NETWORK UTILITIES – THE EU INSTITUTIONS AND THE MEMBER STATES

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1. INTRODUCTION

This chapter draws general lessons from the European perspective. It clarifies the fundamental roles of Community regulatory policy and competition law, in particular in coordinating national regulatory approaches and promoting liberalisation in the context of the integration of European network industries.

In network industries, regulatory reforms and liberalisation are expected to improve static and dynamic efficiency of enterprise by ensuring a better allocation of resources and fostering the availability new products and services by encouraging technological innovation. The whole process should, therefore, lead to reduction in costs and prices as well as increase the demand and supply.

However, changes brought about by liberalisation also imply adjustment costs. The main challenges are to encourage efficiency, competition and general public acceptance with the liberalisation process. To ensure that the benefits of liberalisation will be shared, political choices are needed. At the European level, that includes in particular:

- the question of the appropriate level of public intervention (European, national, local), taking into account the principle of subsidiarity; and

- the question of the respective roles of competition authorities and sector-specific regulatory authorities.

The first part of this chapter summarises the present EU governance model adopted for network industries, and the choice made of the different possible approaches (liberalisation and harmonisation) and the different policy instruments (directive, regulation, recommendation). Network industries have in common the fact that network infrastructure involves at the same time a heavy fixed cost and potential substantial economies of scale. However, network industries differ widely at the same time in term of their importance from a public service obligation point of view, the extent of natural monopoly, and even factors of production composition (capital intensities, qualification of labour force). Therefore, there is not one general accepted EU governance model for all network industries (telecommunications, transport, energy).

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The second part of the chapter looks only at the telecommunication sector, a sector where the progress of the liberalisation process is most advanced. It presents the EU model in term of detailed description and analysis of international competencies at the national and EU levels.

The third part of the chapter, again addressing only the telecommunication sector, presents a perspective on the respective responsibilities and capabilities of sector-specific regulation and competition law in the process of the liberalisation of the telecommunication sector.

2. PRESENT EU GOVERNANCE MODEL FOR NETWORK INDUSTRIES

2.1. Approaches: liberalisation and harmonisation

Liberalisation measures are based on Article 86 of the Treaty. The basic principle of Art. 86 concerns the application of competition law to public undertakings or undertakings with special or exclusive rights. Member States may not give rights or maintain measures which impede the Treaty's competition rules. Therefore, liberalisation has focused on removing the special and exclusive rights, e.g. monopoly status, enjoyed by undertakings in network industries while keeping in mind Member State and Community commitments to services of general economic interest. Liberalisation measures based on Article 86 are a crucial part of the Community's plan to realise the benefits of full competition. Based on competition policy principles, liberalisation measures have removed legal entry barriers across Member States and set forth general rules for competition in network industries.

This liberalisation has to cope with public service obligations that may be imposed by the public authorities on the body rendering the service such as protecting the environment, economic and social cohesion, land use, planning and promotion of consumer interest. [2]

Harmonisation is based on Article 95 of the Treaty. The basic principle of Art. 95 is to remove barriers to the construction of a common market. In the context of network industries, harmonisation refers to how Member States align or "harmonise" their sector-specific regulatory regimes. The intent of employing a harmonised approach is to create a common denominator of regulatory rules within the Common Market, to ensure a sense of security (or credible commitment) for private investment as well as to encourage the development of a true common market for network industries.

In telecommunications, liberalisation and harmonisation were pursued simultaneously, with liberalisation directives opening individual subsectors complemented by harmonisation directives through the ONP framework. The Commission thus adopted a series of Directives on the basis of Article 86 of the Treaty asking the Member States to abolish the exclusive rights and certain special rights that they had granted to their public-sector telecommunications companies. Directives were also necessary to harmonise the legislation of the Member States in order to avoid the erection of new barriers between Member States.

