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ERG Report
on
Guidance on the application of the three criteria test

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Executive Summary

1. Introduction

On 17 December 2007, the European Commission adopted the Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation. In line with the 2003 Recommendation, in the new document reference is made to the application of the following three criteria in order to determine whether a market is a candidate market for *ex ante* regulation:

- (a) the presence of high and non-transitory barriers to entry;
- (b) a market structure which does not tend towards effective competition within the relevant time horizon;
- (c) the insufficiency of competition law alone to adequately address the market failure(s) concerned.

The implications arising from the application of the three criteria test have been a source of concern for I/ERG, as discussed in I/ERG's Opinion on the draft Recommendation on relevant markets¹, and are likely to become more prominent in the second round of market analysis initiated recently by NRAs, due in particular to the fact that the list of candidate markets has been reduced from 18 to 7.

2. Experience by NRAs regarding the application of the three criteria

The experiences gathered to date in the first round of market analysis reveal different practices in the application of the three criteria test, depending mostly on different obligations in the national law. The importance given by NRAs to the three criteria as a test itself also appears to have varied depending on the specific circumstances.

In general, experiences with the three criteria tend to confirm that in cases where both the three criteria test and SMP analysis is undertaken, it is difficult to dissociate the first criterion (barriers to entry) and the second criterion (tendency towards effective competition) from the elements that are considered in an SMP analysis. This also appears to be acknowledged in Recital 6 of the Recommendation.

Also, generally NRAs consider that the level of detail required in the assessment of the three criteria was in no instances higher than the level of detail required for SMP assessment. The same conclusions apply in relation to the burden of proof, where again the common view is that in no circumstances was the burden of proof for assessment of the three criteria higher than the burden of proof necessary to show the existence (or absence) of SMP.

3. Indicators that may be of relevance for the purposes of applying the three criteria

With regard to each of the three criteria identified by the Commission, the following indicators may be of assistance to NRAs when assessing fulfilment, or otherwise, of the three criteria test. The indicators listed below should not be considered a compulsory list of requirements or a closed list.

¹ IRG (07) 25.

(a) High and non transitory barriers to entry

NRAs have found it difficult to identify the main indicators acceptable to the European Commission to substantiate the existence of high entry barriers. According to the 2002 Commission Guidelines, the following indicators may be useful for NRAs to assess the magnitude of the barriers to entry.

- Existence of sunk costs
- Control of infrastructure not easily duplicated
- Technological advantages or superiority
- Easy or privileged access to capital or financial resources
- Economies of scale, economies of scope
- Vertical integration
- Barriers to develop distribution and sales network
- Products or services diversification

In addition, NRAs may examine whether high barriers to entry are susceptible to be non-transitory in the context of a modified Greenfield approach, that is, in the absence of regulation in the market concerned but including regulation which exists in markets that are upstream or closely related. In a modified Greenfield approach context, some of the barriers listed above might be reduced, for instance through the existence of a wholesale access obligation (which could reduce or eliminate barriers such as control of infrastructure not easily duplicated, technological advantages or superiority, and vertical integration) or the existence of a wholesale obligation of cost orientation.

With regard to legal barriers, in general terms they may be said to be relatively lower than structural barriers. However, general regulation might still affect the costs and the possibilities to enter a market. In particular, the need to obtain 'rights of way' in the access markets, spectrum availability, or collocation of GSM antenna, may increase the time and resources needed for entry in some relevant markets.

(b) Tendency towards effective competition

The second criterion assesses whether a market would tend towards effective competition without regulation and within the relevant time horizon. Therefore, the timeframe selected is very relevant for the analysis. As a forward-looking approach involves assumptions that are not easy to forecast, a shorter timeframe reduces the risk of committing assessment errors. Therefore it is reasonable to assume that the relevant time horizon to assess the second criterion should in principle be the same time horizon that is taken into account in the relevant market analysis.

The following criteria are possible indicators to assess whether a market tends towards effective competition.

- Market shares

- Price trends and pricing behaviour
- Control of infrastructure not easily duplicated²
- Product/services diversification (e.g. bundled products or services)
- Barriers to expansion
- Potential competition

(c) Sufficiency of competition law

In compliance with the third criterion, NRAs should assess whether competition law is sufficient to address market failures in electronic communications markets. This assessment may consider factors such as those set out below.

- Degree of generalization of non-competitive behaviour
- Degree of difficulty to address non-competitive behaviour
- Non-competitive behaviour brings about irreparable damage in related or connected markets
- Need of regulatory intervention to ensure the development of effective competition in the long run
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4. Burden of proof and interaction between the three criteria and SMP

The three criteria are cumulative criteria and therefore should be applied as a unity. Failure to meet one of the criteria will in any event necessarily lead to the conclusion that the market is not a candidate market for *ex ante* regulation.

Following the adoption of the 2007 Recommendation, and in view of the second round of market analysis that will be carried out by NRAs, the following five main scenarios may be envisaged.

1. Markets included in the 2007 Recommendation and that also according to NRAs should be regulated *ex ante*
2. Markets included in the 2007 Recommendation and that according to NRAs should not be regulated *ex ante*
3. Markets included in the 2003 Recommendation but excluded from the 2007 Recommendation and that according to NRAs should be regulated *ex ante*
4. Markets excluded from the 2007 Recommendation and that also according to NRAs should not be regulated *ex ante*

² Consideration of alternative infrastructures should be consistent with the conclusions reached in the application of the first criterion.

5. Markets that were not included either in the 2003 or the 2007 Recommendation but that according to NRAs should be regulated *ex ante*

With regard to Scenario 1 and 2 above, the assessment of the three criteria is not a necessary precondition for the review of markets already listed in the Recommendation, although NRAs remain free to undertake such an assessment if they so wish.

