

Consumer welfare, innovation and competition

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1. Introduction

1. Good afternoon, ladies and gentlemen, it is my great pleasure to address you this afternoon, as Chairman of the Board of the Netherlands Competition Authority, (Nederlandse Mededingingsautoriteit, or as we call it, the NMa). I am going to talk to you about consumer welfare, innovation and competition from the perspective of the NMa.
2. I do not plan to deliver my views on any complex theories of intellectual property law. I will leave that to the distinguished academics among us - some of whom have already shown us their expertise this morning. What I will do is speak to you about the views of the NMa on these subjects. And I will illustrate in that context how we focus on consumer welfare in some recent cases of the NMa, and in our advocacy on this issue.

2. Role of competition law and policy, authorities and regulatory bodies in controlling the use of market power

3. When taking consumers' concerns into account, it is important to keep in mind the overall welfare of consumers in general. An individual consumer may complain about a supplier going out of business or being taken over. But that may be coloured by the inconvenience the consumer experiences due to having to develop a new commercial relationship with the newer, maybe bigger supplier. The consumer cannot be expected immediately to appreciate increased efficiencies. Similarly, when a new product appears on the market, consumers may be quick to complain about the

development of market power through intellectual property rights and the high prices such rights bring.

4. It is for the Competition Authority to step back and look at the market ex ante, before the innovative product was brought to the market, and realise that there will be increased choice for the consumer, which weighs favourably against the high price. It is important for a Competition Authority to listen carefully to consumer complaints, and to place them in the economic context ex ante.
5. Let us look at that economic context. I will begin with dominance. Dominance exists when an undertaking has considerable market power. We see this described, for instance in the European Commission's Guidelines on Enforcement Priorities for Article 82 of the Treaty. The Dutch equivalent of article 82 is section 24 of the Netherlands Competition Act. The wording of section 24 exactly mirrors that of article 82 EC and they both outlaw abuse of dominance. The law does not however outlaw dominance. Dominance as such is not the problem.
6. However, dominance may involve anticompetitive concerns. Dominance may be abused so that the competitive process is hampered, for instance by the foreclosure of efficient competitors, so that ultimately consumers are harmed. This is also explained in those same Commission Guidelines, which speak of anticompetitive foreclosure.
7. Since dominance is not of itself problematic, this raises an important question:

8. Should we allow a dominant firm to maximize profits, even if this involves a loss of consumer welfare in the short run, but it leads to a possible increase in consumer welfare in the long run?

Or

9. Should we intervene when a dominant firm engages in short run profit maximization?

10. The question is important because we do have the ability to intervene and constrain the pricing behaviour. Sector-specific regulators do so all the time. But should we do so, in a normally functioning market, just because a dominant player exists?

11. Think of the position of the potential competitor, waiting in the wings, to enter the market, as soon as the dominant firm goes too high in price. If the Competition Authority intervenes, although constraining pricing behaviour may increase short run consumer welfare, it may also interfere with the incentives of that potential competitor to enter the market. His profit perspectives are reduced, his incentive to enter is diminished.

12. Another problem with constraining the pricing behaviour of the dominant firm is that it may decrease incentives to innovate for both the dominant firm and potential entrants or small competitors. An easy example of this is the Microsoft/Apple story. There have been complaints for years about Microsoft gaining such a lead in the personal computer market over Apple. It was claimed that Apple really had the better technology, and that Microsoft made progress in the market simply because it can be used on any computer. Regardless of the accuracy of such claims, it seems that Microsoft's taking the lead in one market, spurred Apple to innovate on another market. Apple invented a clever new product, the I-Pod, and has

carved out its own niche. Had Microsoft been constrained in its campaign to ensure that everyone had a computer, would Apple have been able to develop a musical product designed around the fact that those buying it have computer access?

