



# **METHODOLOGY FOR ASSESSMENT OF SIGNIFICANT MARKET POWER (SMP) UNDER SECTION 39(2) OF THE COMMUNICATIONS ACT, 2009**

## **CONSULTATION DOCUMENT**

**ECS 09/2011**

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UTILITIES REGULATION & COMPETITION AUTHORITY

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## **1. INTRODUCTION**

The Utilities Regulation and Competition Authority (URCA) has issued this consultation paper pursuant to s.39(2) of the Communications Act, 2009, ("Comms Act") that mandates URCA to

*"establish and publish criteria-*

- (i) relating to the definition of markets in the electronic communications sector; and*
- (ii) against which market power may be assessed,"*

*for the purposes of making a determination [on whether a licensee is an SMP (sic) licensee]."*

The Comms Act, at s.39(1), details the required conditions for determining that a licensee is an Significant Market Power (SMP) licensee:

*"...a licensee is an SMP licensee if the licensee, individually or with others, enjoys a position of economic strength which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors, consumers and subscribers."*

Based on the legislative provisions, URCA's role in the determination of SMP has the following features:

- the definition of relevant markets;
- the determination of market power, where SMP licensees are those is a position of economic strength which allows them to behave to an appreciable extent independently of competitors, consumers and subscribers; and
- the determination as to whether the SMP licensee enjoys individual or joint (with others) SMP.

There is an implicit requirement under s.39 of the Comms Act that market reviews be conducted in accordance with a framework established by URCA, to assess the continued SMP position of or the transition of a SMP licensee to a position of non SMP. This requirement is evident by s.116 of the Comms Act which, while presuming The Bahamas Telecommunications Company Limited ("BTC") and Cable Bahamas Ltd ("CBL") to have SMP in specific identifiable but relevant markets, allowed both licensees to make representations, with supporting evidence, to URCA, to rebut the presumption of SMP (s.116(6) of the Comms Act). This requirement is further contained in the Electronic Communications Sector (ECS) Policy for The Bahamas which states

that the interim market definitions and SMP determinations become rebuttable after 12 months and will be subject to more detailed market reviews to be conducted by URCA.

The SMP methodology proposed in this document is based on the regulatory framework in place for the ECS, specifically the Comms Act and the conditions set out in licences granted to providers of electronic communication services in The Bahamas. The proposed methodology also references and draws upon, where appropriate, international best practice.

As the subject matter of this consultation is one of public significance, licensees and interested parties are hereby being afforded a reasonable opportunity to submit written responses to URCA's proposals. The document contains a number of proposals to assist respondents in preparing their written submissions on the consultation. However, respondents may comment on any or all parts of the document as they see fit.

## **1.1 URCA Response to a Determination of SMP**

A determination in accordance with s.39 of the Comms Act, triggers certain non-discretionary obligations and other specific obligations within the standard Individual Operating Licence of the SMP licensee, namely:

- Non-Discretionary Obligations
  - Condition 32 - non-discrimination;
  - Condition 35 - requirement to publish charges and terms and conditions;
  - Condition 36 - consumer protection;
- Other Specific Obligations
  - Condition 37 on retail price controls;
  - Condition 38 on infrastructure sharing and development;
  - Condition 39 on conditional access systems;
  - Condition 40 on obligation to provide access and interconnect; and
  - Condition 41 on accounting separation.

URCA must only impose regulatory measures which are efficient and proportionate to their purpose and to introduce them in a manner that is transparent, fair and non-discriminatory. This means that where URCA believes that market forces alone are unlikely to achieve the objectives of the Comms Act within a required timeframe, it may introduce regulatory requirements, having due regard to the costs and implications for affected parties.

For the elimination of doubt, URCA will adopt a public consultation process in relation to any specific obligations to be imposed on a licensee determined to have SMP individually or jointly with others. URCA will after that consultation, publish its final determination on obligations imposed on SMP licensees, with reasons, and may take such action as is determined to be

appropriate having due regard to the objectives of the Comms Act and the Sector Policy, and the costs and implications for affected parties.

## **1.2 Responding to this Consultative Document**

Responses to this consultation document should be submitted to URCA by 5:00 p.m. on 29 June 2011. Persons may send their written responses or comments to the Director of Policy and Regulation, either:

- by hand, to URCA's office at UBS Annex Building, East Bay Street, Nassau; or
- by mail to P.O. Box N-4860, Nassau, Bahamas; or
- by fax, to (242) 393 0153; or
- by email, to [info@urcabahamas.bs](mailto:info@urcabahamas.bs).

URCA reserves the right to make all responses available to the public by posting responses on its website. If a response is marked confidential, reasons should be given to facilitate evaluation by URCA of the request for confidentiality. URCA may publish or refrain from publishing any document or submission, at its sole discretion.

