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Monopolisation, Moat Building and Entrenchment Strategies – Note by Costa Rica

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More documents related to this discussion can be found at www.oecd.org/competition/monopolisation-moat-building-and-entrenchment-strategies.htm

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1. Economic moats and entrenchment

1. An economic moat refers to a company's ability to maintain a competitive advantage over its competitors by establishing mechanisms that result in a barrier that protects that advantage.

2. A company can establish an economic moat in a variety of ways, depending on the type of sector or industry in question, for example, (i) through low costs (due to technological advantages or access to inputs), but also through the existence of high sunk costs that make it unfeasible to develop alternative industries based on the same technology, cost advantages can facilitate predatory strategies; (ii) by size (large firms), size advantages specifically imply a number of additional advantages such as economies of scale and network effects, and the size of the firms themselves often leads to a large market share, which can be associated with the existence of market power; (iii) switching costs, switching costs can be increased due to lack of alternative options, the size of competitors (and their ability to meet demand), the existence of long-term contracts, regulatory constraints (requirements to have the good or service of a particular economic agent), or even by the existence of distribution and exclusivity agreements; (iv) due to the existence of special rights, these rights may derive from issues associated with the protection of intellectual property (such as patents) that are particularly relevant in technology sectors, or from regulatory issues that generate a specific right or advantage, even because they are segments protected by law (such as natural monopolies); v) for other issues, such as brand recognition or technological superiority.

3. Economic moats are often used by companies to achieve market leadership, and this can allow them to accumulate significant market shares. When economic moats are sustainable over time, companies can discourage or even prevent the entry of potential competitors, leading in many cases to the development of concentrated markets.

4. An economic moat does not have to be the result of anti-competitive conduct focused on the exclusion of current and potential rivals but can result from a sustained situation over time in which, precisely the existence of the moat produced an environment of protection for the company in question, allowing it to become a company with market power.

5. On the other hand, an entrenchment is understood as a situation in which the company develops a strategy focused on consolidating or expanding a dominant position. These types of strategies often leverage the market power that the company already enjoys in a given market or group of markets and can lead to a significant decrease in competition in the market.

6. Entrenchment strategies may involve specific strategies focused on mergers and acquisitions of companies located in other complementary markets or where there may be bundling or portfolio effects. And they seek to strengthen or expand an existing market position.

2. Antitrust analysis and potential challenges in the existing legal frameworks

7. Both the general normative framework and the sectoral regulatory framework on competition in Costa Rica allow flexibility to consider the effects that the concepts of economic moat and entrenchment may have in terms of the analysis of anti-competitive practices and merger contrrol in the telecommunications sector.

2.1. Investigation and sanction of anti-competitive practices.

8. With regard to the investigation and sanction of anti-competitive practices, article 52 of the General Telecommunications Law, Law 8642, provides that it is the obligation of the Superintendence of Telecommunications (SUTEL), inter alia, to "*prevent and detect monopolies*", for which it must "*investigate cartels, monopolistic practices, illegal merger and other restrictions on the efficient functioning of the telecommunications market, and to impose the measures and penalties provided for in the legal system*." In addition, this article recognizes among the anti-competitive objectives or effects of monopolistic practices *"limiting, diminishing or eliminating competition in the telecommunications market".*

9. In accordance with the above, Article 54 of Law 8642 provides the following in relation to relative monopolistic practices (abuses of dominant position and vertical restraints): "*Relative monopolistic practices shall be considered to be acts, contracts, agreements, arrangements or combinations made by network operators or providers of telecommunications services, by themselves or acting in conjunction with other economic agents, and the object or effect of which is or may be the undue displacement of other market operators or suppliers, the substantial impediment to their access or the establishment of barriers to entry or exclusive advantages in favor of one or more persons".*

10. In addition, Article 54 establishes, among others, the following legal types that can be used in cases of moat building or entrenchment: "*Unjustified actions to increase costs or hinder the production process of a competitor*" and "*Any deliberate act that has the sole purpose of procuring the exit of operators or suppliers from the market or involves an obstacle to their entry*."

11. In this sense, the current regulatory framework is broad enough to be able to analyze possible conducts related to economic moats or entrenchment, which may result in eventual anti-competitive conduct.

2.2. Merger control.

12. Regarding merger control, the regulatory framework is also broad enough to specifically consider cases of entrenchment. In particular, Article 101 of the Law on the Strengthening of the Competition Authorities of Costa Rica, Law 9736, provides as follows regarding the analysis of mergers: "*Mergers that do not have the foreseeable object or effect of significantly impeding competition in the relevant market affected by the transaction shall be approved by the highest body of the corresponding competition authority, or in other similar or substantially related markets*."

13. In accordance with the above, Article 146 of the Regulations to Law 9736 provides that a merger shall be a significant impediment to competition in the market in the following cases:

> *"(a)* ***Grants or strengthens a position of substantial power*** *to the resulting economic agent, with which it may hinder, diminish, damage or impede competition in the market.*

(b) Substantially facilitates the exercise of monopolistic practices by the participants in that concentration, either individually or in coordination with other economic operators.

