

Telefónica's response to DG COMP's consultation regarding a New Competition Tool

September 8, 2020

1. Executive summary

Telefonica welcomes this opportunity to comment on DG COMP's proposals for a New Competition Tool (NCT). In summary, our assessment of this IIA from DG COMP is as follows:

- If there is a problem with antitrust tools being insufficient to address problematic digital platform markets, then the first approach must be to fix antitrust, rather than create a new layer of market supervision. DG COMP has not clearly identified the gaps in competition law, nor why antitrust economic tools cannot be adapted to solve these issues. We make some proposals in this regard; **Telefonica believes that antitrust can be adapted to capture problematic digital platform markets.**
- The evidence contained in the IIA does not support DG COMP's assertion that there are more general market concentration problems in the economy. The referenced economic papers, in particular from the OECD, contradict the narrative put forward in the IIA. **The Commission has not done enough to justify a horizontal tool that covers the whole economy**, there simply isn't the economic evidence of a problem.
- Telefonica believes that there are competition problems in digital platform markets, but **we believe that an ex-ante framework is the better approach to deal with these digital platform markets** – as happens in other sectors which require systematic targeted intervention. So we are strongly supporting DG CNECT's parallel proposal 3b as an alternative to any NCT.
- **The legal basis given in the IIA to justify the need of the NCT are misconceived:** the NCT takes the form of an "ex-ante" intervention, yet explicitly the need for an NCT is based there being no breach of antitrust rules under the meaning of Art. 101 & 102 TFUE. It follows that the NCT cannot be justified based on Art. 103 TFUE.
- The UK's market investigation tool is seen as a model for the NCT, at least by DG COMP. The CMA's MI tool has a number of important checks and balances, in particular in relation to the selection of markets for review and the separation of the investigation function from the CMA executive. Telefonica believes that **a limited NCT might generate wider support if the Commission is clearer on how the application of any new rules would be triggered and controlled.**
- Similarly, clarity of scope will be important if the Commission is to develop its case for an NCT. Any NCT proposed by the Commission will only deal with Single Market problems, rather than national markets. Telefonica believes that **any NCT should not add regulation to already economically regulated sectors, especially in light of the lack of evidence presented for a general weakening of competition.** Existing laws are more than enough for those already regulated ex-ante.

2. The justification for a New Competition Tool (NCT)

An NCT focussed on digital markets

We agree with DG COMP, as highlighted in the IIA, that the current competition tools have been shown to be insufficient, ineffective and even slow to address anticompetitive conducts exerted by a few digital platforms.

This should naturally raise two questions:

- (1) Can existing tools (specifically antitrust methods) be updated such that they can effectively address competition problems? and only if not;
- (2) Should there be new rules that deal with these problems specifically? If so, should these rules:
 - a. Be an ex-ante framework: ie the proposals of DG CNECT launched in the parallel consultation¹; or
 - b. A new competition tool?

To answer these questions a thorough and rigorous economic analysis of the impact on social welfare would be required, something that is lacking at the moment. Absent this analysis, the Commission should opt for the least intrusive of the proposed measures. And if, as it seems, the welfare problem is confined to a certain set of businesses of well-known features, then the tool should be limited also to that scope.

It appears to Telefonica that the launch of DG CNECT's proposals has led DG COMP to miss out the important intermediate steps of reviewing competition law in general and consulting on changes to existing tools to address any shortcomings as they relate to digital platforms.

During the term of this Commission, DG COMP must review general competition law and its effectiveness in order to adapt the current tools to the Digital Economy, as well as reviewing a number of elements of competition law that expire during this mandate.

Specifically, the Commission enjoys wide-ranging powers that can be more systematically used in order to tackle competition problems in digital platform markets:

- i. Use the existing Article 17 sector-inquiry power to improve the regulatory framework or feed into regulatory initiatives: a further use of sector inquiries would help to solve (if any) likely structural market failures in traditional sectors, having DG COMP making suggestions to regulators with the "ex-ante remedies" power left to the discretion of the sector specific regulator;
- ii. Imposition of behavioural or structural remedies (Article 7 and recital 12) in an ex-post intervention; and
- iii. Further use of interim measures (Article 8), limited in time.

¹ <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12418-Digital-Services-Act-package-ex-ante-regulatory-instrument-of-very-large-online-platforms-acting-as-gatekeepers>

In addition, the current reviews on the Horizontal and Vertical Guidelines and the Market Definition Notice should be clearly focused on the Digital Economy, in order to respond to the challenges and new types of agreements emerging from the digital sector; as well as to address how the presence of digital platforms should be taken into account defining a relevant product market.