## **1.3 Structure of Document**

The remainder of this document is structured as follows:

- Section 2 provides an overview of legislative context for market reviews;
- Section 3 outlines URCA's methodology for market definition;
- Section 4 outlines the criteria URCA would use when assessing whether a licensee is an SMP licensee;
- Section 5 outlines the criteria URCA would use when assessing whether licensees are jointly SMP; and
- Section 6 provides a high level summary of URCA's proposals for assessing SMP.

## **2. LEGISLATIVE CONTEXT FOR MARKET REVIEW**

The Electronic Communications Sector (“ECS”) in the Commonwealth of The Bahamas is governed by three separate but interrelated Acts of Parliament, namely:

- the Communications Act, 2009 (“the Comms Act”);
- the Utilities Regulation and Competition Authority Act, 2009 (“the URCA Act”); and
- the Utilities Appeals Tribunal Act, 2009 (“the UAT Act”).

The URCA Act established URCA as the converged sector regulator and competition authority for electronic communications networks and carriage services.<sup>1</sup> The Comms Act complements the URCA Act and grants unto URCA wide ranging *ex ante* and *ex post* powers to regulate licensees operating in the ECS. Further, the Comms Act establishes an SMP-based system of ex-ante regulation and outlines the approach that URCA must undertake in relation to SMP licensees.

In the performance of its functions, as it pertains to SMP, Part VI of the Comms Act defines URCA’s powers with respect to market reviews and the overarching framework applicable to those reviews. Section 39(2) of the Comms Act bestows upon URCA the remit to establish the appropriate criteria applicable when defining the relevant markets in the ECS, and against which an objective assessment of market power can be undertaken:

*“URCA shall establish and publish criteria –*  
*(a) relating to the definition of markets in the electronic communications sector;*  
*and*  
*(b) against which market power may be assessed,*

*for the purpose of making a determination under subsection (1).”*

The criteria, duly established in accordance with s.39(2), are for the purpose of making a determination of SMP under 39(1):

*“URCA may at any time determine that a licensee is an SMP licensee if the licensee, individually or with others, enjoys a position of economic strength which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors, consumers and subscribers.”*

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<sup>1</sup> Telecommunications, broadcasting (including pay TV), and radio frequency spectrum.

In making that determination of SMP, the Comms Act, at s.39(3) provides a non-exhaustive list of criteria against which any given licensee is to be assessed by URCA, namely:

- (a) *the licensee's market share;*
- (b) *the licensee's ability to influence market conditions;*
- (c) *the licensee's access to financial resources;*
- (d) *the licensee's experience in providing products to the market; and*
- (e) *any other criteria considered relevant by URCA.*

### **3. METHODOLOGY FOR MARKET DEFINITION**

In keeping with established principles of sound regulatory governance, URCA shall by this consultation establish the methodology for market reviews. The proposed methodology outlines URCA's approach to market definition and the assessment of market power in accordance with Part VI of the Comms Act and is applicable to retail, and wholesale markets. URCA's proposed approach to market definition is similar to that used for purposes of competition.<sup>2</sup> However, there are some notable differences in application. Market definition in the context of competition or *ex post* inquiries focuses on specific services (that is, it has a 'focal product or service' which is central to a complaint or investigation) and is usually retrospective. In contrast, market definition in the case of *ex ante* or SMP analysis is normally forward looking and does not proceed from an initial 'focal product or service'. Consequentially, it is often the case that markets defined for the purposes of implementing *ex-ante* regulation are wider than the markets defined for the purposes of *ex post* inquiries.

In evaluating whether a licensee is an SMP licensee under s.39 of the Comms Act, URCA proposes to adopt a two-stage process. This approach is broadly consistent with best approaches used elsewhere for assessing SMP in communications.<sup>3</sup>

In the first stage URCA will define the relevant market. In the second stage URCA will identify any firm or firms that have SMP singularly or jointly in the defined relevant markets. In this section, URCA sets out its proposed approaches to market definition.

In defining markets URCA proposes to use the following main determinants of the relevant market, namely:

- the relevant service/product market which includes the services/products in question and all other services/products that are substitutable or interchangeable; and
- the relevant geographic market.

#### **3.1 Relevant Service/Product Market**

In the first step to defining the relevant service/product market, URCA will consider all product and services that are interchangeable, given appropriate characteristics and pricing. To that end, URCA will investigate demand-side and supply-side substitution by applying the SSNIP (Small but

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<sup>2</sup> ECS COMP.5-Market Definition at [www.urcabahamas.bs](http://www.urcabahamas.bs).

