internet market in Argentina shows that the participation of independent ISPs has declined noticeably in the last few years.

3.5. *Technological convergence, substitution of platforms and essential facilities*

39. In residential service, where an essential facility can still be considered to exist in the last mile, only telephony providers are currently subject to the public burden of providing open access to their local loops.

40. Increasing convergence, along with the regulatory environment in Argentina, has led to the development of household access networks other than those of the telecommunications networks (e.g., the cable operators' HFC networks).

41. Although their penetration is limited to urban areas, these networks have spread to a very significant degree, especially in comparison with other Latin American countries.

42. As a result of convergence, users have come to place more value on access to the last mile, and this in turn has fostered competition to capture these users.

43. In view of the current state of the technology, it may be concluded that the capacity demanded by households has combined with the regulatory environment to create a market where competition for end services to the residential sector comes almost exclusively from firms with their own access infrastructure.

44. As markets become more open, and competition to provide telecommunications and audiovisual services through a range of physical channels becomes more possible, progress must be made in opening up last-mile access, so that competition to capture users develops and the prices and/or variety of services offered improve.

4. Approach to competitive issues in the gas, electricity and telecommunications sectors

45. As regards the question of competition in regulated sectors, it should first be noted that under Argentina's current competition legislation authority for competition policy is fully centralised and excludes no sector. The authority is not shared with any sectoral regulator. This situation is a result of the antitrust legislation that went into effect in September of 1999. Before that, some of the authority was assigned by legislation on the privatisation of the gas and electrical sectors.

¹² It should be noted that there are incentives for an incumbent to employ a price scheme that permits the intensive use of investment in already installed networks.

46. Argentina's competition legislation has no specific provisions on essential facilities, although there are legal instruments such as the above-mentioned Decree 764/2000, which defines the network elements of operators with dominant positions as essential facilities, and hence makes these elements plausible objects of regulation regarding prices and conditions.

47. Similarly, gas- and electricity-sector legislation touches on the question of essential facilities in that it mandates open access to the transportation and distribution segments of these markets.

48. In the sectors being discussed here, there have been no issues of overlapping jurisdiction between the competition authority and sectoral regulators in terms of declaring particular activities of a sector to be essential facilities. As mentioned above, the legislation regulating activity in the electricity and gas sectors mandates open access to certain elements of the country's transportation and distribution infrastructure.

49. It should be underlined that, as mentioned earlier, vertical disintegration is one of the guiding principles of legislation in the gas and electrical sectors. Provisions in the sectors' regulatory frameworks make it unlikely that the national competition agency will find it necessary to issue an order regarding economic concentration.

50. In the case of telecommunications, the above-mentioned decree establishes rather clearly delimited roles for the telecommunications authorities and for the ministry to whose sphere of responsibility the activity of the National Competition Commission (Comisión Nacional de Defensa de la Competencia, or CNDC) is relevant.

51. Argentina's competition authority has the legal authority to, for example, impose remedial measures including disinvestment for economic concentration. Since the law has no particular provisions in this area, and in particular no constraints on disinvestment measures, structural disinvestment orders involving vertical disintegration in regulated sectors are a possibility.

52. Given the scope of the actual enforcement of regulations in the telecommunications sector, and the level of technological innovation over the past decade, the CNDC had major impact in relevant markets. This is a result of its analysis of mergers and behaviour, as well as its market studies.

53. .Analysis and assessment in this area must take account of technical developments and telecommunications investment, as well as regulatory conditions. All of these factors can foster or impede competition, as well as making it more or less necessary to define what are essential facilities in the sector's infrastructure segment.

54. Analysis of complaints regarding possible violations of the Competition Law has turned up no cases in which it was necessary to define a particular infrastructure as an essential facility in order to determine whether or not anticompetitive conduct was present.

55. The CNDC has evaluated the possibility that an owner of an essential facility could engage in certain anticompetitive behaviours, such as ex ante analysis in a merger context of possible action by victims of the merger. It considered the possibility that concentration would increase incentives for practices such as evasion of regulation, opportunistic behaviour and extension of market power¹³ in the electrical transport and distribution markets.

¹³ In this connection, see the website of the CNDC at www.cndc.gov.ar under "concentraciones económica destacadas", for the notice on Goyaike Perez Companc Petrobras.

