



Commission for  
**Communications Regulation**

## Discussion Paper

### Regulatory approach to Bundling and Temporary Discounts

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## 1 Introduction

This paper discusses regulatory issues that relate to the introduction of bundled retail products and also of temporary retail discounts by SMP operators in Irish telecommunications markets.

The purpose of the paper is to provide some discussion of regulatory issues, and options for regulatory measures, with a view to stimulating some debate in the Irish market about when and how it may be appropriate to regulate bundled retail products and temporary discounts. Some of the regulatory measures discussed are currently in force. No specific proposals for new regulatory measures or changes to existing ones are made in the paper.

ComReg would like to understand the views of interested parties on these matters. ComReg is particularly interested to understand views about:

- whether any specific regulation should apply to bundled products and/or temporary discounts;
- in what circumstances regulation should apply;
- what type of regulation should apply;
- other issues in this context that need to be considered.

Any views submitted will help inform the work that ComReg currently does to enforce existing retail obligations on eircom in its capacity as an SMP operator and may contribute to the development of proposals for any new regulatory requirements for SMP operators when new SMP designations are made in the next few months.

ComReg will make the responses available for inspection at ComReg offices. ComReg appreciates that some of the issues discussed in this paper may require respondents to provide confidential information for their comments to be meaningful. In view of this, respondents are requested to clearly identify confidential material and if possible to include it in a separate annex to the response. Such information will be treated as strictly confidential.

Views should be submitted by 5pm on 31 October 2003 to:

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## 2 Bundling

Bundled services/products are a common phenomenon with respect to the mobile market. Following completion of the testing phase for wholesale line rental and its subsequent availability in volume terms in the coming weeks/months, ComReg anticipates that more bundled offers will be brought to the fixed market<sup>1</sup>. This coupled to the fact that we are currently in a period of legal transition between the old and new regulatory framework for telecommunications, ComReg believes that this is an opportune time to solicit the views of market participants about the regulation of bundled retail products.

### 2.1 What are Bundling and Tying?

The term bundling is generally used to describe the practice of conditioning the sale of one product on the purchase of another product. For example, a multi-product firm might supply two products, A and B, for a single price. These products might also be available separately at two different prices. We consider tying as a special case of bundling, where one or more of the products in the bundle is only available as part of the bundle. Two examples of tying are given below.

- An operator may only offer a bundle containing two services/products as a single bundle i.e. only a bundle (A,B) is offered for purchase as opposed to A and B being sold separately e.g. in telecommunications a CPS operator might only sell local and national calls as a package and not as individual options.
- Alternatively, product A might be a firm's main product offering and product B might only be available after A has been purchased. Product B does not have to be purchased. In telecommunications this might be a case where having purchased call services from an operator a consumer is also now able to purchase ancillary services such call waiting, mailboxes etc, even though the latter cannot be purchased separately.

### 2.2 Need for Regulation

In some circumstances bundling can be beneficial for consumers. Firms may enjoy cost savings due to economies of scale or scope through, for example, lower marketing and billing costs or due to technical efficiencies. In addition to the potential for lower prices from passed on cost savings, bundling can enable consumers to choose packages that suit their own particular calling patterns and hence reduce bills. Bundles can also enable consumers to choose a package that best suits their attitude to risk, for example, by varying the proportion of their bill that is made of charges that are fixed or variable.

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<sup>1</sup> Although ComReg anticipate that more bundled packages are likely to be offered as a consequence of wholesale line rental, the issue of bundling per se is wider than just in the context of line rental and we would ask that this be reflected in any comments submitted in relation to the issue.

Nevertheless where a firm enjoys market power in one market it may, through the use of tying and under certain conditions, be able to leverage<sup>2</sup> this power into another market, squeeze competitors out of the second market and then raise prices above the competitive level or simply retain market share that it might otherwise have ceded. Therefore from a competition analysis perspective, the main negative effect of tying on competition would be foreclosure on the market of the tied product. This obviously could have detrimental effects on consumers. There will also be negative impacts on consumers if they are forced to purchase products that they do not require.

For bundled products where tying is not present, there may still be risks relating to predatory pricing and/or excessive pricing. Bundling can make it harder for consumers to compare prices offered by different operators, and so may lead to less competitive pressure in the market. For similar transparency reasons, an operator with market power could also use bundling as a tool for “disguising” predatory behaviour. The risk of excessive pricing seems lower, since consumers could choose the lower prices provided by the unbundled products (assuming these are not excessively priced) though, again, this depends on the degree of transparency.