With regard to the expected Merger Control review, we believe there is a clear need for new thresholds such as the value of the transaction in order to catch under the scope of review the so-called “killer acquisitions”.

If there are problems with antitrust methodologies that make it difficult to deal with competition problems in digital markets, then DG COMP should seek to improve and update the defective methods – rather than propose an incremental layer of market regulation. If your car stops working at the side of the road, you don’t immediately buy a new one. You see if you can fix up your car and go on your way. Telefonica has long argued that antitrust rules require updating – they do not need to be superseded by a New Competition Tool.

Finally, an ex-ante framework is better suited to deal with sector specific market failures than a New Competition Tool. In our response to DG CNECT’s parallel consultation, we show how its Option 3b – a full ex-ante regulatory framework, could be made tractable. There is no need to duplicate supervision through a sector specific NCT as well. This is especially true given the lack of academic consensus and the principle of proportionality when establishing new rules.

Indeed, we note that DG COMP wants to ensure that overlap with the proposals of DG CNECT is minimised, similarly it should also be seeking to remove any conflicts with general competition law and sector specific regulation for other industries. This is best undertaken in the round, during the review of competition law, rather than as an adjunct to the proposals of DG CNECT.

Justification for a new competition tool with a horizontal scope

Turning to the justifications made by the Commission in the IIA for expanding the scope of an NCT beyond digital markets, to the whole economy, the argument runs as follows:

- **Increasing firm profitability is evidence of a lessening of competition;** and
- **oligopoly market structures allow tacit collusion,** which would be enhanced with digital tools such as Artificial Intelligence.

It is worth examining these claims in more detail to see if the evidence put forward by DG COMP is sufficient to warrant intervention, which we do below. A subsidiary argument is also put forward that:

- **The problems in digital markets will affect all markets, because all markets will eventually become digital.** This claim is obviously not true, or at least presents a gross simplification of how the interfaces between digital platforms and the rest of the economy work. Just because Uber uses a digital platform to compete with taxi firms, does not make the entire taxi or personal transportation sector “digital”. It is the intermediation service of the platform of Uber that is “digital”, not the act of paying a taxi fare in exchange for transportation.

Are higher firm profits evidence of the need for a New Competition Tool?

Firstly it is worth observing that there might be a number of reasons for higher firm profits:

- (1) The location of profit taking in the value chain might be changing – profits might be being extracted in different parts of the value chain as other parts commoditise and value is added elsewhere. It is important to examine the profits of all firms, rather than a subset; and/or
- (2) The next question to ask is whether “supernormal” profits are a transitory feature or not? In contestable markets with freedom of entry and exit, it is the presence of supernormal profits that encourages entry and innovation by rivals, which eats into the profit taking by the established firms, returning profitability back to the efficient level. The *transitory* existence of higher profits is an economic signal for more competition to take place, not a signal for regulation.

It is only where markets are not contestable, there is limited or no entry and exit, and where supernormal profits persist for a protracted period that, from an economic point of view, there *might* be a competition problem. Digital markets are often said to exhibit such features, but it is the contestability that should be tackled in our view, not the profit margins which are just a symptom. This is why Telefonica supports an ex-ante regime based on securing contestability, like Option 3b proposed by DG CNECT.

Returning to the justification for a horizontal new competition tool, the Commission quotes its own Single Market Performance Report 2019² as showing that there is “a *growing body of economic evidence in the EU suggesting increasing market concentration and increasing firm profitability levels*” [our emphasis]. Firstly, Telefonica notes that the relevant passage from the report runs to just one page out of sixty-two. On page 25 of the Staff Working Document, the Commission’s analysis of “*signs of weakening competition*” is as follows:

“Following a period of relative stability, indicators of competition have deteriorated after the [2008 financial] crisis. These trends are less pronounced in Europe than in US but still clearly detectable [.....] The observed patterns include industry-level concentration which according to OECD data climbed over the past 20 years in both the US and Europe. Possible explanations include structural changes in the economy, in particular the rise of new technologies with more efficient production methods, as well as a weakening of competition.” [our emphasis]

Firstly, it is worth pointing out that industry-level concentration is not the same as market concentration. As the authors of the quoted OECD study say³:

“Industry concentration is related to, but distinct from, the concept of market concentration. Industry concentration measures the extent to which economic activity is concentrated within a small number of large companies or business groups within an industry. Market concentration, instead, describes the weight of leading firms in a market for particular products or services that are close substitutes. Accordingly, market concentration is a far narrower definition than what is typically reflected in industry concentration measures. The fact that a large share of industry activity is due to a

² <https://data.consilium.europa.eu/doc/document/ST-15321-2019-ADD-1/en/pdf>

³ Industry Concentration in Europe and North America, Bajgar et al, January 2019 (OECD), paragraph 4.

handful of large firms does not necessarily mean that product markets within that industry are highly concentrated. While industry concentration can be used as an initial indicator to screen for changes in the degree of competition, by itself it can say little about whether or not market competition is changing." [our emphasis]

Bajgar continues at footnote 3 in that paper:

"....to get from industry concentration to market competition one needs to be confident that a) there is a reliable relationship between industry concentration and market concentration (see OECD, 2018b, and Werden and Froeb, 2018), b) that market concentration is a good indicator of market power (often not the case in differentiated product or geographic markets, platform markets and innovative markets); and c) that market power reflects a lack of competitive intensity rather than being a sign of competition in action."