With regard to Scenarios 3 and 4 above, in these instances the three criteria test may be of particular relevance. Although each review conducted by NRAs will necessarily be case-specific, some general conclusions may be drawn with regard to the burden of proof and the interaction between the three criteria and SMP:

- First, the burden of proof necessary to demonstrate that the three criteria are (or are not) met should under no circumstances be higher than the burden of proof required for a finding (or no finding) of SMP. The same conclusions should also hold true with regard to the level of detail (data that needs to be supplied) necessary for the passing of the three criteria.
- Second, the obligations set by the three criteria test are symmetric in nature, in that the burden of proof should be the same regardless of whether a market that has been retained in the 2007 Recommendation is deemed not to be susceptible to *ex ante* regulation at national level, or whether a market that has no longer been retained in the 2007 Recommendation is considered to be susceptible to *ex ante* regulation at national level.
- Third, the burden of proof for fulfilling the three criteria test and maintaining at national level a market that was included in the earlier 2003 Recommendation but that is no longer included in the 2007 Recommendation should be lower than the burden of proof that may be required for defining a market that has never made part of the list of candidate markets retained by the European Commission in its Recommendations. This is because the conclusions drawn by the European Commission to justify withdrawal of a previously regulated market in the 2007 Recommendation may prove not to be valid at national level, where the market situation may still be closer to the one identified in the first round of market analysis.
- Last, a finding by the NRA that either the market fails to fulfil the three criteria test, or that no operator is deemed to have SMP, should in principle be sufficient to withdraw regulation after a reasonable period of notice has been given to affected parties. NRAs should therefore retain the possibility to notify withdrawal of a market exclusively on the basis of either absence to meet the three criteria or lack of SMP, it being unnecessary to carry out both assessments.

1. Introduction

On 17 December 2007, the European Commission adopted the Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications and services³ (hereinafter, “the Recommendation”). The Recommendation replaces the earlier 2003 European Commission Recommendation⁴.

In the new Recommendation, as well as in the Explanatory Note accompanying the text⁵, particular reference is made to the application of the so-called three criteria test for determining which markets are susceptible to *ex ante* regulation. According to Point 2 of the Recommendation, when identifying markets other than those set out in the Annex to the Recommendation, National Regulatory Authorities (“NRAs”) should ensure that the following three criteria are cumulatively met:

- (a) the presence of high and non-transitory barriers to entry. These may be of a structural, legal or regulatory nature;
- (b) a market structure which does not tend towards effective competition within the relevant time horizon. The application of this criterion involves examining the state of competition behind the barriers to entry;
- (c) the insufficiency of competition law alone to adequately address the market failure(s) concerned.

The three criteria are set up by the European Commission to serve as a first tool when considering whether a market may be subject to *ex ante* regulation. By reference to the three criteria test, the European Commission aims to establish a common framework for identifying relevant markets to be applied throughout the EEA in order to reduce national regulatory divergences.

By referring to the three criteria, the Commission is identifying markets that are at first sight susceptible to *ex ante* regulation. However, this does not mean that regulation will always be necessary. As stated in Recital 18 of the Recommendation, *“the fact that this Recommendation identifies those product and service markets in which ex ante regulation may be warranted does not mean that regulation is always warranted or that these markets will be subject to the imposition of regulatory obligations set out in the specific Directives. In particular, regulation cannot be imposed or must be withdrawn if there is effective competition on these markets in the absence of regulation, that is to say, if no operator has significant market power within the meaning of Article 14 of Directive 2002/21/EC [...]”*. Thus, in the context of market reviews, a finding of SMP will be a necessary pre-condition before regulation can be imposed on a relevant market.

³ OJ L344/25 of 28 December 2007.

⁴ OJ L114/45 of 8 May 2003.

⁵ Explanatory Note - Accompanying document to the Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications and services, SEC (2007) 1483 final.

The European Commission Recommendation is a “soft law” instrument, and thus is not legally binding on Member States and NRAs. According to article 249 EC Treaty, *“recommendations and opinions shall have no binding force”*. However, it is undeniable that the views of the European Commission as set in the Recommendation are important for the market review process that NRAs – in cooperation with the European Commission – must undertake. According to article 15(3) of Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the Framework Directive⁶), *“national regulatory authorities shall, taking the utmost account of the recommendation and the guidelines, define relevant markets appropriate to national circumstances, in particular relevant geographic markets within their territory, in accordance with the principles of competition law. National regulatory authorities shall follow the procedures referred to in Articles 6 and 7 before defining the markets that differ from those defined in the recommendation”*.

Some of the issues raised with regard to the application of the three criteria test by NRAs are not novel, as the test was already set out in the 2003 Recommendation. However, the practical challenges arising from its implementation are likely to become more prominent in the context of the second round of market analysis that NRAs have recently initiated.

In particular, the 2007 Recommendation reduces the number of markets that, in the view of the European Commission, are susceptible to *ex ante* regulation from 18 to 7. Considering that, in the first round of market analysis, the vast majority of the 18 markets initially included in the 2003 Recommendation were also retained by NRAs for the purposes of regulation at national level, practical issues are likely to emerge in relation to the possible maintenance of *ex ante* regulation on markets no longer considered in the new Recommendation, as well as with regard to the withdrawal of regulation in markets that – in line with the Recommendation – are no longer considered by NRAs as candidate markets for *ex ante* regulation.

The implications arising from the application of the three criteria test have been a source of concern for I/ERG, as discussed in I/ERG's Opinion on the draft Recommendation on relevant markets⁷. The experiences gathered to date in the first round of market analysis reveal different practices in the application of the three criteria test, depending mostly on different obligations in the national law. The objective of this ERG document is therefore to provide coherent guidance for NRAs in their application of the three criteria test.

For this purpose, the document deals with the following aspects.

- First, reference will be made to the experience so far by NRAs in their dealings with the European Commission regarding the application of the three criteria. These experiences, gathered via the submission of a questionnaire to NRAs, are further detailed in Annex 1 of the present document.
- Second, this document points to a number of indicators that may be of relevance for the purposes of applying each of the three criteria listed in the Recommendation.

⁶ OJ L108/33 of 24 April 2002.

⁷ IRG (07) 25.