<sup>3</sup> The Office of Fair Trading (OFT) in the UK, Hong Kong, the Australian Competition and Consumer Commission (ACCC), EU, and regional regulators in Barbados, Jamaica, Anguilla, Cayman Islands.

Significant and Non-transitory Increase in Price) test. Demand-side substitution, in this methodological framework, means that as the price of the 'hypothetical monopolist' increases, consumers substitute away from the service(s)/product(s) under examination to substitute service(s)/product(s). Supply-side substitution refers to the ability of licensees not presently providing the service to increase or switch production capacity to the production of the service/product in response to a price increase by the 'hypothetical monopolist'.

### **3.1.1 SSNIP or Hypothetical Monopolist Test**

The SSNIP test, as discussed extensively in ECS COMP.5- Market Definition, is a standard conceptual approach used to identify demand-side and supply-side factors constraining the price setting behaviour of a 'hypothetical monopolist'. The initial reference point for the application of the SSNIP test is captured in the following question: 'if there was only one provider of a defined set of services/products in a defined geographical area, would that 'hypothetical monopolist' find a small but significant (and permanent) price increase (say 5-10%) profitable? If so, then a relevant market can be defined for *ex ante* regulatory purposes. The underpinning logic, is that, a profitable price increase can only be had where the competitive restraint of other services/products and other geographical areas is non-existent. The reason why a small but significant price increase might not be profitable is that the 'hypothetical monopolist' could lose a sufficiently large volume of business because of demand-side or supply-side substitution or both.<sup>4</sup>

When applying the SSNIP test, URCA will commence firstly from the narrowest set of services/products and geographical area, and gradually widen the scope of the products, until the answer to the question is in the affirmative. The services/products and geographical area included at that stage would be considered to be within the market.

In applying the SSNIP test, URCA will consider a period of one to two years as an appropriate "non-transitory" period.

### **3.1.2 Demand-side Substitution**

URCA will consider demand-side substitution when applying the SSNIP test to define the relevant service/product market. In the instance where a large number of end-users substitute away from the service(s)/product(s), even if many other end-users do not, the price increase would be unprofitable.

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<sup>4</sup> For a comprehensive discussion of market definition and dominance see the UK telecoms regulator's on *The Application of the Competition Act in the Telecommunications Sector*, January 2000. The document may be downloaded from Web site <http://www.oftel.gov.uk/competition/cact0100.htm>

### **3.1.3 Supply-side Substitution**

URCA will similarly consider supply-side substitution when applying the SSNIP test to define the relevant service/product market. The existence of prospective competitor that can quickly enter the relevant market would act as a constraining influence on the pricing behaviour of the 'hypothetical monopolist'.

Supply-side substitution is a form of market entry that is especially easy, inexpensive and effective. The easier it is for other licensees to make alternative services/products available and in sufficient quantity, the greater the constraint on the price setting behaviour of the 'hypothetical monopolist'. Where licensees are unable to respond or unable to switch supply in a reasonable time period or face significant cost of doing so, then the 'hypothetical monopolist' has sufficient market power for a price increase to be profitable. In those instances, supply-side substitution will be considered when assessing potential competition.

### **3.1.4 Evidence when Defining Relevant Product Markets**

URCA may take into account a range of evidence when defining the relevant markets. In doing so, URCA recognises that the type of evidence that will be of most use, and the type of evidence that would be available, will depend on the circumstances of each case.

URCA will therefore seek information from licensees when conducting market reviews. URCA may also contact relevant third parties, such as the main customers, suppliers and competitors in the ECS, in order to obtain their views about the boundaries of the service/product markets and to obtain other factual evidence.

Requests for information of this kind will usually include questions relating to the recipient's perceptions of likely reactions to hypothetical price increases. URCA may also request interviews with relevant employees or carry out site visits, in order to better inform its analysis.

As an initial step in considering pertinent evidence necessary to defining the relevant market, URCA would most likely undertake an analysis of the relevant service's/product's characteristics, intended use and/or users and the price of the service/product. However, although a service's/product's characteristics and intended use and/or user will often provide a useful starting point for the analysis, it will usually be necessary to consider other criteria, *inter alia*:

- **Evidence of Previous Substitution:** URCA will consider in its deliberations instances where recent past events or shocks in the market may have been facilitated by substitution between similar services/products. By way of illustration, instances where changes in relative prices induced appropriate changes in quantity may be highly indicative of substitutability. Additionally, past launches of new services/products may be indicative of services/products intended to replace or substitute existing ones.