The evidence in DG COMP's IIA uses the wrong metric from which to infer a lessening of competition. It has failed to demonstrate a relationship between industry concentration and market concentration, as well as failing to demonstrate that market concentration (which it has not measured) leads to the creation of market power. Finally, as Bajgar highlights, concentration might just be a *"sign of competition in action"*, rather than *a priori* a competition problem.

The referenced Staff Working Document posits that efficiency, new technology, structural change and/or a weakening of competition could all be *"possible explanations"* for higher industry (sic) concentration. Being just one of many *"possible explanations"* is not a sufficiently robust basis on which to make proposals to regulate competition in the entire economy through a New Competition Tool. Furthermore, this evidence relates only to industry concentration, rather than demonstrating cause and effect – that increased industry concentration has led to negative consequences for consumers in terms of price, quality and choice. It is a factual observation about industry concentration made in the paper, not a determinative point about persistent supernormal profits of firms in more concentrated product markets. The change is also recent, *"following a period of relative stability"*, so still potentially transitory, these profits might be competed away through the normal process.

The Staff Working Document continues:

"The trend involving higher concentration ratios and markups is also reflected in increased market power, especially among larger firms. Possible explanations include changes in business dynamics and structure of markets. This concerns winner-takes-most outcomes, also referred to as the "superstar firm" hypothesis, where the more productive firms increasingly reap the benefits of network effects and scale economies." [our emphasis]

Again, possibilities and hypotheses are not a sound basis for wide-ranging untargeted legislation. The Staff Working Paper then turns its attention to the issue of digitalisation:

"The digitalisation of the economy increases the importance of knowledge assets. A few firms, especially in digital-intensive sectors, benefit from high and increasing markups and gain large market shares due to the intensive use of intangible assets, such as data analytics, and the difficult replication of successful business models, together with declining IT capital prices."

If true (again this point is asserted without evidence), it would point to a targeted piece of legislation to reduce the market power of the *"few firms"* in *"digital intensive sectors"*, not a

potentially horizontal instrument affecting all firms in all sectors. Such evidence would point to DG CNECT's asymmetric ex-ante solution (option 3b) not an instrument affecting all firms in all sectors as proposed by DG COMP. The latter would dramatically increase the potential for overlapping intervention in sectors which are already subject to an ex-ante regime, such as telecom markets.

The Staff Working Document continues in the same vein:

"Such outcomes are possibly also going beyond the digital economy. Firm markups have also increased, especially among the most successful firms."

Here is what the quoted paper from Bajgar (OECD) says on this matter (at paragraph 10 of the quoted report):

"This research suggests that economies appear to be less dynamic, with declining entry and exit rates across most OECD economies and increased divergence between top and bottom productivity firms. At the same time, market power appears to have increased, as indicated by increasing mark-ups of top firms and falling labour share of income. Whether these findings are the result of a reduction in competition, or a sign of competition in action – with market power representing a temporary reward for innovative and efficient firms – remains unclear. Our results should, thus, not be interpreted as unambiguous evidence of reduced competition, and much less yet of a need for particular policy interventions." [our emphasis]

Given the caution of the authors, it is unclear why this report and its data are adduced as evidence in support of DG COMP's NCT proposal. **The authors explicitly caution against using these data to evidence any particular policy intervention.** Yet the OECD report is one of the few pieces of "evidence" in the IIA.

The final bit of evidence used in the Staff Working Document is a report entitled *"Globalization and the fall of mark-ups."* [our emphasis]. From this, DG COMP's IIA concludes:

"More generally, price cost margins (as a further markup indicator) remain comparatively higher in services than in manufacturing".

What one can observe from these data is that the prices of goods have benefited from the scale effects of global consumption and production, whereas services (which tend to be more localised) have not. It is also worth noting that the very same Staff Working Document says *"Excess restrictions in professional services stifle competition and limit market entry. Regulation, while instrumental in certain professional services, can often be associated with significant economic costs through limiting market entry and competition."* In some services at least, the solution is deregulation, not more regulation.

