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Working Party No. 2 on Competition and Regulation

REGULATION AND SEPARATION IN TELECOMS

-- Presentation by Martin Cave --

14 June 2010

The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its meeting on 14 June 2010.

Please contact Mr. Sean Ennis if you have any questions regarding this document [phone number: +33 1 45 24 96 55 -- E-mail address: sean.ennis@oecd.org].

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OECD
14 June 2010
'Regulation and Separation in Telecoms'

Martin.Cave@wbs.ac.uk

Martin Cave

Martin.Cave@wbs.ac.uk

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Highlights of the telecoms separation debate

- 1985- the break up of Bell: local versus long distance- 'a reckless but successful gamble'
- 1999- regional separation of NTT in Japan
- 2001- OECD recommendation on structural separation in regulated industries and associated debates
- [2000s-divestment of telco cable operations in Germany, Portugal etc]
- 2005-functional separation of BT in UK
- 2000s-divestment of telco cable operations
- 2005-2008-further functional separations (Australia, Italy, Sweden, NZ)
- post 2008-the age of NGAs, public subsidy and their consequences (Singapore, solvent countries *passim).*

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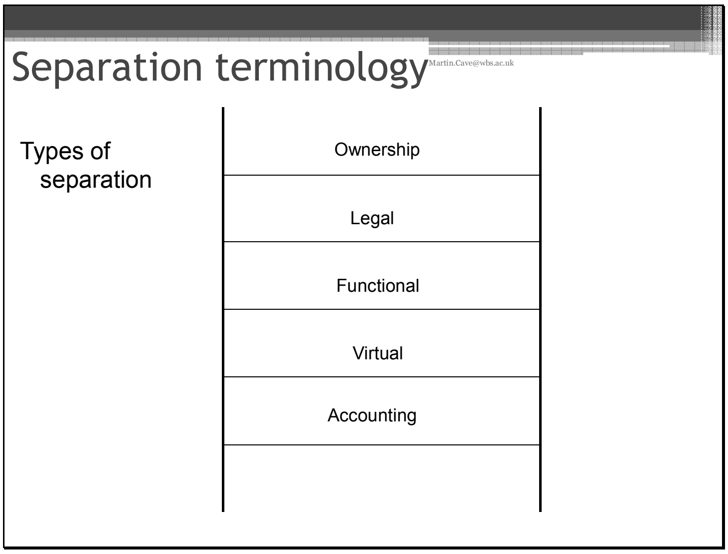

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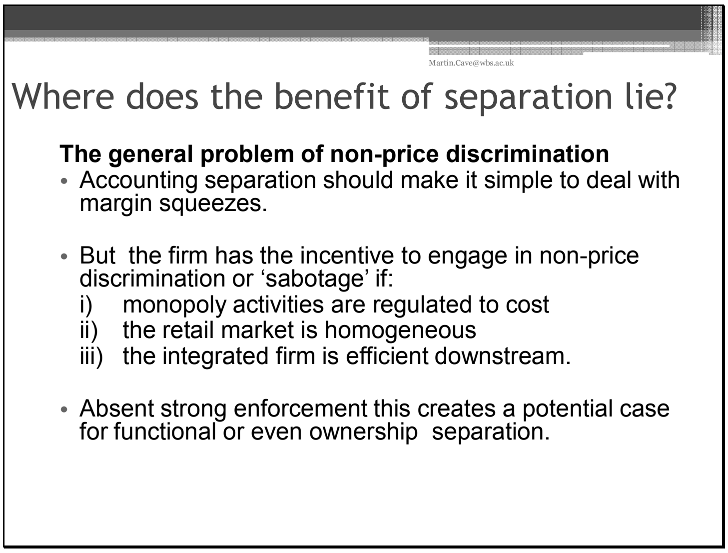

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Martin.Cave@wbs.ac.uk

What are the costs of separation (if more competition is the benefit)?