- Third, the burden of proof that might be required in the application of the three criteria, and the interaction between the three criteria and SMP for the purposes of reviewing markets that are susceptible to *ex ante* regulation, is discussed.

2. Experience by NRAs regarding the application of the three criteria

As noted, experience in the application of the three criteria test has so far been limited, although this is very likely to change once NRAs proceed with the second round of market analysis. As showed in Annex 1, under national law a vast majority of jurisdictions are required to assess the three criteria prior to regulating a market not included in the Commission Recommendation⁸. This is because national law has generally followed the wording of article 15(3) of the Framework Directive, according to which, “*national regulatory authorities shall, taking the utmost account of the recommendation and the guidelines, define relevant markets appropriate to national circumstances [...]*”. Also in line with the Recommendation, NRAs are generally (unless otherwise specified by national law) not required to re-conduct a three criteria analysis for markets that have already been considered candidates for *ex ante* regulation in the European Commission Recommendation, and can thus proceed directly with the SMP assessment in order to determine whether there are operators that may be subject to regulatory obligations.

This document makes reference to around 20 instances in which issues relating to the application of the three criteria test were considered (see list provided in Annex 1). Based on the existing cases, so far there has been uncertainty on the approach regarding the application of the three criteria test, in particular in relation to essential aspects like the level of detail required (as opposed to the level of detail required in an SMP assessment) or the burden of proof necessary to satisfy the three criteria test. Also, according to NRAs it has been difficult to draw conclusions on what could be the main indicators to fulfil the three criteria or not.

The importance given by NRAs to the three criteria as a test itself also appears to have varied depending on specific cases. For instance, in relation to the second round of market analysis conducted by OFCOM in Case UK/2008/0748, *Wholesale trunk segments of leased lines* (a market no longer included in the 2007 Recommendation), the NRA stated that passing the three criteria test was not a legal requirement to impose remedies, thereby giving this test little importance in the presence of a detailed SMP analysis⁹. On the contrary, the application of a detailed three criteria test was determinative in cases like IE/2007/0697-0700, *Retail calls markets in Ireland*, where regulation was lifted exclusively on the basis of non-fulfilment of the three criteria.

It also transpires from existing cases that the European Commission does not have an established burden of proof for the fulfilment of the three criteria test. This is

⁸ In question 1c NRAs were asked whether they can regulate a market not included in the Recommendation without carrying out the 3 criteria analysis. 16 out of 19 respondents stated that this is not possible under their national law.

⁹ Nevertheless, upon specific request by the European Commission, OFCOM has throughout the notification process provided the Commission with evidence in relation to the fulfilment of the three criteria test.

explained by the fact that in some cases the Commission has deemed a short discussion of the three criteria test as sufficient (e.g. Case MT/2006/0389 *Transit services in the fixed public telephone network*), whilst in other cases a more detailed analysis of the three criteria test was not considered sufficient (e.g. Case PT/2005/154 *Transit services in the fixed public telephone network*).

Another unclear aspect remains the importance that the European Commission itself gives to the three criteria test in the presence of an SMP analysis. For example, in Case SE/2006/0341 *Wholesale trunk segments of leased lines*, in its comments letter the Commission states that it had some queries regarding the SMP analysis provided by the NRA, however since the market was excluded on the basis of the 3 criteria test, this was deemed sufficient to accept that the market was competitive. In contrast, in Case PT/2005/154 *Transit services in the fixed public telephone network* the Commission stated that the evidence provided for the three criteria test was insufficient to prove that the market was not susceptible to *ex ante* regulation, however based on the SMP analysis the NRA could adopt its final decision. These cases suggest that the overlap between the three criteria test and the SMP analysis is significant.

In general, experiences with the three criteria tend to confirm that in cases where both the three criteria test and SMP analysis is undertaken, it is difficult to dissociate the first criterion (barriers to entry) and also the second criterion (tendency towards effective competition) from the elements that are considered in an SMP analysis¹⁰. In those instances, it can be said that the level of detail required for the application of the three criteria has been lower than the level of detail required for SMP analysis. In any event, in general NRAs consider that the level of detail that was required in the assessment of the three criteria was in no instances higher than the level of detail required for SMP assessment. The same conclusions apply in relation to the burden of proof, where again the general conclusion is that in no circumstances was the burden of proof for assessment of the three criteria higher than the burden of proof necessary to show the existence (or absence) of SMP.

3. Indicators that may be of relevance for the purposes of applying the three criteria

According to Recital 5 of the Recommendation, to identify markets that are susceptible to *ex ante* regulation, it is appropriate to apply the following cumulative criteria: presence of high and non-transitory barriers to entry; structure that does not tend towards effective competition within the relevant time horizon; and sufficiency of competition law.

According to Recital 6, “*the main indicators to be considered when assessing the first and second criteria are similar to those examined as part of a forward-looking market analysis, in particular, indicators of barriers to entry in absence of regulation, (including the extent of sunk costs), market structure, market performance and market dynamics, including indicators such as market shares and trends, market*

¹⁰ This is also reflected in § 6 of the new Recommendation: “*the main indicators to be considered when assessing the first and second criteria are similar to those examined as part of a forward-looking market analysis [...]*”.

prices and trends, and the extent and coverage of competing networks or infrastructures”.

The Commission provides additional indicators in Recitals 9-11 for high entry barriers; Recital 12 for tendency towards effective competition; and Recital 13 for sufficiency of competition law.

According to these considerations, in the following paragraphs some additional guidance is provided to facilitate practical application of the three criteria test. These indicators could be useful to assess their compliance. However, they cannot be considered either a compulsory list of requirements or a closed list. NRAs should have the opportunity to determine which are the most relevant and suitable criteria applicable to the relevant market and the national circumstances.

High and non-transitory barriers to entry

The Recommendation states that “[s]tructural barriers to entry result from original cost or demand conditions that create asymmetric conditions between incumbents and new entrants impeding or preventing market entry of the latter”.