13. So we see this trade-off between short run (consumer welfare) interests – intervening to constrain price - and longer run (consumer welfare) interests, not intervening to allow the creation of incentives for new entrants and innovation.
14. On the other hand, the dominance may give an incentive to the dominant firm to prolong its market power beyond its normal lifespan. Then the trade-off swings in favour of intervention. Where the dominant firm uses its market power to compel its customers to boycott its competitors' products.... Or to deprive its competitors of access to raw materials... In such situations, where potential new entrants and innovations are foreclosed by the dominant firm, intervention is necessary to protect consumer welfare.
15. For a competition authority the trade-off I have just described is even more pressing than for regulators, since competition law usually applies to non-regulated firms. These firms are more likely to have established their dominant position by competing in a competitive surrounding.
16. Where dominant firms do not operate in a competitive surrounding, a sector-specific regulator is likely to be appointed. Price control is not the role of the NMa. Price control is the role of the specific regulator. The specific regulator constrains the pricing behaviour of the regulated firm,

while at the same time keeping incentives for the firm to invest and innovate.

17. Outside of the situation where there is foreclosure, there are two exceptional situations where a Competition Authority will be more likely to intervene. Firstly, there may be situations where a natural or legal monopoly exists, but for historical or political reasons, the dominant firm is not regulated. In that situation, the natural or legal monopoly may be exerted indiscriminately for a long period of time.
18. Secondly, demand for a product may be very inelastic (also in the longer run). In that case, demand does not vary significantly regardless of price variations. Hence prices may be so high for so long that the dominant player is overcompensated for investments and innovations.
19. Especially in situations that combine the two circumstances (a non-regulated natural monopoly with inelastic demand for instance), interfering with pricing behaviour may be justified.
20. Even then, a competition authority should take incentives into account. We should look at how and why incentives for investing and innovating will be influenced. This will allow us to determine whether or not pricing behaviour should be constrained and at what level.
21. Of course, not everyone fully supports this approach. While we all agree that consumer welfare should be at the heart of competition policy, we often disagree about how that should be done. My German colleagues will (probably) stress that the competitive process needs to be protected, as it is through the competitive process that the consumers' welfare improves.

At the NMa, on the other hand, our line is that protecting competition does not mean protecting all competitors, but protecting efficient competitors. Long-term consumer welfare is not enhanced by protecting small and medium sized enterprises, simply because they are small and medium sized.

22. This may seem like a minor difference of accent but it could be quite fundamental in the praxis of a competition authority. The most difficult lesson in competition, especially for politicians, is that competition among enterprises leads not only to winners, but to losers. This truism is of even more importance today as we face into economic crisis.

23. Especially in times of economic crisis it is important to resist any political knee-jerk reactions to protect less efficient businesses in a way that could be damaging to the enforcement of competition law, and ultimately to consumer welfare.

3. Intellectual property rights and the stimulation of innovation

24. I am going to turn now to two cases with which the NMa has dealt, which illustrate the trade off between intervention to keep prices low for the short-term benefit of consumers and non-intervention to preserve long-term consumer welfare. The first of these is a case concerning intellectual property rights.

25. In 2007, the NMa published an inquiry and a report on the monitoring of performing rights organizations. We had received complaints about the alleged abuse of a dominant position by performing rights organisations (PROs). As you know, PROs are the administrative organisations which

collect royalties from users on behalf of rightholders. The complaints related primarily to the tariffs being imposed on users.

26. The inquiry found that, according to the methods currently feasible for assessing whether tariffs are excessive, the Competition Act is of limited use when it comes to effectively regulating tariffs and the level of tariffs set by PROs. We concluded that a more specific form of regulation would be appropriate
27. Tariffs are excessive if they are not proportional to the economic value of a product. Cost orientation is the starting point of a frequently used method for determining whether tariffs are excessive. However, there are problems in applying cost orientation with regard to PROs. It is near impossible to determine the appropriate remuneration payment to the rightholder. Consequently, we found cost orientation is not practically applicable to PRO tariffs.
28. The NMa therefore examined the usefulness of two alternative methods for determining whether tariffs are excessive in case of PROs. We looked firstly at international tariff benchmarking among Member States. We found that the international tariff comparison is practically feasible, but there are theoretical difficulties. One of these is that as a rule organizations in a dominant position are being compared. The NMa found that such a comparison would be unlikely to lead to a conclusion that tariffs are excessive.
29. Secondly, as PROs generally employ a form of price discrimination, the NMa has made an attempt at investigating its impact on welfare. We requested an external bureau to investigate the extent to which welfare

effects resulting from price discrimination employed by a PRO may be identified

30. We found many theoretical difficulties which are outlined in that report. It is generally deemed undesirable to take action against price discrimination when the welfare effects are so unclear. Such a case would risk being overturned by the judiciary on appeal. If PROs are brought under the obligation no longer to employ price discrimination, a PRO may proceed by charging a monopoly price. In that case, prices may increase for some users, while others may see prices fall. The total balance for consumers as a whole is then also unclear. Such a method would require detailed information and indicators that could hardly be recovered or measured.