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[2] Communication from the Commission "Services of general interest in Europe", Sept. 1996

For the energy sector, liberalisation (the opening of markets for electricity generation, transmission, and distribution) was begun in 1996 without accompanying harmonisation measures. In the energy sector, after a first proposal for a Directive on common rules for an Internal Market in 1992, and a very lively debate, the Council decided in 1996 and 1998 that market opening should be 26% for electricity and 20% for gas, increasing gradually over a period of 10 years without fixing a date for full opening of markets.

In air transport, liberalisation was achieved by the freedom of establishment with the end of exclusive rights of state-owned "flag carriers" and by introducing free movement of services, cabotage being now allowed. However, a large number of city-pair routes still feature duopolies of established companies. This is why the control of mergers and alliances are so important in the air transport sector. In contrast to the telecommunications sector, air transport lacks a single unifying theme -- such as open network provision -- within which harmonisation measures are developed and revised.

2.2. Instruments: legislative initiatives in network industries

Three main legislative instruments were used in the network industries: regulations, directives and recommendations. Regulations have direct effect in national courts, and therefore do not require transposition into national law for implementation for Member States. Therefore, a regulation as a Community legislative instrument allows less room for variation in application of policy among Member States. Directives instruct Member States to develop and implement national legislation in order to implement policy decisions of the Community. As a Community legislative instrument, Directives require transposition into national law in order to be effective. Recommendations are not mandatory, but they may be adopted by the Commission and implemented by national authorities in six months, compared to at least three years for directives.

Beginning in 1988, telecommunications liberalisation directives opened the markets for terminal equipment, advanced telecommunications services, satellite and mobile services, telecommunications services via cable networks, and finally the full array of telecommunications services (including voice telephony) in 1998. Harmonisation was also pursued via Directives through the unifying program of open network provision (ONP). As liberalisation and harmonisation were pursued entirely through Directives, much of the program has required substantial input and accomplishment by Member States. Member State implementation of the liberalisation Directives has been completed by nearly all Member States, while transposition of the harmonisation Directives proceeds with only a handful of Member States behind schedule.

More and more soft law and recommendations are used in the telecom sector, since the adoption by the Council and the European Parliament of directives require at least 3 years and the technological development in these sectors are quite fast. Recent recommendations were based on "benchmarking" exercises as for leased lines or interconnection. These recommendations present the pricing situation for all the different Member States and recommend that the three lowest prices are benchmarked for all the Member States.

Energy liberalisation has focused on market subsectors (transmission, generation, distribution) although these were opened all at once, in the 1996 Directive on Common rules of the internal market in electricity, rather than sequentially in separate Directives. The Directive has been transposed into national law in nearly all the Member States, and Member States have gone beyond the minimum open requirement of the Council when implementing the electricity Directive.

2.3. Restructuring of network industries in the US and the EU

For the telecommunications sector in the United States, which has a long tradition of complex regulatory oversight between the 50 state public utility commissions (PUCs), the Federal Communications Commission (FCC), and the courts, liberalisation has proceeded on many jurisdictional fronts. Liberalisation advanced subsector by subsector, with challenges among each of the parties with regulatory oversight from time to time. First, terminal equipment markets were opened; then, international and advanced telecommunications services were liberalised, followed by long distance services and finally voice telephony in 1996. This was achieved not through a successive program of legislation, however, in contrast to the EU. The 1996 Telecommunications Act bringing full liberalisation for telecommunications actually capped nearly 20 years of liberalisation at the state level, within the FCC, and in court decisions (most notably with one of the largest antitrust cases in U.S. history, the 1984 AT&T divestiture.)

As in the EU, liberalisation of the energy sector in the US has only recently begun. Many U.S. states have begun to experiment with allowing competition at the local level for energy transmission, as competition is allowed but not required by federal law.

For air transport, liberalisation involved opening the air carrier market to new entry, and removing price regulation for air fares. However, unlike in telecommunications or energy, air transport liberalisation culminated in a complete restructuring of regulatory oversight for the industry at the national level. The federal air regulatory agency, the Civil Aeronautics Board (CAB), was abolished entirely. In its place is a new independent agency, the Federal Aviation Administration (FAA) which focuses on air safety. Regulation of ancillary services, such as airport management, is achieved at the state and local level.