As it has been pointed out above, NRAs have found it difficult to identify the main indicators acceptable to the European Commission to substantiate the existence of high entry barriers. According to the 2002 Commission Guidelines, the following indicators may be useful for NRAs to assess the magnitude of the barriers to entry:

- Existence of sunk costs
- Control of infrastructure not easily duplicated
- Technological advantages or superiority
- Easy or privileged access to capital or financial resources
- Economies of scale, economies of scope
- Vertical integration
- Barriers to develop distribution and sales network
- Products or services diversification.

In addition, NRAs may examine whether high barriers to entry are susceptible to be non-transitory in the context of a modified Greenfield approach, that is, in the absence of regulation in the market concerned but including regulation which exists in markets that are upstream or closely related.

In a modified Greenfield approach context, depending on the case being analysed, some of the barriers to entry indicated above might be reduced to the benefit of new entrants. For instance, a wholesale access obligation could lower or even eliminate the following structural barriers to entry in a downstream market:

- Control of infrastructure not easily duplicated: new entrants may have access to, and make use of, specific network facilities of the incumbent.

- Technological advantages or superiority: alternative operators may access the technology used by the incumbent and compete with the same technological advantages.
- Vertical integration: the availability of regulated wholesale services may ease that new entrants gradually develop their own network on the basis of the incumbent's network.

A wholesale obligation of cost orientation in conjunction with an access obligation could further contribute to reducing the barriers to entry in a downstream market by allowing new entrants to acquire the necessary inputs at a price which would allow them to compete at the same level with the downstream provider of the incumbent.

Nevertheless, the availability of regulation in adjacent markets does not always guarantee a significant reduction or the elimination of the barriers to entry listed above. This could, for instance, be the case with regard to easy or privileged access to capital or financial resources, the existence of product or services diversification, or the development of a wide distribution and sales network.

NRAs should take into account any relevant factor that might affect their assessment, potentially increasing entry barriers faced by operators. In particular, developments in access technologies such as next generation access (NGA) investment could imply the necessity to extend the network to a lower network level, as unbundling of local loops may prove technically and economically difficult for alternative operators.

Finally, it might be useful to assess the effective impact that upstream remedies have on the entry of new operators, that is, whether obligations are effective and redress a market failure, or whether problems remain due to the incentives of the incumbent operator not to allow for new entry in spite of the existence of these obligations (i.e. undue delay in the provision of a regulated wholesale service, quality discrimination, etc.).

Regarding legal and regulatory barriers, the Recommendation states that, *“Legal or regulatory barriers are not based on economic conditions, but result from legislative, administrative or other state measures that have a direct effect on the conditions of entry and/or the positioning of operators on the relevant market”*.

The main legal barriers which can be found in the electronic communications markets are as follow:

- Need to obtain an administrative authorization or licence in order to operate in the market.
- Limits and conditions attached to the use of spectrum.
- Effects of general regulation over the new entrants.

In general terms, legal barriers may be said to be relatively lower than structural barriers. For instance, as a result of the new regulatory framework, entrants just need a general authorisation to enter the market, rather than a licence as in the previous framework, which reduces the administrative burden for operators. However, general regulation might still affect the costs and the possibilities to enter a market. In particular, the need to obtain ‘rights of way’ in the access markets, spectrum

availability, or collocation of GSM antenna, may increase the time and resources needed for entry in some relevant markets.

Tendency towards effective competition

The Recommendation states that, *“[e]ven when a market is characterised by high barriers to entry, other structural factors in that market may mean that the market tends towards an effectively competitive outcome within the relevant time horizon”*.

The second criterion assesses whether a market would tend towards effective competition without regulation and within the relevant time horizon. Therefore, the timeframe selected is very relevant for the analysis. As a forward-looking approach involves assumptions that are not easy to forecast, the shorter this timeframe, the lesser the risk of committing assessment errors. Therefore it is reasonable to assume that the relevant time horizon to assess the second criterion should in principle be the same time horizon that is taken into account in the relevant market analysis (otherwise there is a real risk of lifting regulation when effective competition is still some way off into the future).

As noted above, Recital 6 of Recommendation stresses that, *“the main indicators to be considered when assessing the first and the second criteria are similar to those examined as part of a forward-looking market analysis (...)”*. Therefore, possible indicators to analyse the second criterion are related to SMP analysis. In this sense, this report is taking into account considerations referred to by the ERG in the Working paper on the SMP concept for the new regulatory framework (ERG (03) 09rev3). In any case, the following criteria are possible indicators to assess whether a market tends towards effective competition. NRAs should have the opportunity to determine which are the most relevant and suitable criteria applicable to the relevant market and the national circumstances.

1) Market shares

Market shares could serve as a first indicator on whether a market tends towards effective competition.

NRAs could assess market shares either on the basis of volume or value of sales and their trend during the last years. In this sense, while persistence of a high market share over time can point towards the existence of dominance, declining market shares on the other hand may provide evidence of entry and increasing competition (although this may not always preclude a finding of dominance).

2) Price trends and pricing behaviour

NRAs could analyze price trends of services included in the reference market. In this context, the ability to price at a level that keeps profits persistently and significantly above the competitive level is an important indicator for market power. Again, this indicator could assist NRAs in assessing whether a market tends towards effective competition. This analysis logically depends on the availability of relevant data or whether, for example, a benchmarking is feasible.

3) Control of infrastructure not easily duplicated

NRAs could assess whether alternative operators can readily develop their own network to provide products/services which are included in the reference market or whether, considering a modified Greenfield approach methodology, regulatory measures may favour the existence of those alternative networks¹¹.

4) Product/services diversification (e.g. bundled products or services)

Product or service diversification can be observed particularly in more mature markets and is characterised by the fact that an undertaking is able to provide a “portfolio” of related products and services, which, especially when combined with bundling, may have the consequence of making competitive entry into the supply of one or more of the services potentially more difficult. In that sense product/services diversification may enable the undertaking in question to secure and maintain its client basis.

5) Barriers to expansion

There may be more active competition where there are lower barriers to growth and expansion. While growth and expansion is easier to achieve for individual firms (and in particular for new entrants) in growing markets, it might be inhibited in mature, saturated markets, where customers are already locked in with a certain supplier and have to be induced to switch.