(c) Establish barriers to entry, prevent third parties from accessing the relevant market, related markets or essential inputs.

(d) Affects the dynamics in the markets affected by the concentration in such a way as to generate adverse effects on consumers." (The emphasis is intentional.)

14. In this sense, the assessment of the competition authority must consider the creation or reinforcement of substantial market power, whether coordination between economic agents is possible and whether adverse results are generated for consumers, so that it allows to consider possible situations of entrenchment that seek to extend or leverage already existing dominant positions to other markets.

15. In particular, SUTEL's Merger Analysis Guide establishes the following regarding the creation or reinforcement of market power as an element to prohibit a merger subject to analysis: "***the creation or reinforcement of substantial power in the market is an element that must be assessed by SUTEL*** *in accordance with the criteria of Article 15 of Law 7472,* ***but it is neither sufficient nor indispensable to object to a merger****. Under the new standard, the theory of harm to be formulated by SUTEL must be based on the economic effects of the transaction and not on the market power of the agents that are integrated (Weinstok, 2020, p. 94) Thus, concentration is not valued according to the power acquired by the parties (although this is an element to be considered) but focuses on the characteristics of the market the dynamics of competition between the economic agents involved in it and the possible loss of competition that could be generated by the merger...*" (The emphasis is intentional.)

16. In relation to conglomerate mergers, the aforementioned Guide states: "*However, some mergers of this type could attract the attention of SUTEL when, as a result of the merger, the resulting economic agent may exclude competitors from the market and, as a consequence, affect the competitive dynamics (ICN, 2006, p. 13). Typically* ***this is more likely to occur in markets where the parties have substantial power in their respective markets and also the markets in which the parties operate are closely related, such as products that complement each other, or that belong to a range of products that are usually purchased by the same group of customers for the same end-use*** *(European Commission, 2008)*" (emphasis added). This could be the basis for defining an eventual theory of harm based on an entrenchment strategy.

17. The above elements show that the current regulations allow for the assessment of cases of entrenchment in merger control, however, SUTEL has not had any case in which it has used a theory of damage of this nature as the basis of its analysis.

3. Case of study.

18. As previously discussed, one of the circumstances that can generate the existence of an economic moat refers to the existence of normative issues that generate a specific right or advantage to a certain agent.

19. In the case of the Costa Rican telecommunications sector, a number of administrative and legal decisions have been identified that could have resulted in the state operator enjoying a significant advantage over privately owned operators in relation to the provision of mobile services.

20. Thus, the state operator has benefited from a series of decisions that have led to the fact that to date it has no obligations in the concessions it holds in terms of radio spectrum (which reduces costs in relation to its competitors), it has three times more radio spectrum than its competitors (due to the lack of processes for the recovery of unused or underused spectrum); It does not have the expiry of the concessions it holds (which implies that it would not be in the need to pay for the spectrum historically attributed in perpetuity).

21. This situation has become an advantage for this operator and has generated a situation of asymmetry in the market, which has become particularly relevant in the case of the deployment of the latest mobile technologies, such as the deployment of 5G networks, where the imbalance of the market can weaken future market competition, given the advantages enjoyed by that operator.

22. Given that the existence of this advantage has not resulted from actions directly carried out by the operator itself, but from decisions and omissions radio spectrum control, SUTEL has so far used the tools available in the field of promotion and advocacy of competition, to promote the elimination, or at least a reduction in the advantages granted to the state-owned operator, and that the playing field can be levelled through the application of competitive neutrality policies.

23. In the opinions[1] issued by SUTEL, it has been emphatic that: "*The asymmetry in the allocation of the radio spectrum may generate differences in the ability of operators to meet the growing demand for data in the medium and long term, which generates a weakening effect on market competition",* as well as the fact that *"An operator with a particularly high share of spectrum allows it to offer superior services that eventually competitors might not be able to replicate. If other operators are unable to replicate new services because spectrum is not available in a timely manner, it can lead to a competitive disadvantage for those operators, which in turn can result in weakened competition*."

24. He also warned about the risk of possible anti-competitive conduct because of this situation: "*There is a risk that an operator with a very high share of spectrum and mainly if it is being underused or not used, may use its excess spectrum capacity as a deterrent to prevent its competitors from reacting strongly to the competitive pressures exerted by it. An excess of capacity translates into competition matters, as a leverage mechanism that can eventually allow anti-competitive conduct to be sustained (for example, predatory practices), since excess capacity generates the possibility of absorbing customers displaced from others*" (emphasis in the original).

25. In recent years, the state-owned operator has taken a series of administrative actions and deployed a series of behaviors allegedly to protect and extend said advantage, those actions led to the filing of complaints for the alleged commission of anti-competitive practices by said economic agent in terms of its behavior in relation to the management of the radio spectrum for the deployment of mobile 5G networks, these complaints are currently in the preliminary investigation stage (which is confidential in accordance with Article 38 of Law 9736).

[1] See Opinions contained in the reports: 04225-SUTEL-OTC-2021, 09228-SUTEL-OTC-2022 and 01556-SUTEL-OTC-2023.