- **Consumer Preferences:** URCA may conduct its own surveys to gather the direct views of end consumers about substitute services/products. Where it is impossible or impractical to do so, URCA will take into account any available pre-existing evidence of consumer preferences, including marketing studies commissioned by licensees, recent consumer surveys, data from consumers' purchasing patterns and/or market research studies. URCA may also have regard to independent surveys which have already been conducted. Where URCA uses a consumer survey conducted by or on behalf of a licensee, URCA may give consideration to it but will carefully assess the methodology adopted to ensure that the evidence is robust and reliable.
- **Barriers and Switching Costs:** URCA recognises that there are instances where similar services/products may appear on an initial assessment to be demand-side substitutes, but there may be barriers to and/or costs of switching that renders those services/products from constituting one single service/product market. Examples of these would include regulatory barriers or other forms of state intervention, the need to incur specific capital investment in order to switch to alternative inputs, the location of customers, learning and human capital investment, and uncertainty about the quality and reputation of unknown suppliers. URCA will consider whether such barriers or switching costs exist and, in such instances, URCA will assess their likely impact on the level of substitution.
- **Quantitative Studies:** URCA will consider quantitative studies, inclusive of statistical and econometric methods, that speak to own price and cross price elasticity of demand of a service/product or group of services/products. URCA recognises that such studies normally require a substantial amount of information that might not be readily available, but where these studies are available, URCA may take such evidence into account where it can be shown to be robust and reliable, and fit for purpose.

**Proposal No. 1: Statement on Defining Relevant Service/Product Markets**

*URCA proposes to utilize the SSNIP test to define the relevant service/product market. In doing so, URCA proposes to have regard to the following criteria, inter alia:*

- *Demand Side Substitution;*
- *Supply Side Substitution;*
- *Evidence of Previous Substitution;*
- *Consumer Preferences;*
- *Barriers and Switching Costs; and*
- *Quantitative Studies.*

## **3.2 Relevant Geographic Market**

In defining the relevant market, URCA must also consider the appropriate geographic boundary of the market. This is usually defined in terms of the entire country, a region within a country, etc. The geographic boundaries of the relevant market are defined by the extent to which the product(s) of competing licensees at different geographical locations or regions can impose competitive constraints on the price setting behaviour of the hypothetical monopolist. It is only when the geographical dimension of the relevant market has been determined that URCA may properly assess the conditions of effective competition therein.

### **3.2.1 Evidence when Defining Relevant Geographic Markets**

URCA will generally take a preliminary view of the scope of the geographic market on the basis of broad indications as to customers' preferences, current geographic patterns of purchase and technical or regulatory barriers, as well as a preliminary analysis of pricing and price differences between different areas. This preliminary view will be used as a working hypothesis in URCA's further analysis to reach a more precise geographic market definition.

The types of evidence that URCA is likely to consider relevant to an assessment of the scope of the relevant geographic market are as follows:

- **Past Evidence of Customers Diverting Orders to Suppliers in Other Areas:** URCA will consider evidence of changes in prices between different areas and consequent reactions by customers as being indicative of geographic regions within the same market. URCA will therefore apply the same quantitative tests used for product market definition for geographic market definition.
- **Basic Demand Characteristics:** The nature of demand for the relevant product may in itself limit the geographic scope of the market. Limiting factors might include local preferences, language, culture or lifestyle.
- **Views of Third Parties:** URCA may contact the main customers, suppliers and competitors of licensees to gather their views on the boundaries of the geographic market and other relevant factual information.
- **Barriers and Switching Costs:** URCA will consider the extent to which there are barriers or costs associated with diverting demand to companies located in other areas. These may include regulatory barriers (for example, licensing for particular territories), technical barriers (such as the reach or footprint of particular networks) and physical barriers (such as between islands). There may also be switching costs associated with changing from one network supplier to another (for example, additional equipment or upgrade costs).

**Proposal No. 2: Statement of Defining Relevant Geographic Markets**

*URCA proposes to have regard to the following criteria when defining the relevant Geographic market, inter alia:*

- *Past Evidence of Customers Diverting Orders to Suppliers in Other Areas;*
- *Basic Demand Characteristics;*
- *Views of Third Parties; and*
- *Barriers and Switching Costs.*

## **4. CRITERIA FOR ASSESSING MARKET POWER**

Section 39(1) of the Comms Act states that "*a licensee is an SMP licensee if the licensee, individually or with others, enjoys a position of economic strength which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors, consumers and subscribers.*"

When assessing SMP the Comms Act established at s.39(3) a list of criteria against which market power may be measured, namely:

- *the licensee's market share;*
- *the licensee's ability to influence market conditions;*
- *the licensee's access to financial resources;*
- *the licensee's experience in providing products to the market*

Each of the above stated criterions is discussed below.