6) Potential competition

The threat of potential entry may prevent undertakings in the relevant market from raising prices above competitive levels. However, if there are significant barriers to entry, this threat may be weak or absent. Under a modified Greenfield approach, regulatory measures imposed on SMP operators in related markets may reduce the barriers to entry. If such is the case, potential competition would increase, as undertakings may enter the relevant market within the time horizon considered.

Structural barriers plus any evidence of both potential and actual entry are relevant to the assessment, although lack of entry may also be a rational decision given price signals and potential profits.

Sufficiency of competition law

According to the Recommendation, *“the decision to identify a market should also depend on an assessment of the sufficiency of competition law to address the market failures that result from the first two criteria being met”*. The Recommendation also states that *“[c]ompetition law interventions are unlikely to be sufficient where the compliance requirements of an intervention to address a market failure are extensive or where frequent and/or timely intervention is indispensable”*.

In compliance with this criterion NRAs should assess whether competition law is sufficient to address market failures in electronic communications markets. This assessment may consider factors such as, for example, those set out below.

- 1. Degree of generalization of non-competitive behaviour.** Competition law may be considered to be sufficient if the frequency of NCAs’ intervention is likely to be low. On the other hand, if a market failure needs a frequent and/or

¹¹ Consideration of alternative infrastructures should be consistent with the conclusions reached in the application of the first criterion.

timely intervention, or if it is necessary to set remedies that involve the provision of an electronic communications service in terms, for example, of access conditions, pricing, etc., the existence of competition law may not be considered a sufficient basis to justify withdrawal or non-consideration of *ex ante* regulation.

With regard to competition problems arising in the context of vertical leveraging, *ex ante* regulatory measures may be required to prevent anticompetitive practices such as outright refusals to deal, constructive denial of access through excessive prices, and discrimination. An undertaking with SMP on one market may have the means and incentives to deny access to an essential input with the intent of extending monopoly power from one market to downstream markets.

In this context, in cases of vertical integration where one of the potential market failures identified is the leveraging of market power towards downstream markets, regulatory obligations could be needed. In these instances, it is important to recall that access mandated under competition law provisions would be subject to very strict requirements, which may find no application in the cases at stake. Similarly, the compliance requirements arising from administrative intervention will normally be too extensive for competition law alone (e.g. need for detailed accounting for regulatory purposes, assessment of costs, and so on)¹².

2. **Degree of difficulty to address non-competitive behaviour.** Some of the problems in the application of competition law rules relate to the difficulty to address anticompetitive behaviour (as competition authorities do not usually get information from operators on a regular basis), and the burden of proof when identifying such practices. In these scenarios, *ex ante* regulatory measures may be more effective than sanctions to prevent market failures and thus ensure the development of a competitive landscape.

In the assessment of excessive pricing scenarios arising in a context of single firm dominance, competition law may in certain instances be insufficient, due to the difficulties in the detection and proof of such conduct. In electronic communications, timely and efficient intervention against instances of excessive pricing is critical, due to its impact over customers, for example in the provision of access services or the provision of termination services. In these cases *ex ante* regulation as opposed to competition law is more effective in guaranteeing a timely and effective response. As mentioned above, it is also important to recall that mandatory access is more difficult to impose under competition law.

Likewise, competition law may in certain instances be insufficient to address problems arising in markets that exhibit collusive (collective dominance) features. Again, these market structures have an effect on consumers that is similar to exploitative excessive pricing, thus justifying the need for specific *ex ante* regulatory intervention.

¹² See also Explanatory Note, p. 34: “in addition, where competition is not effective, competition law is not sufficient to redress the market failure as, under competition law, the provision of wholesale broadband access services could not in principle be mandated, and compliance requirements would in any case be high (including detailed monitoring of cost and technical conditions)”.

- 3. Non-competitive behaviour brings about irreparable damage in related or connected markets.** According to the Recommendation, there are situations where timely intervention may be indispensable to prevent serious and irreparable damage to competitors.

In a context of leveraging, undertakings with SMP may have incentives to engage in conduct that increases barriers to entry, thus limiting the ability of competitors to successfully operate in the market. The effects of the conduct of the dominant undertaking will need to be carefully scrutinized, as once a particular conduct is successful it will be very difficult to bring the market dynamics back to the point of departure. This may justify, for example, regulatory scrutiny over bundled offers prior to the launch of such offers.

Moreover, regulatory surveillance under *ex ante* regulation may be required to address any potential attempts for vertical leveraging. This includes for instance an assessment of each individual offer as well as a price squeeze test where both wholesale and retail costs are taken into account¹³.

- 4. Need of regulatory intervention to ensure the development of effective competition in the long run.** The imposition of regulatory obligations may be deemed more efficient than competition law in those cases where particular objectives of article 8 of the Framework Directive are pursued. In some instances, the application of competition law rules may create some tension with the promotion of effective competition in dynamic terms. In particular, in those instances where duplication of infrastructure is possible, the application of *ex ante* measures that take into consideration the promotion of efficient investment may be more efficient in the long run than the application of competition law alone. In these cases, coordination of the regulatory conditions imposed in the different levels of the value chain may be considered key to attaining those objectives¹⁴.

4. Burden of proof and interaction between the three criteria and SMP

Experiences gathered so far by NRAs in the application of the three criteria reveal a different approach by the European Commission with regard to the burden of proof and evidence that might be required for sustaining that a market is (or is not) a candidate market for *ex ante* regulation. While the merits of each case will need to be addressed on an individual basis, this section aims to set some further insight on the way in which the three criteria test could be applied more consistently.

At the outset, it is important to stress that due to differences in the transposition of the European directives into national laws, or differences in the interpretation of the law, different opinions exist with respect to whether, and when, it is necessary to apply the three criteria test.

¹³ The fact that NRAs adopt an *ex ante* approach may also have an influence in the cost assessment methodology being considered.