31. As it could find no satisfactory method on the basis of the Competition Act for examining whether PROs are employing excessive tariffs, the NMa recommended that a more specific form of regulation for PRO tariffs be introduced. I will say more about this later when we turn to the issue of the NMa's advocacy efforts in this field.

32. The NMa's PRO report is a good example of the difficulties involved in bringing an article 24 case on excessivity in a case involving intellectual property rights. More commonly, competition authorities may be faced with this sort of regulatory trade-off assessment when dealing ex ante with cases of merger notification.

33. This brings me rather neatly to the second case I wish to speak on today. This is a recent merger decision of the NMa where issues of dominance and innovation came together.

34. In December 2008 the NMa approved the setting up of a joint venture by two Dutch companies to roll out fibreglass networks for the consumer market throughout the Netherlands. The plans for the joint venture were driven by the desire and need to innovate in the field of communications.
35. At present the copper network is the most used network in the Netherlands for telephone and internet. It is broadly known that the copper lines have limited capacity and eventually will be phased out. Given the discussions within the EU, and given the activities of market participants, the copper network will most probably be replaced by a network of fibreglass across the EU in the near future, which results in much higher transmitting capacities.
36. One of the companies to set up the joint venture is KPN, which is the former state-owned monopoly in telecommunications. KPN wants to upgrade from its current, relatively slow, copper cable network, but lacks the knowledge to build the much faster fibreglass networks itself. Therefore it approached a company called Reggefiber, which specialises in rolling out fibreglass networks.
37. Reggefiber's business, however, has slowed down because it cannot find enough future telecom operators who will make use of their new network, once it has been put in the ground. This lack of operators not only slows down the growth of this one company, but also the expansion of glassfibre coverage in our country.
38. The planned joint venture would combine the expertise of Reggefiber's in building fibreglass networks with KPN's large customer database and thereby speed up the expansion of the fibreglass network. This is

advantageous to the consumer. But fibreglass will also lead to the possibility to offer all kinds of new products and services for companies. In sum fibre glass will boost innovation and therefore it is of essential importance that its rollout be implemented as soon as possible. Newly appointed USA President Obama, has expressed an interest in how the Dutch are facilitating fibreglass rollout.

39. This all sounds very positive, in terms of innovation, and the NMa thought likewise. The problem with this joint venture, however, was that it could create a company with near monopoly power in the market. And this is exactly what a competition authority has to guard against.

40. With the desire not to hamper innovation in the communications industry, while making use of the rather unique situation in the Netherlands, and in close co-operation with the Telecom Regulator, we came to a very satisfying result.

41. What makes the Dutch market situation different from that of most other countries is that next to a vast network of copper lines, which finds its history in telecommunications, we also have a coax (cable) network which reaches more than 90% of Dutch households. This coax network was put in the ground originally for transmitting television signals and nowadays it is also used for internet services and voice over IP. This means that unlike most other countries, we already have a very fast alternative for copper networks which is coax.

42. Then you could ask yourself: Why would we worry as a Competition Authority about this joint venture if there is already a network that is superior to copper?

43. The answer is that unlike with copper networks, it is not possible to give other parties, like internet service providers, access to the existing coax network.
44. Therefore, with the anticipated phasing out of the copper network that has to allow regulated access to the network by multiple internet service providers, blocking the joint venture would condemn these providers to exit the telecommunications market or to wait longer before being able to offer a superior product to customers with fibreglass network.
45. They would have to wait for new companies that do have the resources and customers to start building a fibreglass network, before they could finally offer fast internet connections to businesses and consumers, with all the innovative possibilities this brings along.
46. Therefore, we gave our approval to the initiative. But because of the possible dominant position the joint venture will have on the markets for access to glassfibre (and copper) networks, our approval was made conditional on certain undertakings, or remedies as we call them. Here we worked closely with the Dutch Telecom Regulator, to develop a regulatory framework of the future fibreglass network that will guarantee access for other internet providers for a reasonable price.
47. The remedies accepted by the NMa in the Reggefibre case are interesting in the context of today's discussion for two reasons. Firstly, the remedies show a good practical example of the trade-off which I set out earlier. Secondly, the remedies show pragmatism and a good example of how we can optimise the relationship between sector-specific and competition

regulation, because they were worked out by the NMa in conjunction with the OPTA, the Dutch Telecom Regulator. Let me expand on those two points of interest.

