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LATIN AMERICAN COMPETITION FORUM

Session III: Triple/Quadruple Play in Telecoms

Contribution from Chile (TDLC)

13-14 Septembre 2011, Bogotá (Colombia)

The attached document from Chile (TDLC) is circulated FOR DISCUSSION under Session III of the Latin American Competition Forum at its forthcoming meeting to be held on 13-14 September 2011 (Colombia).

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Session III: Triple/Quadruple Play in Telecoms

-- CONTRIBUTION FROM CHILE (TDLC*) --

1. Introduction

1. In Chile, the competitive effects of the bundling practices in the Telecommunication industry is doubtless more worrisome than in Europe. The main problems are: 1) non-existing wholesale access to networks and 2) integration between the major providers of both fixed and mobile services.

2. Wholesale Access

2. In order for competitors to be able to replicate the bundles offered by dominant companies access at competitive prices is required as stated in the background paper.

3. The TDLC has urged the sector regulator in several opportunities since 1998 about the importance of ensuring the wholesale access to the fixed line network by competitors. Initially the intention was simply to introduce competition in fixed voice service, later the main concern was competition in broadband provision and then competition in bundles.¹

4. Given that every five years, prior to the recalculation of regulated prices in the telecom sector, the TDLC must to determine in which services there is not enough competition to allow free setting of prices, it has ordered in the three last processes that tariff for network disaggregation should be fixed by the sector authority.

* Tribunal de Defensa de la Libre Competencia, Chile.

¹ Resolución 515/98, Resolución 686/2003, Informe 2/2009.

5. Furthermore in the most recent process, 2009, the TDLC urged the Subtel to exercise its regulatory and overseeing attributions in order to ensure that an effective supply of facilities' resale is offered by the telephone companies owning fixed networks. The TDLC suggested that this could be achieved by the establishment of the obligation to have minimum bids that contain all the elements necessary for contracting by third parties, by maintaining updated and free public access information about the network facilities that can be disaggregated and finally by issuing a rule of general application detailing the technical and administrative services necessary to establish a uniform pricing mechanism transparent and homogeneous for the companies subject to the price regulation of these services.

6. With regard disaggregation in the mobile sector the TDLC has made recommendations as well. In the context of a merger between two mobile phone companies, the TDLC urged the sector regulator to create the conditions for the incorporation of MVOs to the market².

7. Although the sector regulator has set maximum prices for the use of the fixed lines of the dominant firms, very few transactions of the kind have been observed. The fact is that the sector regulator has not been active in implementing disaggregation.

8. In 2003, a Supreme Decree³ was issued by the Undersecretary of Telecommunications (Subtel). This decree clearly established the obligation of the owner of the fixed net to offer resale in wholesale conditions to other firms in the market, offers that should include all elements necessary for the contract to be celebrated. The conditions for such resale would be regulated through the promulgation of regulations related to the resale of telecommunications services and the disaggregation of telecommunication networks. The entry into force of this obligation was conditional on the enactment of those regulations on resale and disaggregation, which never occurred and was finally abrogated by the same institution.

9. Furthermore, in 2008, during de discussion produced in the last process, the regulator revealed a position against disaggregation and recommended to rely completely on competition among platforms. If the position of the regulator is to prevail in Chile, it might be harder to accept bundling as a competition harmless mechanism.

10. Content disaggregation or vertical disintegration: In 2005, as a result of a merger between the two main cable TV operators, the TDLC prohibited the merger company to act as a distributor of content or to acquire any content with a exclusivity to broadcast clause, with the exemption of specific events.

3. Market Structure

11. In Chile the most important firm in terms of market share in fixed lines, *Telefónica Chile*⁴ S.A., is related in ownership with *Telefónica Móviles S.A.* (Movistar S.A.), that holds the most important share in the mobile voice service market. This is shown in the following table with the market shares and number of subscribers in both the fixed and the mobile network markets.

² Resolución N° 02 / 2005, 4 de enero de 2005.