¹⁴ As also noted in the Explanatory Note, p. 34: “Moreover, it is important to maintain co-ordination and consistency between regulation of wholesale broadband access and that of local loop unbundling”.

Following the adoption of the revised Recommendation on relevant markets, and in view of the second round of market analysis carried out by NRAs, the following five main scenarios with respect to the application of the three criteria test may be envisaged (see also flowchart in Annex 2)¹⁵:

Scenarios	Three Criteria	SMP
1. Markets included in the 2007 Recommendation and that also according to NRAs should be regulated <i>ex ante</i>.	Optional According to national circumstances ¹⁶	Yes
2. Markets included in the 2007 Recommendation and that according to NRAs should not be regulated <i>ex ante</i>.	Either 3 criteria test or SMP assessment may be sufficient (according to national circumstances)	
3. Markets included in the 2003 Recommendation but excluded from the 2007 Recommendation and that according to NRAs should be regulated <i>ex ante</i>.	Yes ¹⁷	Yes
4. Markets excluded from the 2007 Recommendation and that also according to NRAs should not be regulated <i>ex ante</i>.	Either 3 criteria test or SMP assessment may be sufficient (according to national circumstances)	
5. Markets that were not included either in the 2003 or the 2007 Recommendation but that according to NRAs should be regulated <i>ex ante</i>.	Yes	Yes

It is worth noting that the three criteria are cumulative criteria, and in ERG's view should be applied as a unity. Failure to meet one of the criteria will in any event

¹⁵ These scenarios assume that NRAs completed round 1 of market analysis, which was the case in the majority of jurisdictions. A sixth scenario, that where a market is no longer included in the 2007 Recommendation but was not made subject to regulation *ex ante*, is not assessed as in those cases. The Explanatory Note clarifies that in those instances “NRAs have no obligation to review that market”.

¹⁶ Some NRAs are required by national law to carry out a three criteria test as part of every market review even though the market has already been identified on the basis of the three criteria by the Commission (e.g. BNetzA).

¹⁷ The majority of NRAs (16 out of 19 respondents to the questionnaire) are required to carry out the three criteria test. However, Ficora and NCAH have stated that application of the three criteria test would not be necessarily required if attention was paid exclusively to national law. In the UK, OFCOM does not deem it obligatory to carry out the three criteria test for markets which have been determined uncompetitive under the 2003 Regulation, but is rather obliged to carry out a full SMP analysis to maintain or remove existing regulation. This has been the case for example with the second round of notifications for the leased lines markets. In this case OFCOM did not carry out a three criteria test for the wholesale trunk and terminating segments of leased lines. Nevertheless, in the end OFCOM still had to provide evidence in relation to the three criteria test following a specific request for information from the European Commission.

necessarily lead to the conclusion that the market is not a candidate market for *ex ante* regulation.

With regard to Scenario 1 and 2 above, for markets that had already been identified by the European Commission as candidate markets, NRAs generally focused in the first round of their analysis on SMP assessment alone, in order to determine whether a market should or not be made subject to *ex ante* regulation. According to the Commission's Explanatory Note to the Recommendation, *"for those markets listed, the Recommendation creates a presumption for the NRA that the three criteria are met and therefore NRAs do not need to reconsider the three criteria. However, it is open to a NRA to assess the three criteria in terms of whether they are satisfied for the specific market if the NRA believes that this would be appropriate"* (§ 2.2). The assessment of the three criteria is therefore not a necessary precondition for the review of markets already listed in the Recommendation, although NRAs remain free to undertake such an assessment if they so wish.

With regard to Scenarios 3 and 4 above, in these instances the three criteria test may be of particular relevance. Although each review conducted by NRAs will necessarily be case-specific, some general conclusions may be drawn with regard to the burden of proof.

First, the burden of proof necessary to demonstrate that the three criteria are (or are not) met should under no circumstances be higher than the burden of proof required for a finding (or no finding) of SMP. Also, it should be recalled that the first criterion (presence of high and non-transitory barriers to entry) and the second criterion (tendency towards effective competition) are inherently related to the SMP assessment. Therefore, in those cases where the SMP analysis will be undertaken (e.g., for the purposes of regulating a market no longer included in the Recommendation), reference to the SMP analysis should in principle be sufficient to prove that the first and second criterion are also met¹⁸. The same conclusions should also hold true with regard to the level of detail (data that needs to be supplied) necessary for the passing of the three criteria.

Second, as stated in the I/ERG Opinion on the draft Recommendation on relevant markets, ERG is of the view that the obligations set by the three criteria test are symmetric in nature, in that the burden of proof should be the same regardless of whether a market that has been retained in the 2007 Recommendation is deemed not to be susceptible to *ex ante* regulation at national level, or whether a market that has no longer been retained in the 2007 Recommendation is considered to be susceptible to *ex ante* regulation at national level.

Third, the burden of proof for fulfilling the three criteria test and maintaining at national level a market that was included in the earlier 2003 Recommendation but that is no longer included in the 2007 Recommendation (Scenario 3) should be lower than the burden of proof that may be required for defining a market that has never made part of the list of candidate markets retained by the European Commission in its Recommendations (Scenario 5). This is because the conclusions drawn by the European Commission to justify withdrawal of a previously regulated market in the 2007 Recommendation may prove not to be valid at national level, where the market

¹⁸ On the other hand, a more detailed analysis might be expected with regard to those jurisdictions that consider de-regulating a market on the basis of not fulfilling the three criteria test alone.

situation may still be closer to the one identified in the first round of market analysis. This “temporal element” is lacking with regard to new markets that have never been considered to be susceptible to *ex ante* regulation, which would thus require some further evidence by the NRAs as to the appropriateness of intervention¹⁹.

Also, in order to prove fulfilment of the three criteria test for maintaining regulation in a market listed in the 2003 Recommendation but not in the 2007 Recommendation (Scenario 3), in principle it should be sufficient for NRAs to substantiate why the elements invoked by the European Commission in its Explanatory Note to justify withdrawal of a market from the list on the basis of the three criteria are not applicable to the national circumstances, thus leading to the conclusion that the situation is closer to that existing under the 2003 Recommendation.