### **2.3 Possible Regulatory Measures**

From a regulatory point of view the main concerns in relation to bundling will be to deal with any anti-competitive effects that might arise from a firm’s bundling strategy. In general where an operator does not possess any market power either individually or jointly with another operator, in the provision of any of the bundled products, at the retail or wholesale level, then it logically must follow that such an operator cannot engage in anti-competitive activities and consequently no intervention either on an ex ante or ex post basis seems necessary<sup>3</sup>. Where operators do possess market power in one or more of the markets included in the bundle there are numerous ways in which an ex ante regulatory approach might be used to deal with potential anti competitive effects. The issues are likely to be more complex where an operator has market power relevant to some but not all elements of the bundle.

Each of the following requirements for a dominant operator, discussed in more detail below, would impose varying degrees of restraint on that operator and benefits for the market:

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<sup>2</sup> Market power can be leveraged vertically or horizontally – vertically from an upstream to a downstream market or horizontally from one upstream market to another upstream market or from one downstream market to another downstream market. Therefore vertical leveraging will involve wholesale and retail markets while horizontal leveraging will generally involve leveraging at one or other of those levels. In the context of bundling it is horizontal leveraging that is relevant.

<sup>3</sup> Nevertheless, it could be the case that due to technical innovation, for example, the bundle itself may become part of a new market. For example if fixed and mobile services could be sold over a single handset at some stage this bundle could constitute a new market in itself.

- Require that prior to the introduction of a bundled product that the dominant operator objectively justifies the bundle.
- Impose a requirements to ensure product transparency such as requiring all retail products to also be made available on an unbundled basis.
- Require that the wholesale elements that enable the provision of any retail bundle must be made available to non-dominant operators.
- Require that in addition to providing unbundled wholesale elements of any retail bundle offered by a dominant operator, that they also offer an equivalent wholesale bundle.
- Require bundles to be cost orientated
- Prohibit the bundling of a product/s in which an operator holds a dominant position with a product from a market that is deemed to be effectively competitive
- Prohibit bundling of electronic communications services (ECS) with non-ECS'.

It should be noted that the measures listed above are intended to be specific to bundling. Therefore even if none of these measure were to be applied the usual obligations that might be imposed for retail products generally would still apply to bundled products in the same manner as would be the case for unbundled products e.g. obligations with respect to transparency or the need to have cost oriented wholesale equivalents etc.

*Requirement for objectively justifying bundle*

There must be a reason why an operator wishes to sell its products as a bundle. If a dominant operator cannot provide a justification for the bundling that is not of an anticompetitive nature then this might be an indication that the purpose of the bundling is to engage in such practices. Examples of objective justification could range from demonstrating cost savings associated with bundling to catering to the demands of customers for such products.

*Requirement that all retail products also be made available on an unbundled basis*

This would ensure greater choice for the customer. It may also provide greater transparency, to the extent that more informed decisions can be made about whether or not services should be purchased from one operator as a bundle or should be purchased individually from different operators. However, this requirement could arguably also lead to greater confusion for customers where bundled and unbundled products coexist.

This approach could also act as a discipline on dominant operators that might otherwise engage in excessive pricing, at least where constraints on excessive pricing, such as the price cap, already exist for unbundled products. In addition, were the regulator to impose a further requirement for cost orientation on a bundle, the availability of equivalent unbundled products could facilitate the identification of the 'implied price' of each element of the bundled product.

*Requirement that all wholesale elements be made available*

The availability of all wholesale elements to non-dominant operators should contribute to providing those operators with the opportunity to compete directly with the bundle being offered by the dominant operator. The aim would be to ensure that

it is both technically and commercially feasible to replicate the bundled offering of the dominant operator. In some cases, in order to meet this aim, there might also be a need for the wholesale offering to be bundled. This requirement would also contribute to ensuring that the dominant operator does not discriminate between its own retail arm and other retailers. In some circumstances, perhaps where other wholesale products provide equivalent services for other operators, this requirement might impose an unnecessary burden on an SMP operator.