³ D.S. N° 742 Decreto Supremo N° 742, de 2003, Ministerio de Transportes y Telecomunicaciones. “*Regula las condiciones en que pueden ser ofrecidas tarifas menores y planes diversos por los operadores dominantes del servicio público telefónico local necesarias para proteger los intereses y derechos de los usuarios.*”

⁴ The name of the company has changed over the period. In this note we call *Telefónica* the main fixed company and Movistar its sister mobile company.

Table 1: Market shares and number of subscribers for the Fixed and the mobile network markets (Numbers at December 2010)

Panel A: Fixed Network		
	Market Share	Number of Subscribers
<i>Telefónica</i>	56,2%	1.944.739
VTR	18,5%	638.176
Entelphone	5,7%	195.972
Telsur	5,2%	180.759
Claro	2,9%	101.218
Other Fixed	11,5%	396.642
Total Fixed	100%	3.457.506
Panel B: Mobile Network		
	Market Share	Number of Subscribers
Movistar	41,0%	8.129.251
Entel	36,4%	7.229.289
Claro	22,5%	4.465.518
Nextel	0,1%	27.557
Total Mobile	100%	19.851.615

*Data Source: Subtel

12. The numbers above were more critical in 1997 when *Telefónica* had 65% of the fixed market and 43% of the mobile market. This horizontal integration between the main providers of both fixed and mobile telecoms has induced discriminatory behavior with respect to other mobile companies. For example in 1999⁵, the company was fined for his plan called “Personal Super Phone”, a service allowing redirecting calls aimed to a fixed phone to a mobile phone. This service was available only to its sister mobile firm. There were implicit subsidies involved that benefited the mobile segment (Ruling 483/1997). The conduct was prohibited by “Comisión Resolutiva” (predecessor of the TDLC). The Commission also ordered that integrated mobile firms should operate under the same obligations than public firms.

13. Later, in 1998, the same company created the plan “Calling Party Pays Plus” in the midst of the regulatory discussion prior to implementing the “Calling Party Pays”. The dominant firm plan, again, was designed to cover only the calls between their own clients and was brought to the “Comisión Resolutiva” by their competitors. The company was fined with the maximum amount allowed.

4. Cases related to bundle

4.1 Double play

14. In its Ruling 97/2010, the TDLC determined that *Telefónica* violated the Law⁶ by a) tying together the sale of broadband and telephone service and b) setting an implicit negative price for voice traffic.

15. The TDLC ordered *Telefónica* to sell separately each of the services integrating their packages. Therefore, and as long as *Telefónica* is dominant in the broadband service, it cannot tie the latter to any other product or service and must therefore maintain an offer for naked broadband. Also, *Telefónica* was ordered to establish prices for their bundles superior to, at least, the separate sale price of the most expensive service included in the bundle. It should be noticed that *Telefónica* main competitor, VTR, had - since 2004- the same obligation imposed as a condition in a merger process.

⁵ Resolución 547/1999.

⁶ Article 3.b) of Decree Law No. 211.

16. Finally, the TDLC recommended to the Executive the promulgation of a sectoral policy clearly contemplating the obligation for all telecommunications companies to sell separately each of the telecommunications products and services that integrate joint offers or packages.

5. Present debate: bundles and off-net/on-net tariffs

17. On March 2011, the TDLC started a process to examine two worrisome phenomena in the telecom market. On the one hand, the FNE (Fiscalía Nacional Económica or Economic Prosecutor) presented its concerns about the effects on competition of bundled offerings of certain telecommunications services, including voice (both fixed and mobile services), broadband and cable television. On the other, the TDLC has stated its own concerns about the barriers to entry introduced by the strong difference between on-net and off-net tariffs in the mobile market and its incipient link with the fixed voice market and had initiated a *sua sponte* inquiry. These two issues were accumulated in one process still in progress.

18. There are three main characteristics of the Chilean telecommunication industry that can generate problems when facing the above mentioned issues: a) in 2009, the TDLC allowed fixed tariffs to be free, for the first time, relying on the discipline force of the mobile service (to be developed in the following paragraphs); b) there is no effective wholesale access, so some mobile service firms cannot replicate the quadruple play that the major fixed voice service are able to offer and c) Movistar owns the biggest firms in both fixed and mobile clients.