Another paper is identified in the Staff Working Document as lending support to the assertions we expose above; namely *"Increasing Differences Between Firms: Market Power and the Macro-Economy"*, Van Reenen 2018, London School of Economics, Centre for Economic Performance.

The reader does not need to get far beyond the Abstract of the Van Reenen paper to realise it does not lend weight to the Commission's assertions in the Staff Working Paper, but rather contradicts them:

"Higher sales concentration and apparent increases in aggregate markups have led to the concern that product market power has risen substantially which is a potential explanation for the falling labor share of GDP, sluggish productivity growth and other

indicators of declining business dynamism. I suggest that this conclusion is premature. Many of the patterns are consistent with a more nuanced view where many industries have become “winner take most/all” due to globalization and new technologies rather than a generalized weakening of competition due to relaxed anti-trust rules or rising regulation.” [our emphasis]

DG COMP has adduced no evidence that would justify its proposed new competition tool, in particular in a horizontal form. In fact, the evidence it has provided so far contradicts this narrative completely.

3. Legal basis

Going through the IIA, we have clear doubts on the legal basis taken by DG COMP to justify the need for this new competition tool, in particular referring to Articles 103 and 114 TFEU for the following reasons:

- The NCT is not aimed at giving effect to the principles set out by Articles 101 & 102 of the TFEU because it is foreseen to be applied in a “ex-ante” intervention and not related to either the behaviour of the targeted company nor based on the breach of antitrust rules carried out by a undertaking that enjoys a dominant position in a given market. Therefore, the NCT cannot rely on Article 103 TFEU’s grounds to justify its need.
- Article 114 provides the legal grounds required by Commission to propose any legislative tool aimed at harmonising law across Member States and thus avoiding fragmentation in the internal market. However, we believe there are not national laws to harmonise either in competition law or sectorial regulation that justify the need for the new competition tool.

It appears to Telefonica that the proposed NCT would need to be justified based on the evidence of an enforcement gap in competition law more generally rather than just two assertions in this IIA and the coincidental proposal for ex-ante regulation by another DG. Moreover, we note that DG COMP wants to ensure that overlap with the proposals of DG CNECT is minimised, similarly it should also be seeking to remove any conflicts with general competition law and sector specific regulation for other industries. This is best undertaken in the round, during the review of competition law, rather as an adjunct to the proposals of DG CNECT.

4. Functioning of any New Competition Tool

There is no economic justification for a horizontal scope – ruling out Options 1 & 3. Whatever DG COMP finally puts out to further consultation, the proposals need to be much clearer on:

- (1) The scope of digital platforms – both what is inside this definition and what is specifically excluded, such as already economically regulated sectors;
- (2) The scale required for a “single market” dimension – as in antitrust, how many EU markets must be affected before the identified problem falls within the scope of any new MI tool?

- (3) The triggers for a market investigation. The UK MI tool is triggered either by a reference from a limited set of external bodies, or following an own initiative study by the CMA. This market study phase is itself a burdensome exercise for the Authority, such that embarking on any investigation following on from this must be a serious undertaking.
- (4) A separation of the investigation function from the executive of DG COMP. DG COMP cannot act as inquisitor, judge and jury in this process. The UK's MI tool uses an external panel of lay members, the same panels that review mergers under the UK regime. This creates adequate distance between the executive of the CMA and the team investigating the relevant market.
- (5) Possibility for the targeted companies to express their views during the whole process: the UK's MI tool sets out a continuous dialogue between the affected firms and the CMA, mainly by means of formal hearings and remedies hearings when the Market Study turns to a Market Reference. It should be ensured that DG COMP allows for this continuous feedback during the procedure until the final result when the Market Study turns to "Phase 2" with the Market Reference where there is a higher likelihood that remedies might be imposed.
- (6) DG COMP's decisions after the market investigation procedure should focus on recommendations to policymakers, sectorial regulators and only where necessary remedies on market actors.
- (7) Remedies should be applicable both to the market under investigation and, where there is evidence of anticompetitive tying or leveraging of dominance, to adjacent markets. This is a very important feature for gatekeeping platforms.
- (8) A quick appeals procedure before the Courts is needed in order to lessen, as much as possible, the uncertainty and the reputational impact of the targeted undertaking.

We also see that there is a potential overlap with competition law, in particular with merger procedures. One feature of merger analysis is to understand whether theories of harm related to the merger could be tackled by the specific sector regulatory regime. It follows that DG COMP will need to determine whether, in any given merger scenario, the NCT would be able to deal with the competition problem it foresees. This is just one example, but it shows that given the nature of the tool, the NCT should really be considered in relation to competition law overall, rather than just the overlap with a potential sector specific ex-ante tool proposed by DG CNECT.