*Price-cost requirements*

There are a number of possible price-cost related measures for both bundled and unbundled products that can be employed to protect both other operators and/or consumers from anti-competitive behaviour. These include whether the focus of regulation is on below cost selling (predatory pricing) or above cost selling (excessive pricing) and the most appropriate measure of costs<sup>4</sup>.

Bundling and/or tying could be used as a mechanism by which dominant operators leverage market power in an anti competitive manner by engaging in predatory or excessive pricing. Requiring some link between the price of the bundle and costs could limit or prevent this. There are a number of ways in which this might be applied to SMP operators and the following list should not be viewed as either prescriptive or exhaustive:

- Require that the price of the overall bundle exceeds the aggregate cost of providing that bundle including some reasonable rate of return<sup>5</sup>.
- Require that the price or implicit price of individual elements of the bundle are above the costs of providing each of the services individually.
- Require that the price or implicit price of the products in which the operator has a dominant position are above cost.
- Require that the price or implicit price of the smallest 'contestable market' in the bundle is above cost. In principle this would mean that an operator need only be cost orientated for elements that might fall into any 'competitive arena' identified in the bundle e.g. it is unlikely that any operator would enter the market solely to provide local weekend calls. In this case the smallest contestable market or competitive arena that an operator might enter could be the market for all local calls or it might be all local and national calls or some wider market. Therefore under this requirement only the combined elements of each identifiable contestable market would need to be above cost<sup>6</sup>.

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<sup>4</sup> For instance the costs used could be marginal, average variable or average total costs. These could be calculated in a number of ways, including through the use of historic costs, current costs and long run incremental costs.

<sup>5</sup> Under such a requirement the issues are more complex where an operator bundles say, service A that might already be subject to cost based remedies, such as accounting separation, with service B that is not subject to any regulation. In this particular case detailed disclosure of the costs associated with service B could be required to make a sensible price-cost assessment for the bundle as a whole.

<sup>6</sup> In general the sum of each 'contestable market' in the bundle will be equal to the bundle itself. Therefore every element of the bundle would fall into some contestable market.

Implementing such requirements could have a positive impact through limiting the scope for excessive or predatory pricing. However, the imprecise nature of some cost data, and the lack of a firm theoretical consensus on which costs measures are the most appropriate to apply, means that care needs to be taken to avoid applying any such requirements too rigidly. The intended benefits for consumers could be undermined, by, for example, wrongly intervening on the basis that prices were predatory and thereby raising consumer prices, or by wrongly intervening on the basis that prices were excessive, thereby acting as a deterrent to future infrastructure investment and product innovation.

*Prohibit bundling of regulated with otherwise unregulated products*

Where an operator possesses market power in the provision of one of the services in a bundle, and they bundle this service (A) with another service (B), they could potentially leverage their market power from A to B in an anti-competitive way. One way of preventing this situation from arising is to prohibit the bundling of such services. This requirement might also extend to the prohibition of bundling electronic communications services (ECS) with services that are not ECS. However, this approach, if applied as a blanket prohibition could lead to the prevention of bundles where there are genuine benefits to consumers, eg through lower prices or greater choice, that outweigh any negative impacts on competition.

With respect to all of the potential measures outlined above, any such requirements might be set by the regulator on a case by case basis as the nature of the specific issues become known, or they might be general requirements that are set in advance and are required in all bundling cases. A combination of these two approaches could also be feasible, for example, all bundles should be objectively justified and apply all other requirements on a case by case basis. In general, setting the requirements in advance can be expected to increase the levels of certainty for market participants and may contribute to reducing the timescales within which SMP operators can introduce bundled products. However, they may also be more likely to lead to unintended impacts from the regulation where the approach is less suited for application to a specific case.

Another aspect that needs to be considered is the manner in which bundling is dealt with in the context of the price cap currently in place on a number of eircom's services. Potentially eircom could develop bundled products entirely made up of price capped services or products made up of a combination of both price capped services and uncapped services. If the price of bundled services are included in assessment of price cap compliance then in the first example, calculations in compliance assessments could be relatively straightforward. However, where price capped services are bundled with other uncapped services then a significant degree of complexity will be added to apportioning revenues for the purpose of compliance calculations. There may also be reasons for ignoring any new bundled products for price cap compliance purposes, even where they include services in the price cap. For example, changes to the prices of discount schemes are not included in the price cap. If a bundled product were viewed as a type of discount scheme, then it might be excluded.