### **4.1 Licensee's Market Share**

A licensee's share of the relevant market is a useful starting point in identifying licensees having SMP. Market share may be measured by total gross revenues in the market, total subscriber numbers, total traffic volumes and total capacity. URCA however recognises that if not used in conjunction with other indicators, market share alone could be a misleading measure of market power. A licensee that has substantial market share in the relevant market might be constrained in its price setting behaviour by the fact that entry barriers are low or non-existent. In addition, buyers could also have substantial bargaining power as is the case if there is only a single buyer (monopsonist). URCA recognises that a licensee with a small market share is unlikely to have SMP unless barriers to entry are high and competition from other licensees in the market was ineffective. Thus, the use of market share as an indicator of market power needs to be considered in the context of an examination of market conditions such as entry conditions and the behaviour of competitors and customers.

URCA proposes, for ease of administration, to establish certain thresholds for SMP, namely"

- a licensee with less than 25% market share will be presumed to be a non-SMP licensee;
- a licensee with at least 75% market share will be determined to be a SMP licensee; and
- a licensee with a market share of between 25% and 75% will be presumed to be a SMP licensee.

These thresholds are starting points only and do not supersede the definition of SMP as stated in s.39(1) of the Comms Act. URCA will therefore not proceed to investigate whether a licensee

is an SMP licensee unless it considers that the conduct of the licensee in question exhibits the features of market power within the meaning of s.39(1) of the Comms Act. ***URCA welcomes comments and alternative proposals from interested parties on the thresholds proposed above.***

#### **4.2 Licensee's Ability to Influence Market Conditions**

A licensee's ability to influence market conditions can be indicative of that licensee having a position of SMP. That ability to influence market conditions may be manifested, *inter alia*, in the Licensee's ability to set prices in the relevant market independently of market conditions, competitors, customers and consumers, to set prices in the relevant market consistently and significantly higher than the competitive level, or to limit the ability of customers to switch. The underpinning rationale is focus on the licensee's ability to shape the structure of the market and provide that licensee with an unfair competitive advantage. URCA will, in accordance with s.39(3) of the Comms Act, use the Licensee's ability to influence market conditions as described in this part to as being indicative of that licensee having SMP.

#### **4.3 Access to Financial Resources**

The ease or privilege at which a Licensee can access financial resources on a scale that places that Licensee at an advantage over other Licensees, has been deemed a factor favourable under s.39(3) of the Comms Act for determining that Licensee as having SMP. URCA recognises that any 'special' privilege access to financial resources, afforded to a Licensee, can potentially act as a barrier to entry or provide an unfair advantage to a Licensee. In those instances, the Licensee with easy access to financial resources will allow that Licensee to influence the structure of the market and potentially exclude other market participants. URCA will in accordance with s.39(3) of the Comms Act use the ease at which a Licensee can access financial resources, as described in this section as being indicative of that licensee having SMP.

#### **4.4 Licensee's Experience in Providing Products to the Market**

The experience derived from introducing new and providing existing services/products to the market can be invaluable to the development and sustainability of a competitive advantage by a Licensee operating in the ECS. The advantage derived from the concept of learning-by-doing can improve productivity and economic efficiencies, which should inevitably lead to lower wholesale and retail rates and prices. URCA is however mindful that learning-by-doing may not be easily replicated by new licensees to the ECS and the inability to transfer technical 'know-how' and 'know-why' may restrict effective competition in the short to medium terms. URCA further recognises that an established licensee may be able to leverage its experience and knowledge in the ECS to secure and maintain an economic position of strength that enables it to an appreciable extent, behave independently of other licensees, consumers or subscribers. This is

typically manifested in the established licensee's control (implicit or otherwise) over distribution and supply channels, advertising and access to the electronic and print media, and over key human capital resources.

**Proposal No. 3: Statement on Mandatory Criteria for Assessing Market Power**

*URCA shall use the following mandatory criteria for assessing market power:*

- *Licensee's Market Share;*
- *Licensee's Ability to Influence Market Conditions;*
- *Access to Financial Resources;*
- *Licensee's Experience in Providing Products to the Market*

*URCA proposes to use the following thresholds when defining market share which being measured by total gross revenues in the market, total subscriber numbers, total traffic volumes or total capacity:*

- *a licensee with less than 25% market share will be presumed to be a non-SMP licensee;*
- *a licensee with at least 75% market share will be determined to be a SMP licensee; and*
- *a licensee with a market share of between 25%-75% will be presumed to be an SMP licensee.*

*URCA may consider alternative proposals from interested parties on the proposed thresholds once those proposals are supported by empirical evidence and sound reasoning.*

The statutory criteria against which market power will be measured are non-exhaustive and URCA has the remit, under s.39(3)(e) of the Comms Act, to consider other relevant measures of market power. To this end, URCA proposes to have regard to the additional criteria listed below and any other relevant measures of market power it considers necessary from time to time, *inter alia*:

- barriers to entry;
- number of active competitors;
- extent of countervailing power among buyers;
- prices and profitability;

- vertical relationships;
- the influence of other members of the licensee's group;
- economies of scale; and
- economies of scope.