56. The CNDC has authority to investigate and punish acts of discrimination by the owner of an essential facility, although in the case of electricity and gas the very structure of the sector makes discriminatory conduct by the concessionaire of the facility unlikely.

57. Note should be made of one additional factor that affects the scope of authority of the CNDC and the sectoral regulators. Under Argentine law, when the CNDC is considering implementing a measure to address economic concentration, it must consult the relevant sectoral regulator for an opinion regarding the effects of the proposed measure on competition in the sector. It is also required to solicit the regulator's opinion on whether the measure is compatible with the sector's regulatory framework. Besides action by the CNDC, a merger that violates sectoral regulations can be prohibited by the sectoral regulator.

58. The CNDC has the technical antitrust knowledge needed to punish acts of discrimination by the owner of an essential facility. Quite a different type of interaction also occurs between sectoral regulators and firms that own essential facilities such as gas and electricity. Such firms may have specialised knowledge regarding cost, price formation and other variables relevant to competition, and share this knowledge with authorities.¹⁴

II. Final considerations

59. As the above text reflects, Argentina's experience in enforcing competition policy in sectors where there is infrastructure considered to constitute essential facilities varies. There are some areas of activity (gas and electricity are examples) that have not undergone the sort of technical change that makes changes in the antitrust approach necessary.

60. The telecommunications market, on the other hand, has undergone technical changes (convergence), and the relevant markets have been restructured and redefined. This makes it more complicated to deal with essential facilities in a particular infrastructure. An example is the last mile of copper pair for residential access, which may carry different types of telecommunications and audiovisual communications (voice, Internet access, television programming, etc.).

61. In that case, firms have urged on the regulatory authorities and/or CNDC the notion that certain activities – e.g., the cost of interconnecting networks to provide services other than telephony – are beyond the scope of the sector's regulatory framework.

62. They have also postulated that potential problems of competition of a vertical nature that emerge from economic mergers involving unified infrastructure in upstream markets (trunk networks and local links) and downstream markets (copper pair last-mile access)¹⁵ should be solved through regulation rather than antitrust action.

63. Given such disparate postures, the CNDC has limited itself to enforcing the competition law without depending on the sectoral regulator's being able to implement measures that contribute to solving the competitive problems detected.

¹⁴ The same tab of the institution's website provides information on the ruling regarding an economic merger of the companies AES and GENER within the electrical generation market. There the sectoral regulator supplied the CNDC with valuable information on electricity price formation and on the possible exercise of market power if the merger were approved.

¹⁵ One example of this type of effect may be seen in CNDC ruling 744 of 25 August 2009 on merger 741 between Telefónica de Argentina and Telecom (listed as Pirelli-Telecom-Telefónica under "concentraciones económicas/dictámenes destacados" at www.cndc.gov.ar).

64. In this respect, the position of the CNDC is not terribly different from the approach to these questions taken internationally. The European Union's conceptual framework considers antitrust policy the general rule applicable to all markets, and regards ex ante regulation as an exceptional approach. In this scheme, it is the competition authority that determines the threshold between antitrust action and ex ante regulation, based on definition of the relevant markets and on analysis of their features.¹⁶

¹⁶ “Under the new framework, regulation remains nevertheless the exception, while the application of antitrust rules is the rule. The imposition of regulation has to be justified on a case-by-case basis. This is why the new regulatory framework is flexible and limits regulatory intervention to those activities where it is (for the time being) necessary. However, as soon as a market becomes effectively competitive and regulation is no longer necessary to sustain competition, then regulation should be phased out.

“In any case, it is important to note that the new regulatory framework does not affect the powers of the Commission under the competition rules of the Treaty and the Merger Regulation. The fact that undertakings are subject to regulation does not prevent the application of competition law to the electronic communications industry.

“In summary, the decision to subject a market to ex ante regulation should be based on an overall assessment of the state of the effectiveness of competition within such a market, taking into consideration not only static but also dynamic criteria. Markets which fulfil these two criteria should also be made subject to ex ante regulation if competition law remedies are deemed insufficient for ensuring effective and sustainable competition.”

The Economics of Antitrust and Regulations in Telecommunications. Perspective for the new European Regulatory Framework. 2004, Chapter II, p. 17.