In the US, for industries under the purview of independent sector-specific regulatory agencies, federal legislation traditionally gives the overall framework and powers for oversight of a particular sector, and agency regulations implement the framework through detailed regulations. However, depending upon when the framework statute was written or revised and the general political forces in the environment surrounding regulatory oversight, there may be more or less room for agency interpretation. Finally, in the U.S. judicial system there is an explicit and well-developed body of administrative practice which involves the federal courts much more directly in the implementation of regulation, particularly in the form of judicial review.

Regulatory decision-making is far more centralized in the US (as would be expected), with the FCC especially since the Telecommunications Act in charge of developing and administering the full complement of sector-specific regulation required in the transition from monopoly to full competition (e.g. licensing,

interconnection, etc.) As with the EU, the energy sector has only recently begun to liberalise (and in the US there is no federal-level legislative measure requiring full competition equivalent to the 1996 Directive). With regard to air transport, the US seems far more aggressive in liberalising the sector, going so far as to abolish federal level oversight except for air safety and the full removal of price and entry barriers. In contrast to the US, easures to develop a European-wide air traffic control and safety authority in the EU have languished, while state aid to national carriers was given in order to compensate for some of the effects of competition in air transport.

3. INSTITUTIONAL COMPETENCIES AT NATIONAL AND EU LEVELS (SUBSIDIARITY) FOR THE TELECOMMUNICATIONS SECTOR

3.1. Overview: institutional division of labor

The principle of subsidiarity maintains that if activities can be or should be accomplished at the Member State level, they will be. Community-level activities are to be restricted to those functions which involve a Community interest. With regard to the introduction and maintenance of competition in network industries, and particularly the telecommunications sector, the Community interest is in promoting the common market and establishing clear rules of the game for the emerging competitive environment.

According to the economic analysis of institutional incentives (issues of agency), a trade-off exists between the possibility of capture and the information needs of the regulatory authority.[3] Research suggests that where possible, regulatory oversight should remain as close to the actual players and conduct of the market as possible in order to allow for ease of information-gathering and the development of an accurate perspective on the industry or sector. However, the proximity of the regulator to the regulated industry invites the possibility of capture by the industry or industry segments under regulatory oversight.

While keeping in mind the possibility of capture, which can be overcome by such institutional measures as adequate salaries and arms-length relationships between regulator and regulated firm, oversight functions have indeed been delegated to the level closest to the industry, e.g. the national level. It is understood by many Member States and market players that national-level authorities are best positioned to implement Community policy toward telecommunications, based upon their understanding of the unique characteristics of the national environment.[4]

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[3] « Liberalisation of network industries : Economic implications and policy issues, » European Economy, 1996.

[4] COM(1999)537, 11 November 1999, Fifth report on the implementation of the telecommunications regulatory package, OJ C 1998/265, 22.8.1998 p. 2.

3.2. Regulatory competencies

As liberalisation of the sector proceeds, more and more functions are to devolve toward the Member States.

NRA responsibilities include: drafting or granting authorisations to enter a market; dispute resolution among market players; universal service and tariff rebalancing; and other aspects of implementation of the ONP and liberalisation Directives.

The results of the public consultation on the 1999 Communication Review present the main elements of the future regulatory framework:

- Introduction of more flexibility into the new regulatory framework via the increased use of Recommendations, Guidelines and co-regulatory solutions to problems.

- More room for subsidiarity in resources area since it will make clear that Member States are free to establish auctions and other spectrum pricing mechanisms for assignment of frequency if they consider them necessary to ensure the optimal use of radio spectrum.

- Regulation primarily designed to manage the transition to competition will be imposed on specific undertakings as a function of their market power, and will be removed as competition increases.