Each of the above stated criteria is discussed below.

#### **4.5.1 Barriers to Entry**

The existence of SMP in a market is largely a function of the ease with which potential competitors may enter the relevant market and compete effectively against established operators. In electronic communications, entry is very frequently restricted by the availability of licences to potential entrants to facilitate these entrants to compete against the incumbent. But even in markets in which entry is not barred by legal restrictive arrangements, there may be economic barriers which deter entry or make entry unfeasible. Economic barriers to entry may be derived from incumbency advantage, for example customer inertia, the large sunk cost to establish electronic communications systems, cost of switching from the incumbent operator to a competing operator, uncertainty of new entrant's service quality, and unfair access by competitors to the electronic communications systems operated by an incumbent operator. Incumbency advantages also arise through control over essential network components. In some markets the finite nature of the radio frequency imposes a restriction on the number of operators in the cellular mobile telephony market and other wireless technologies. URCA may consider barriers to entry when making an assessment of a licensee having SMP in a relevant market.

#### **4.5.2 Number of Active Competitors**

The number of active licensees in a relevant market gives some indication of the level of competition in that market, but must be considered in the light of other indicators of market power such as barriers to entry and licensing conditions. The ease with which licences are obtained, the costs of establishing, maintaining and operating the licensed systems in a particular geographic area, and specific obligations attached to licences are important factors to consider. Operators in a duopoly will also generally possess market power because, with only two operators, tacit collusion is likely to be relatively easy. In general, the larger the number of operators in a market, the less likely it is that any individual operator will possess significant market power. URCA may consider number of active licensees in a relevant market when making an assessment of a licensee having SMP in that relevant market.

#### **4.5.3 Extent of Countervailing Power among Buyers**

Under certain circumstances a buyer may impose constraints on the price setting behaviour of the 'hypothetical monopolist'. This may exist in a number of ways, inclusive of instances:

- where the buyer's share of purchases constitutes a sizeable proportion of the supplier's output<sup>5</sup>;
- where the buyer's share of purchases constitutes a sizeable proportion of the supplier's total cost;
- where the buyer has alternative sources of supply; and
- where the buyer can switch between suppliers easily but the supplier has invested in assets specific to that buyer.<sup>6</sup>

In retail markets buyer power is usually limited to large business customers, such as multinational corporations. However, buyer power in intermediate markets, for example, interconnection and wholesale, is only beneficial to end-users when it exerts downward pressure on retail suppliers' prices which in turn lead to lower prices to end-users. URCA may consider the extent of countervailing power amongst buyers when making an assessment of a licensee having SMP in a relevant market.

#### **4.5.4 Prices and Profitability**

In examining market power, and by extension the extent of market competition, focus is usually directed on the process of price formation in the relevant market. This requires an examination of the way in which prices are set which might include predation, price leadership, and parallel pricing. Further, the profitability of firms operating in the relevant market can be an indication of the extent to which market power is influencing price formation. A position of SMP is often associated with the existence of profit in excess of the minimum return required to compensate investors. URCA may consider prices and profitability of any given licensee when making an assessment of SMP in a relevant market.

#### **4.5.5 Vertical Relationships**

In analysing market power the vertical integrated nature of licensees operating in the ECS needs careful consideration. Vertical integration exists where a licensee operates at both the

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<sup>5</sup> In this situation the buyer is in a position to influence the price it pays since any one supplier would not want the buyer to reduce or stop purchasing and switch to an alternative supplier. Residential and micro businesses will generally be too small and diffused to exert an effective constraint on the price setting behaviour of suppliers.

<sup>6</sup> In this regard there are no alternate uses which the assets can be put, or other buyers to whom sales can be made. Sometimes buyers have access to alternate supply on cost competitive terms, for example by in-house production.

downstream (retail) and upstream (wholesale/interconnection) segments of electronic communications industry. By way of illustration, an established electronic communications licensee providing wholesale inputs to other licensees in the wholesale markets while simultaneously competing with those licensees in the associated retail markets indicates the presence of a vertical licensee. In the instance that the vertical integrated licensee enjoys a position of SMP in the upstream market, that licensee may be able to leverage its upstream SMP in the downstream market to frustrate downstream market participants. URCA recognises however that vertical integration need not necessarily constitute a barrier to entry since such a vertically integrated licensee may have low market share and other legal, economic or technological barriers to entry may be non-existent. That notwithstanding, URCA may consider vertical integration of any given licensee when making an assessment of SMP in a relevant market.