19. In relation to the points just mentioned, the mobile voice service has been thought by the TDLC as a mechanism by which the fixed voice service prices could be disciplined, as was established in the in its 2009⁷ report. This disciplining power comes from the fact that in the last years the mobile service has experimented a strong growth in Chile, thus becoming an important competitor of the fixed service.

20. But here an important distinction needs to be made; despite being an important competitor, both services are not necessary close substitutes yet. This distinction is of great importance facing bundles that links both networks, because the mobile service would lose its disciplining power over the fixed one as long as the first it is not a close substitute of the last one.

21. The mobile service can be hardly thought as a substitute of the fixed one. The advantages of the fixed access are the ability to transmit a greater amount of data, a faster broadband and less interference and loss of communications. The benefits of mobile access are the increased mobility and increased demand that mobile products have, as being products demanded by individual consumers rather than households. The average speed of FB (Fixed Broadband) plans employed by consumers is substantially higher than the average speed of plans MB (Mobile Broadband).

22. Bundling between the mobile and fixed services will not be dangerous when there is competition between platforms. This means that they can offer similar sets of products, or at least, offer products that have a high degree of substitution with those of the alternative platform (or package) and have no significant switching costs.

⁷

INFORME N° 2/2009.

23. This is a critical aspect in the analysis of this industry. In Chile, both conditions for the neutrality of bundling are not met:

- Bundles are not replicable: As in 77% of the communes in Chile there is a dominant operator in fixed telephony that has more than 80% of the market⁸, it is not possible to replicate a package that includes fixed and mobile by a different company *Telefónica* in many geographic markets in Chile.
- Products from the fixed service are not good substitutes of the mobile one. As was said above, although both services are experimenting increasing degrees of substitution, there are still clear advantages related to the quality, speed, and scope in the fixed platform, so they are not close substitutes yet. This does not mean that in a close future a new generation mobile network could be a good substitute of the fixed one.

24. So, given that there is not close substitution among the platforms yet and that bundles cannot be replicated by all firms, it is not likely that the mobile network as a whole will act disciplining the fixed service behavior. That means that by allowing bundles between the two networks, the mobile voice service is may lose its disciplining power over the fixed one, leading to a serious threat to competition.

25. Finally, the mobile industry is characterized by a wide difference in the prices charged for on-net and off-net calls. This practice clearly generates a barrier to enter or grow in the mobile voice service market, since there is a clear incentive to subscribe to the company with the largest number of clients.

26. Although, at a first glance, one may think that this behavior arises from excessive access charges, which in Chile are regulated, the same conduct will arise even if the access charge is properly set. The rationale behind this price strategy is an attempt of the company to appropriate the network externalities that arise from the “calling party pays” principle: as a client from other company does not pay for the calls he receives, but still experiments a benefit from the fact of receiving the call, an externality is present and cannot be internalized by the calling company. From this point of view, the calling company has all the incentives to increase the off-net price, in order to reduce the positive externality generated for the other companies’ clients. When, on the other hand, both the client who calls and the receiver are clients of the same company, the company has incentives for lowering the on-net price relative to the off-net price, in order to increase the traffic inside its own network, and in that way, maintaining the benefits generated by the externality among its own clients⁹.

27. Beside the fact that this distortion of prices (that cannot be explained by cost reasons) is inefficient from an economic point of view because it hinders the normal communication between users of different networks, the problem is that this practice not only strengthens the competitive position of the incumbent firms, but also creates barriers to entry since new players will find it very hard to attract clients from actual companies.

28. In this way, if this practice is extended to the calls between fixed and mobile phones of the same company (and some attempts have been observed) the effects on competition will similar to those of quadruple play discussed above.

⁸ Tarziján M., Jorge “Análisis económico acerca de aspectos de la estructura de mercado del sector telecomunicaciones en Chile” June 2001. Information was obtained from data given by Entel.

⁹ This analysis was carried out by Aldo González in his paper “*Efectos de la discriminación de tarifas on-net/off-net en la competencia del mercado de telefonía móvil*”, which has been commissioned by VTR Móviles and presented before the TDLC.