In relation to bundling, ComReg seeks views on the following:

1. *Does the respondent think that any specific regulation needs to be applied with respect to bundled products?*
2. *If so, in what circumstances should such regulation apply?*
3. *What type of regulation should apply?*
4. *Are there any other issues in relation to bundling that need to be considered by ComReg?*

### 3 Temporary Discounts

From time to time operators use temporary offers as a retail marketing tool. These offers often include discounts on standard prices and sometimes include extra services provided for free. Recent examples in Irish telecommunications markets include discounts on calls to certain overseas destinations over holiday periods and a current three month promotion of DSL services.

Concerns may arise about temporary discounts if they are used in an anti-competitive way by operators with market power. This might be the case, for example, if they were used as part of predatory pricing strategy with the aim of driving competitors out of the market so that prices could be raised above the competitive level in the long run. Alternatively, temporary discounts might be used as a legitimate way of stimulating demand and increasing revenues and could certainly be seen as beneficial by customers, at least before any possible anti-competitive effects on the market are experienced.

#### 3.1 Need for Regulation

The need, and legal powers, to regulate temporary discounts may vary with the degree of competition in the markets in question. In any retail markets where there are no operators with SMP at either the retail or the wholesale level then regulation is unlikely to be suitable. Some issues relevant for other circumstances, where SMP is present at the wholesale level, are listed below.

- Where there is no competition and little prospect of competition at the retail level, perhaps because entry barriers are high, temporary discounts are unlikely to have any anti-competitive effect and so there may be no need to regulate to prevent or control them. This circumstance is unlikely to arise in Irish markets.
- Where one or more operators have significant market power (SMP) at the retail level, but where there are other competitors in the market and/or some prospect for competition then more careful consideration may need to be given to whether the discount in question may be anti-competitive. Factors which contribute to making a judgment on the possibility of anti-competitive behaviour may include:
  - length of time for which the discount lasts;
  - size of the discount
  - relationship between the discounted price and cost
  - extent to which the discount might lead to increased revenues
  - whether the discount is aimed at stimulating uptake of a new service
  - likely impact of the discount on market dynamics
  - whether the discount is a “one-off” or part of a wider pattern of discounting
  - whether the discount is targeted at customers more likely to be subject to competition.

Where no operators have significant market power at the retail level, but where one or more operators have SMP at the wholesale level then there may still be some circumstances where regulation to prevent anti-competitive conduct may be desirable. This may be the case where operators that have significant market power at the wholesale level

have incentives to behave in a predatory fashion at the retail level. In these circumstances, the case for regulating retail markets for new or innovative products and services is less clear. The European Commission's SMP Guidelines, for example, note that where there is an issue relating to the leverage of market power from a regulated market into an "emerging" market, any abusive conduct would normally be dealt with through competition law.<sup>7</sup>

### 3.2 Possible Regulatory Measures

In the light of the discussion above, some options for the treatment of temporary discounts are:

- No specific measures applied to temporary discounts – application of the same regulatory requirements for temporary discounts as applied to permanent price changes.
- Allow temporary discounts with no restrictions
- Set limits on the duration, frequency or scope of temporary discounts
- Require that the discount must reasonably be expected to lead to an increase in net revenue without being predatory
- Require that the discounted price be above some measure of cost
- Require that the discount be made permanent if it has had the effect of driving other operators out of the market
- Require that there should be an equivalent discount to the relevant wholesale product.

Any such requirements might be set by the regulator on a case by case basis as the nature of the issues specific to a proposed temporary discount become known, or they might be general requirements that are set in advance and are required of all temporary discounts. A combination of these two approaches could also be feasible, for example, setting a maximum time period for all promotions and applying other requirements on a case by case basis. In general, setting the requirements in advance can be expected to increase the levels of certainty for market participants but may also be more likely to lead to unintended impacts from the regulation, where the approach is less suited for application to a specific case.

In relation to temporary discounts ComReg seeks views on the following:

1. *Does the respondent think that any specific regulation needs to be applied with respect to temporary discounts?*
2. *If so, in what circumstances should such regulation apply?*
3. *What type of regulation should apply?*

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<sup>7</sup> Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, Footnote 92.

4. *Are there any other issues in relation to temporary discounts that need to be considered by ComReg?*