#### **4.5.6 The Influence of Other Members of the Licensee's Group**

URCA recognises that in some instances, a licensee may be able to leverage market power from closely related markets, especially where the licensee's affiliates may be involved in the markets in question. URCA will consider the potential influence of other members of the licensee's group in its assessment of SMP, as this may be indicative of SMP if the licensee and its affiliates can act together to exclude competitors.

#### **4.5.7 Economies of Scale**

As a long run concept that refers to the reduction in the unit cost of production as the size of the licensee and the usage levels of inputs increases, economies of scales can impinge upon market structure. URCA recognises that economies of scale may lend itself to reduction in effective competition in the long run and in some instances in the ECS, towards a monopoly market equilibrium. URCA is however duly cognisant that economies of scale can also lend itself to lower market prices as the unit cost of production decreases with the expansion of output and the size of the firm. URCA will therefore in its deliberation of SMP evaluate the economies of scale and its impact upon the structure of the market.

#### **4.5.8 Economies of Scope**

URCA recognises that in the ECS any given licensee can reduce average cost when producing two or more services/products. This arises from the utilization of the same inputs to produce multiple outputs. The reduction of average cost from economies of scope should ideally lead to lower prices to end users. URCA is however mindful that an SMP licensee with economies of scope may behave in an appreciable manner independent of consumers and not reduce prices accordingly. Further there may be instances where an SMP licensee leverages economies of scope in its service offering, as manifested through bundling which may potentially retard

competition. URCA will therefore in its deliberation of SMP evaluate the economies of scope and its impact upon the licensee within the relevant market.

**Proposal No. 4. Statement on Optional Criteria for Assessing Market Power**

*URCA proposes to use the following additional criteria for assessing market power, inter alia:*

- *barriers to entry;*
- *number of active competitors*
- *extent of countervailing power among buyers;*
- *prices and profitability;*
- *vertical relationships;*
- *the influence of other members of the licensee's group;*
- *economies of scale; and*
- *economies of scope.*

## **5. CRITERIA FOR ASSESSING JOINT SMP**

URCA is mindful that in some instances any one licensee may not meet the criteria established for having SMP. However, the behaviour of that licensee combined with that of another licensee can result in a degree of market power sufficient to permit both entities to behave to an appreciable extent independently of other licensees, consumers or subscribers. In instances where both licensees are legally and economically independent of each other but able to co-ordinate their behaviours (tacitly or otherwise), they are considered to have collective or joint SMP. In evaluating joint SMP, URCA will give consideration to the following criteria, *inter alia*:

- Marker concentration;
- Cost structures;
- Market share;
- Homogeneous services/products;
- Elasticity of demand;
- Potential competition;
- Barriers to entry; and
- Countervailing Buyers' power.

### **5.1 Market Concentration**

URCA recognises that joint dominance is more likely in a highly concentrated market with licensees having relatively similar market share. In such a situation the potential for tacit co-ordination, or otherwise, between licensees may arise to restrict new market entrants or to hasten the exit of existing licensees. URCA is mindful however that a highly concentrated market may not necessarily give rise to a finding of joint SMP. URCA when evaluating market concentration will give consideration to measurements of market concentrations, specifically the Hirschmann-Herfindal Index (HHI). That Index reflects the size distribution and number of firms in a given industry. The HHI is calculated by squaring the relevant market share of each firm competing in the relevant market and then summing the resulting numbers. For the purposes of market concentration URCA proposes to use the following HHI parameters to gauge market concentration:

- Un-concentrated if the HHI is less than 1000;
- Moderately concentrated if the HHI is between 1000 and 1800;
- Highly concentrated if the HHI is greater than 1800.

## **5.2 Cost Structures**

URCA is mindful that it is easier to collude where firms have similar cost structures, similar production capacity, or similar ranges of products. Cost asymmetry tends to rule out ‘focal point’ for pricing policies and so negate the potential to coordinate behaviours. It is more likely therefore, that licensees operating in the ECS may have different marginal cost functions which will render individual price preferences dis-similar for any given output levels.

## **5.3 Market Share**

URCA is mindful that similar market shares have the potential to limit competition especially where those market shares are static over time. The converse is typically true - large imbalance of market share makes joint dominance less likely.

## **5.4 Homogenous Services/Products**

URCA is duly cognisant that price competition is often more robust where service/products are similar or perceived to be similar by end users. However similarity of products may provide an incentive to collude in the medium- to long term as prices equate over time.

