



Essential Facilities: the Rising Tide

It is becoming more and more common for complainants to allege that a competitor controls an essential facility to which they require access. Analogies to the sea ports cases are trotted out and the language of these cases is carefully followed. But the great majority of these claims amount to little more than an attempt to use competition law to try to negate a legitimate advantage enjoyed by a competitor. Competition authorities should treat such claims with scepticism because the over-zealous application of the essential facilities doctrine has the potential seriously to undermine the incentive for firms to innovate.

Estate Agency Services in Scotland

One example where such arguments were rejected was the recent MMC inquiry “Solicitors’ Estate Agency Services in Scotland” (published in August 1997).¹ In Scotland it is common for solicitors to provide estate agent services. Each SPC (Solicitors’ Property Centre) acts as a club providing property advertising facilities in the form of a centrally located showroom and a published property list (known as the Weekly List). House buyers can browse through a range of properties offered by a range of solicitors in one place. As a result, both member firms and their clients enjoy economies of scale in advertising of properties. Non-solicitor estate agents (NSEAs) were excluded from SPC advertising and they argued that this prevented them from competing with solicitors because they were being denied access to an essential facility. The MMC rejected the NSEAs’ claims and concluded that the SPCs were not essential facilities.

The Rationale for an Essential Facilities Doctrine

There are many articles available that set out detailed explanations of the essential facilities doctrine and we do not intend to try to replicate such explanations here. However, a short summary of the rationale is useful. From an economist’s point of view (a view we think is shared by most lawyers) the key issue is that we do not normally think that it is a good idea to require third party access to a private asset. The argument against such a requirement is that it

might undermine the incentive to develop the asset in the first place. Moreover, the effect could extend beyond the asset in question and might affect the incentives of all firms that came to know that requests for such access were often granted.² The argument for such a requirement is that it might increase competition in a downstream market to the benefit of consumers. In the majority of situations we believe that the argument against dominates and only in exceptional circumstances do we consider it appropriate to require such access to be made available. Four questions that need to be answered before such access should be required are set out below.

Necessary Conditions for an Essential Facility

- Is there a downstream market, properly defined, in which competition is absent or substantially lacking?
- Would entry by the firm seeking access improve the extent of competition in the downstream market to a material degree?
- Is there no other route (including replication of the asset) whereby the firm could economically effect competition on the downstream market?
- Are there no other, better placed, firms which could effect competition on the downstream market without requiring access to relevant asset?

Only if the answer to all of these questions is “yes” is there an arguable case for requiring third party access to private assets. If the answer to any question is “no” then the costs in terms of damaged incentives to invest and innovate very likely outweigh the competition benefits of requiring such access.

SPCs and the Conditions Required for the Essential Facilities Doctrine

We believe that the MMC was correct in rejecting the claims of the NSEAs in Scotland as none of the conditions necessary to apply the essential

¹ Lexecon advised Glasgow Solicitors’ Property Centre during the course of this inquiry.

² There are exceptions to this claim. Examples include assets such as gas pipelines which have been developed over decades with public money. Requiring access to such an asset is not likely to make the creator of a private asset worry that the same fate awaited him.

facilities doctrine were present. The MMC, in effect, went through each of the questions above and conducted a rigorous, quantitative assessment.

The MMC undertook a detailed investigation of the competitiveness of the market for estate agency services in Scotland. Consumer survey evidence revealed a high level of satisfaction with the services provided by solicitors which, the MMC concluded, would not have been expected if there was a lack of competition in the market. The MMC also examined whether a higher SPC market share led to higher levels of fees (a variation of the standard price/concentration study discussed in a previous Lexecon **competition memo**). Its analysis showed that there was no consistent relationship between solicitors' fees and their market share.

The possibility of NSEAs replicating the services offered by SPCs was also considered. The MMC saw no reason why NSEAs could not collaborate effectively on the publication of property lists. Even if such collaboration proved not to be feasible, the MMC found that there were other alternative property advertising options available to NSEAs such as newspaper advertising. Consumer survey evidence showed that even where SPCs had a high market share, sellers and buyers continued to view local and national newspapers as a cost-effective way of advertising property.

Thus, the NSEAs may have found it very desirable to have access to the SPCs and the alternatives may have been costly and they may have found exclusion to be a material disadvantage. But this still falls a long way short of the conditions needed to apply the essential facilities doctrine.

Digital Conditional Access

The essential facilities doctrine has also made an appearance in digital broadcasting. This month OFTEL (the UK telecommunications regulator) published guidelines regarding the way in which it will regulate the charges made to broadcasters for conditional access (CA) services in digital satellite in the UK.³ The regulations anticipate that BSkyB will develop a CA system, access to which will be essential for broadcasters to compete with BSkyB.⁴ There is a reasonable case here that the CA system will be an essential facility (as it is unlikely that it would ever be economic for another broadcaster to develop a competing CA system for

digital satellite) but a number of questions remain.

First, it is necessary to believe that digital satellite broadcasting is a separate market so that a lack of competition in this market is a material distortion. Thus it is necessary to believe that digital cable and digital terrestrial are in separate markets and that the market also excludes all analogue broadcasting including the likes of the BBC and ITV. This seems unlikely. There is an argument that pay TV is not a market (because a sole supplier could not maintain price above the competitive level) and even the OFT has defined a pay-TV market that does not differentiate between the different means of delivery (cable and satellite).

But the most serious concern with the application of the essential facilities doctrine here is that it is being applied to a facility which does not even exist and which will require the investment of hundreds of millions of pounds. There is a strong case that the essential facilities doctrine should not be applied to new assets where these have been developed in a risky commercial environment. The reason is that requiring access to be granted immediately severely reduces the normal incentive for a firm to innovate - the capturing of temporary "monopoly" profits while competitors catch up and seek to eliminate the first mover advantage enjoyed by the innovator. The risk is that innovations (a) will not occur at all (b) will be delayed or (c) will occur on a lesser scale than otherwise. These are all costs to the consumer and need to be balanced against the benefits of allowing equal competitive opportunity to firms that wait for others to innovate.

Conclusion

The language of essential facilities is creeping into an increasing number of competition law and regulatory matters. We have given a few examples here but are aware of many others. We have seen cases where retailers with significant but not dominant market shares have been claimed to be essential facilities by manufacturers. The argument made is that where a retailer has own brands it is, in effect, vertically integrated and can withhold supply (of shelf space) in a way that distorts competition. In another matter on which we recently advised, the downstream market already had 400 competitors and was widely agreed to be highly competitive.

On most of these occasions the use of essential-facilities-type language is inappropriate and without foundation and we urge the relevant authorities to be cautious in responding to such claims. True essential facilities are rare and an over-liberal application of the essential facilities doctrine is not in the long run interest of consumers - and that is what competition law is about in the end.

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³ *The Pricing of Conditional Access Services for Digital Television*, OFTEL, October 1997. Lexecon is advising BSkyB in its dealings with OFTEL on this issue.

⁴ "There is therefore a substantial risk that the first conditional access system to be adopted will be a bottleneck. Other service providers wishing to use conditional access to sell subscription services into the market would have to use this system." (para 2.5)

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