- One-off organisation costs (lower for a new fibre network than for a copper network designed for monopoly)
- Continuing costs of contracting
- Co-ordination costs
  - Operational
  - Investment

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Martin.Cave@wbs.ac.uk

The hold-up problem and investment

- Separated firms typically invest in assets which are specialised or co-specialised with respect to geography, function, customers.
- When the investments is made, one firm may behave opportunistically by driving down the price at which it buys the other’s service.
- For fear of this, the second firm does not invest – or the two integrate.
- Is it a major problem? Beware the GM/Fisher Bodies trap.

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Martin.Cave@wbs.ac.uk

Can contracting solve the investment co-ordination problem?

- Information transfer can be accomplished by independent forecasting or constructive engagement
- Contracts can be long term and involve take or pay elements or other forms of risk-sharing
- Examples can be found in sectors such as airlines/airports, energy, railways and in activities of unregulated firms such as Intel (job 1 and job 2)
- How well do such arrangements work?

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Martin.Cave@wbs.ac.uk

What do other sectors tell us about integration and separation? 1

Lafontaine and Slade: ".We did not have any particular conclusion in mind when we began to collect the evidence..We are therefore somewhat surprised at what the weight of evidence is telling us. It says that in most circumstances, profit maximising vertical integration decisions are efficient, not just from the firms' but also from the consumers' point of view. The vast majority of studies support this claim,..even in industries which are highly concentrated.."

(JEL 2007, based on review of c200 empirical studies)

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Martin.Cave@wbs.ac.uk

What do other sectors tell us about integration and separation? 2

Joskow: "Overall I would argue that there is substantial support in the empirical literature for various efficiency motivations for vertical integration. There is minimal empirical support for anticompetitive foreclosure motivations. This suggests that there is little empirical support for antitrust law's traditional suspicion of and hostility toward vertical integration and related non-standard vertical contractual relationships except under extreme conditions where firms controlling bottleneck have the incentive and ability to exercise an anticompetitive foreclosure strategy".

American Bar Association, 2008

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Martin.Cave@wbs.ac.uk

Where are we now in the EU?- mandatory functional separation

- Mandatory functional is now a recognised access remedy.
- Because it is costly and intrusive it should be employed in the presence of evidence of failure of other remedies- ie only deployed if the goal of equivalence is not obtainable without it.
- It should take account of the prospects for end-to end competition (but cannot be geographically differentiated).
- Summary: it will be difficult to fulfil the regulatory conditions and to accomplish it in practice

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Martin.Cave@wbs.ac.uk

Where are we now in Europe? 'Voluntary' functional separation

- No obvious reason to prohibit separation.
- Openreach created over 5 years ago. Success claimed by BT and regulator.
- Telecom Italia has agreed arrangements with regulator, which do not require much re-engineering.
- Voluntary separation achieved in Sweden, subsequently formalised and strengthened (but excluding fibre).

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Martin.Cave@wbs.ac.uk

The NGN effect: co-investment

- Can be private or public, vertical or horizontal
- Private and horizontal: 3 operators in Italy club together to construct a fibre network in major cities, and seek adhesion of incumbent; separation is entailed
- Private and vertical: in theory retailers might co-invest in network construction, through JV or long term contract; difficult to accomplish.

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Martin.Cave@wbs.ac.uk

Co-investment with the government and separation

- Central or local government of fibre networks is now the norm
- In this framework, separation can be enforced contractually as a matter of public policy (Singapore, elsewhere)
- Public bodies can inject limited funds and require networks to be open, but not necessarily separated (eg Portugal)
- Public/private partnerships or JVs in networks entail separation because of different ownership structures in network and retail layers (New Zealand)
- In the limit, complete public ownership of a separated network, and assimilation or elimination of competitors (Australia)

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Conclusions

- Conventional wisdom is that separation of copper networks is a second-best solution to deal with a recalcitrant incumbent.
- NGN create opportunities for separation-friendly network design and for public co-investment.
- The trend towards re-monopolisation creates a conflict between private incentives to invest and need to open networks.
- With public funding, the incremental burden of separation can fall on the public purse.