Last, the question remains as to what type of assessment NRAs might be expected to undertake with regard to markets included in the 2007 Recommendation but that, in the view of the NRA, are no longer susceptible to *ex ante* regulation at national level (Scenario 2), and with regard to markets no longer considered in the Recommendation, and that NRAs also deem are no longer susceptible to *ex ante* regulation at national level (Scenario 4).

In ERG’s view in both cases a finding by the NRA that either the market fails to fulfil the three criteria test, or that no operator is deemed to have SMP, should in principle be sufficient to withdraw regulation after a reasonable period of notice has been given to affected parties, as foreseen by article 16.3 of the Framework Directive. This position appears also to be confirmed by the Recommendation (see in particular, Recitals 17 and 18) as well as by the Commission’s practice in the first round of market analysis²⁰. Therefore, NRAs should retain the possibility to notify withdrawal of a market exclusively on the basis of either absence to meet the three criteria or lack of SMP, it being unnecessary to carry out both assessments²¹. In particular, NRAs should have the possibility of applying the argumentation used by the European Commission in the Recommendation in order to justify non-regulation of a market on the basis of non-fulfilment of the three criteria test also at national level, this being sufficient to remove regulation regardless of any SMP assessment, unless otherwise required under national law.

This position was already set by I/ERG in its Opinion on the draft Recommendation on relevant markets²², in which it is stated that in I/ERG’s view there could be two ways to withdraw regulation without showing the existence of SMP: (i) to conclude that the three criteria are not met anymore for the market at national level, or (ii) to

¹⁹ By the same token, segmentation of the markets included in the Recommendation should, in ERG’s view, also require a lower burden of proof than the identification of completely different/new markets.

²⁰ See, for instance, Case FR/2006/554: *Wholesale broadband access delivered at a single national point of presence in France*; Case DK/2007/618: *Broadcasting transmission services in Denmark*; Case LU/2006/542: *Transit services in the fixed public telephone network* (non-regulation or withdrawal of regulation on the basis of non-fulfilment of the three criteria test).

²¹ This position is also in line with the overall objectives pursued by the three criteria test and SMP assessment, which jointly aim at limiting regulation exclusively to those markets where overall failures can be anticipated – on the basis of the three criteria – and where at least one operator is deemed to have a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.

²² IRG (07) 25.

conclude that wholesale regulation is sufficient [according to article 17 Universal Service Directive] (in case of retail markets)²³.

As revealed in the consultation process for the preparation of this document, in a number of jurisdictions – due to the existence of stricter internal legislation – it will need to be considered whether, according to national law, withdrawal of existing obligations is possible on the basis of exclusive reference to the non-fulfilment of the three criteria.

5. Conclusion

The experiences gathered to date in the first round of market analysis reveal slightly different practices regarding the application of the three criteria, depending on national circumstances.. The importance given by NRAs to the three criteria as a test itself also appears to have varied depending on the specific case.

In general, experiences with the three criteria tend to confirm that in cases where both the three criteria test and SMP analysis is undertaken, it is difficult to dissociate the first criterion (barriers to entry) and also the second criterion (tendency towards effective competition) from the elements that are considered in an SMP analysis. This also appears to be acknowledged in Recital 6 of the Recommendation.

Also, generally NRAs consider that the level of detail that was required in the assessment of the three criteria was in no instances higher than the level of detail required for SMP assessment. The same conclusions apply in relation to the burden of proof, where again the common view is that in no circumstances was the burden of proof for assessment of the three criteria higher than the burden of proof necessary to show the existence (or absence) of SMP.

Moreover, the implications arising from the application of the three criteria test have been a source of concern for I/ERG, as discussed in I/ERG's Opinion on the draft Recommendation on relevant markets²⁴, and are likely to become more prominent in the second round of market analysis that NRAs have recently initiated, due in particular to the fact that the list of candidate markets has been reduced from 18 to 7.

With regard to the assessment of each of the three criteria identified by the Commission, the document discusses some indicators that may be of assistance to NRAs when assessing their fulfilment. However, the indicators should not be considered a compulsory list of requirements or a closed list.

Following the adoption of the 2007 Recommendation and in view of the second round of market analysis that will be carried out by NRAs, the document has envisaged the following five main scenarios:

1. Markets included in the 2007 Recommendation and that also according to NRAs should be regulated *ex ante*

²³ As noted above, sufficiency of wholesale regulation would be considered in the assessment of the first and second criteria.

²⁴ IRG (07) 25.

2. Markets included in the 2007 Recommendation and that according to NRAs should not be regulated *ex ante*
3. Markets included in the 2003 Recommendation but excluded from the 2007 Recommendation and that according to NRAs should be regulated *ex ante*
4. Markets excluded from the 2007 Recommendation and that also according to NRAs should not be regulated *ex ante*
5. Markets that were not included either in the 2003 or the 2007 Recommendation but that according to NRAs should be regulated *ex ante*

With regard to Scenario 1 and 2 above, the assessment of the three criteria is not a necessary precondition for the review of markets already listed in the Recommendation, although NRAs remain free to undertake such an assessment if they so wish.

With regard to Scenarios 3 and 4 above, in these instances the three criteria test may be of particular relevance. Although each review conducted by NRAs will necessarily be case-specific, some general conclusions may be drawn with regard to the burden of proof and the interaction between the three criteria and SMP. The ERG, in line with the comments to the Recommendation, considers that the burden of proof necessary to demonstrate that the three criteria are (or are not) met should under no circumstances be higher than the burden of proof required for a finding (or no finding) of SMP.

The obligations set by the three criteria test should be symmetric in nature, in that the burden of proof should be the same regardless of whether a market that has been retained in the 2007 Recommendation is deemed not to be susceptible to *ex ante* regulation at national level, or whether a market that has no longer been retained in the 2007 Recommendation is considered to be susceptible to *ex ante* regulation at national level.