## **5.5 Elasticity of Demand**

Elasticity of demand measures the responsiveness of demand to change in price. In the instance low elasticity of demand may enforce collusive behaviours, specifically in instances where consumer demand does not change much in response to price changes (presence of low elasticity of demand). Where low elasticity of demand exists there is typically less incentive by licensees to compete on prices and the change in price must be substantially great to stimulate further demand.

## **5.6 Barriers to Entry**

In the assessment of joint dominance URCA will consider the prospect of potential competitors entering the relevant market. The potential for competition may prevent existing licensees from increasing prices above competitive levels in the relevant market. However, potential competition is influenced, to some degree, by market structure, specifically, the ease at which market entry is permissible. Barriers to entry, where significant, may weaken or make absent the threat of potential competition. However, barriers to entry may be less relevant, in the instance where the market experiences continuous technological changes. Market entry, from the perspective of structural barriers and potential and actual entry are relevant to the assessment of joint dominance, although lack of entry may also be a rational decision given price signals and potential profits.

## 5.7 Countervailing Buyers' Power

In the assessment of joint dominance URCA will consider countervailing power as discussed previously in reference to SMP (refer to section 4.5.3).

### **Proposal No. 5. Statement on Criteria to be used for Assessing Joint SMP**

*URCA proposes to use the following criteria for assessing Joint SMP, *inter alia*:*

- *Market concentration;*
- *Cost structures;*
- *Market share;*
- *Homogeneous services/products;*
- *Elasticity of demand;*
- *Potential competition;*
- *Market entry; and*
- *Countervailing Buyers' power.*

*URCA proposes to use the following HHI parameters to gauge market concentration:*

- *Un-concentrated if the HHI is less than 1000;*
- *Moderately concentrated if the HHI is between 1000-1800; and*
- *Highly concentrated if the HHI is greater than 1800.*

## **6. CONCLUSION**

URCA has in accordance with s.39(2) of the Comms Act articulated its proposed methodological approach for Market Reviews and for the assessment of SMP by any licensee operating in the ECS. URCA now invites comments from interested parties on this proposed approach and the following proposals, namely:

### **Proposal No. 1: Statement of Defining Relevant Service/Product Markets**

*URCA proposes to utilise the SSNIP test to define the relevant service/product market. In doing so, URCA proposes to have regard to the following criteria, inter alia:*

- *Demand Side Substitution;*
- *Supply Side Substitution;*
- *Evidence of Previous Substitution;*
- *Consumer Preferences;*
- *Barriers and Switching Costs; and*
- *Quantitative Studies.*

### **Proposal No. 2: Statement of Defining Relevant Geographic Markets**

*URCA proposes to have regard to the following criteria when defining the relevant Geographic market, inter alia:*

- *Past Evidence of Customers Diverting Orders to Suppliers in Other Areas;*
- *Basic Demand Characteristics;*
- *Views of Third Parties; and*
- *Barriers and Switching Costs.*

**Proposal No. 3: Statement on Mandatory Criteria for Assessing Market Power**

URCA shall use the following mandatory criteria for assessing market power:

- Licensee's Market Share;
- Licensee's Ability to Influence Market Conditions;
- Access to Financial Resources;
- Licensee's Experience in Providing Products to the Market

URCA proposes to use the following thresholds when defining market share which being measured by total gross revenues in the market, total subscriber numbers, total traffic volumes or total capacity:

- a licensee with less than 25% market share will be presumed to be a non-SMP licensee;
- a licensee with at least 75% market share will be determined to be a SMP licensee; and
- a licensee with a market share of between 25%-75% will be presumed to be an SMP licensee.

URCA may consider alternative proposals from interested parties on the proposed thresholds once those proposals are supported by empirical evidence and sound reasoning.

**Proposal No. 4. Statement on Optional Criteria for Assessing Market Power**

URCA proposes to use the following additional criteria for assessing market power, *inter alia*:

- barriers to entry;
- number of active competitors
- extent of countervailing power among buyers;
- prices and profitability;
- vertical relationships;
- the influence of other members of the licensee's group;
- economies of scale; and
- economies of scope.

**Proposal No. 5. Statement on Criteria to be used for Assessing Joint SMP**

URCA proposes to use the following criteria for assessing Joint SMP, *inter alia*:

- *Market concentration;*
- *Cost structures;*
- *Market share;*
- *Homogeneous services/products;*
- *Elasticity of demand;*
- *Potential competition;*
- *Market entry; and*
- *Countervailing Buyers' power.*

URCA proposes to use the following HHI parameters to gauge market concentration:

- *Un-concentrated if the HHI is less than 1000;*
- *Moderately concentrated if the HHI is between 1000 and 1800; and*
- *Highly concentrated if the HHI is greater than 1800.*

**For completeness, interested parties need not necessarily confine comments to these specific proposals.**