48. Firstly, the parties have agreed that the joint venture will operate at arm's length from its parents, and crucially, will offer no favourable treatment to KPN when it comes to providing unbundled access to other operators. This involved compelling third party access and introducing a system of price ceilings. Third party access is compelled to all providers of unbundled services (with the exception of the regional incumbent coax internet provider, who will not be entitled to this special treatment.) The aim of the price ceilings is to prevent KPN from being offered low or even overly advantageous prices by the joint venture for access to the fibre network. This could give rise to a price squeeze situation.

49. It was important to set these price ceilings sufficiently low so that other operators than KPN could set up a business case for offering fibreglass services to consumers. However, the price ceilings could not be set too low because that would damage the incentive for this high-risk investment. This is a practical example of the trade-off between encouraging investments and stimulating competition.

50. Secondly, the remedies not only support innovation, but they are innovative in themselves, because of the involvement of the sector-specific regulator, both in the acceptance and in the monitoring of the remedies offered. The remedies in the Reggefibre case are behavioural remedies. Structural remedies were not possible in this case. You are probably familiar with the arguments used by most competition authorities for preferring structural remedies over behavioural remedies. Behavioural

remedies are generally more vulnerable to conflicting interpretation than structural. More problematically, behavioural remedies are difficult to monitor.

3. Inter-agency cooperation, Advocacy and Guidance

4. The Reggefibre case illustrates the importance, and in this case necessity, of inter-agency cooperation. I wish to turn to this issue briefly in the context of intellectual property rights, and also tell you about some of the advocacy we have issued on this topic.

51. The powers of sector-specific regulators in the Netherlands have been carefully tailored in order to ensure that the NMa has sole power to enforce the Dutch Competition Act. However, there are areas in which the NMa gives advice to other Regulators such as OPTA, the Dutch post & telecom regulator. While the NMa works closely together with the sector-specific regulators on these issues, we do not always agree. In such cases, under our Cooperation Protocols we have an agreement to disagree, and to let the judiciary decide who is in the right.

52. On the issue of copyright, the NMa has agreed working arrangements with the Dutch PRO Supervisory Council. This Council supervises PRO's in relation to many aspects concerning replication rights and collecting

rights. What it does not regulate at present are the tariffs charged by collective rights organisations.

53. As I mentioned above, in its 2007 PRO report, the NMa advocated the adoption of a more specific form of regulation for PRO tariffs. One of the suggestions made by the NMa is the adoption of a form of dispute settlement, which would involve the intervention of a regulator whenever a dispute arises between a PRO and a user on the subject of tariffs employed by the PRO. This suggestion has been taken up by the relevant Ministries and a legislative proposal has recently been reviewed by the Dutch Council of State. There is still some discussion on what the relationship would be between the Competition Authority and the proposed Dispute resolution committee, but it should be possible to reach agreement.

4. Conclusion

54. To conclude, the enhancement of consumer welfare, both short and long-term should be to the forefront when we are applying competition law. We should apply the provisions on abuse of dominance vigorously where there is foreclosure of an efficient competitor. We should tread carefully in cases where the remedy sought ultimately amounts to price regulation.

55. When applying the provisions on abuse of dominance to cases involving intellectual property rights, we need to focus, in the trade-off described above, on the long term benefits to consumer welfare. We need to focus on stimulating innovation as in the Reggefibre case. This is more important than ever, as we face economic crisis. Indeed the Reggefibre case is a very good example of how competition should be seen as a solution, rather than a problem, in times of economic crisis, as Commissioner Kroes said at the OECD last month.

56. The NMa is not always the right body to solve every problem in the field of intellectual property. Where necessary, we employ advocacy efforts to stimulate regulation, such as we have done with regard to performing rights organisations. We advise branch organisations against imposing blanket protection on their members, be they efficient or inefficient, which is of no benefit to consumer welfare.