It has been justified also the reasons why the burden of proof for fulfilling the three criteria test and maintaining at national level a market that was included in the earlier 2003 Recommendation but that is no longer included in the 2007 Recommendation should be lower than the burden of proof that may be required for defining a market that has never made part of the list of candidate markets retained by the European Commission in its Recommendations.

Finally, a finding by the NRA that either the market fails to fulfil the three criteria test, or that no operator is deemed to have SMP, should in principle be sufficient to withdraw regulation, after a reasonable period of notice has been given to affected parties.

ANNEX 1. NRA's EXPERIENCE WITH THE THREE CRITERIA TEST²⁵

1. According to your national law:

a) Is it possible to withdraw obligations that had been previously imposed, exclusively on the basis of the 3 criteria analysis? (that is, with no need to carry out an SMP assessment?)	YES (10 countries)	NO (8 countries)
b) Has your NRA powers under competition law rules as well?	YES (3 countries)	NO (18 countries)
c) Would it be possible to regulate a market not included in the Recommendation without carrying out the 3 criteria analysis?	YES (3 countries)	NO (17 countries)
d) Is it compulsory to analyse the 3 criteria in order to regulate a market already included in the Recommendation?	YES (2 countries)	NO (19 countries)

²⁵ The following countries have contributed to the preparation of this Annex, via submission of their answers to a Questionnaire that was submitted to NRAs: Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Hungary, Italy, Latvia, Malta, The Netherlands, Norway, Portugal, Romania, Slovenia, Spain, Sweden, United Kingdom. For some of the questions posed, information was not available by NRAs, which explains why in some cases the number of answers is smaller than the number of participants.

2. Mark which approach was used by the NRA in you country for each of the four cases below in the context of first round market analysis, i.e. under the 2003 Commission Recommendation (choose from 1 to 3)²⁶:

		Market in Recommendation		Market not in Recommendation	
			<i>Insert Number and Name of Market Analysed</i>		<i>Insert Number and Name of Market Analysed</i>
To Regulate	1. 3 criteria only		[not applicable]	1. 3 criteria only	[not applicable]
	2. SMP analysis only		13 countries	2. SMP analysis only	1 country
	3. 3 criteria and SMP analysis		6 countries	3. 3 criteria and SMP analysis	4 countries
Not to regulate or to Withdraw regulation	1. 3 criteria only		5 countries	1. 3 criteria only	1 country
	2. SMP analysis only		11 countries	2. SMP analysis only	1 country
	3. 3 criteria and SMP analysis		4 countries	3. 3 criteria and SMP analysis	1 country

²⁶ In some instances, Member States have used different approaches depending on each specific market being assessed. Likewise, within each individual market, different approaches may have been used on the basis of the different segmentations of the market (for instance, with regard to former market 18: broadcasting transmission services). Therefore, the number of responses is not necessarily identical to the number of participant NRAs.

3. Of the markets listed in Question 2, briefly explain your article 7 experiences (if any), during the first round of market analysis, regarding the application of the 3 criteria:

Market	Case number	MAIN INDICATORS (1)			EC main comments
		Barriers to entry	Trend towards effective competition	Sufficiency of Competition Law	
Norway (ex-market 18)	58296 (ESA)	X		X	
Sweden (ex-market 14)	SE/2006/0341	X	X		NRA undertakes both 3 criteria and SMP assessment to exclude regulation. EC has queries regarding SMP assessment, but in any event regulation excluded as 3 criteria not met.
Portugal (ex-market 10)	PT/2005/154		X	X	According to EC, 3 criteria analysis appears insufficient, but decision not to regulate is deemed adequate on the basis of lack of SMP
Portugal (telephone services for non-geographic numbers publicly available at a fixed location)	PT/2004/59	X	X	X	
Malta (ex-market 10)	MT/2006/0389	X	X	X	
Germany (regional BB conveyance)	DE/2007/0639	X	X	X	
Germany (ex-market 11)	DE/2007/0646	X	X	X	
Italy (ex-market 18)	IT/2006/0424	X			
Italy (retail leased lines > 2Mbits)	IT/2006/0371	X	X		

Market	Case number	MAIN INDICATORS (1)			EC main comments
		Barriers to entry	Trend towards effective competition	Sufficiency of Competition Law	
Italy (wholesale international services markets)	IT/2007/0695	X	X (but some of the 217 routes excluded on the basis of non-fulfilment second criterion)	X	
Italy (retail narrowband internet access services)	IT/2006/0693	X			
Greece (ex-markets 4,6)	EL/2006/556 EL/2006/557	X	X	X	
Austria (ex-market 18, cable)	AT/2003/0018	X	X	X	
Austria (ex-market 18, terrestrial TV and radio)	AT/2003/0018	X	X	X	
Denmark (ex-market 18)	DK/2007/618	X	X	X	
The Netherlands (retail markets for the supply of free to air radio and TV packages via cable transmission)	NL/2005/0247	X	X	X	

Market	Case number	MAIN INDICATORS (1)			EC main comments
		Barriers to entry	Trend towards effective competition	Sufficiency of Competition Law	
The Netherlands (12: WBA Low Quality)	NL/2005/0281	X	(similar to conclusion in SMP assessment)		EC agrees that market tends towards effective competition, NRA should however monitor competition problems as exclusion of regulation is essentially based on the second criterion
The Netherlands (wholesale access for <u>low</u> capacity connections on the public telephone network provided at a fixed location)	NL/2005/0297	X	(similar to conclusion in SMP assessment)		According to EC, 3 criteria test has not been conducted, EC invites NRA to conduct the test
The Netherlands (wholesale access for <u>high</u> capacity connections on the public telephone network provided at a fixed location)	NL/2005/0297	X	(similar to conclusion in SMP assessment)		According to EC, 3 criteria test has not been conducted, EC invites NRA to conduct the test
Latvia (ex-market 14)	LV/2007/0573		X		
Latvia (ex-market 18)	LV/2007/0694			X	

1 Main indicators: please briefly indicate which were the main indicators that were considered for the analysis of each of the three criteria.

ANNEX 2. FLOWCHART