The concept for imposing ex-ante obligations related to access and interconnection would be based on *the concept of dominant position in particular markets, calculated in a manner consistent with competition law practice.*

NRAs would be able to designate undertakings on which they could impose ex-ante obligations where:

- the undertakings has financed infrastructure partly or wholly on the basis of special or exclusive rights which have been abolished, and there are major legal technical or economic barriers to market entry, in particular for construction of network infrastructure; and/or

- the undertaking concerned is an integrated entity and its competitors necessarily require access to some of its facilities to compete with it in a downstream market;

and where both national and EU competition law remedies do not suffice to ensure effective competition and choice in the market concerned.

The types of obligation that could be imposed on an undertaking will cover: non-discrimination and transparency, including accounting separation, pricing of services, including cost orientation, access to, and use of, unbundled network elements and/or associated facilities.

NRAs would draw up the list of organisations for the purposes of implementing the ex-ante obligations and notify such a list to the Commission, together with the precise obligations imposed. Thereafter, determinations of the relevant markets, and of the positions of market players on those markets, would be carried out by NRAs on a regular basis, in order to adapt regulatory obligations.

Such assessment by NRAs should take place in close co-ordination with the national competition authority. Guidelines at European level would be necessary to facilitate correct application of the competition law principles, and to avoid having different market definitions in different Member States.

3.3. Commission Competences - Directives

The Commission is in charge of ensuring a correct transposition of directives. Community competition initiatives in liberalisation of telecommunications involved not only the specific liberalisation directives but also the harmonisation directives.

The Commission has issued decisions relating to the implementation of the liberalisation and harmonisation Directives. The Commission decided to allow certain Member States additional time periods for implementation according to their specific national situation[5]. It has also issued decisions on the Licensing Directive, where Member States had imposed charges on new entrants in mobile telephony markets which were contrary to Article 86(3)[6].

The annual reports on the Implementation of the Telecommunications Regulatory Package focus on the transposition into national law of the key elements of the directives and in the 5th report, attention has moved to the effective application of nationally transposed rules. The conclusions of this report underlines "the comparatively low level of harmonisation in particular of the Community licensing and interconnection regimes….the lack of a proper national implementation of the regulatory framework for cost accounting in many Member States and a lack of competition in the local access market".

Currently, there are several infringement proceedings open against Member States in relation with rebalancing of voice telephony tariffs.

Under the legal monopolies, telecom operators used to cross-subsidise low line rental with high call charges, especially for long-distance and international calls. According to the Full Competition Directive (90/388/EEC) and the Voice Telephony ONP-Directive (98/10/EC), tariffs for voice telephony when offered by dominant operators, have in principle to be cost-oriented.

The success of Internet in the USA is to a large extent due to the combination of cost-oriented line rental and free local calls – including flat rates – allowing to better benefit from the economies of scale allowed by a more intensive use of the network.

Tariff rebalancing does not mean that consumers have to pay more, on average. Rebalancing should be a "zero sum operation", because increases of subscription fees should be compensated by decreases of call charges. Community law requires telephony tariffs to be affordable and the Commission has promoted the application

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[5] Additional implementation periods for the Full Competition Directive for Ireland, Portugal, Luxembourg, Spain and Greece.

[6] GSM Spain, GSM Italy.

of social tariffs and low user schemes, avoiding that the weakest consumers would be hit by increases of telephone tariffs.

3.4. Commission Competences - Competition Policy

The Commission competences in the field of competition policy covers decisions taken under Art. 81, 82 and 86 of the Treaty including merger control as well as sector inquiries launched for telecommunications in 1999. There are only 12 Commission decisions under Art. 81 and 82 from 1982 to 1997 and 7 Commission decisions under Art. 86.

However, even before any decisions is taken, Commission investigations on the basis of competition rules have repeatedly resulted in significant reduction of rates. After the Commission carried out an "own-initiative" (ex officio) investigation on the prices of interconnection between fixed and mobile operators, prices decreased significantly in nearly all Member States where problems were identified. This rate reduction also happened following a complaint by MCI Worldcom against termination rates of fixe mobile operators in three different Member States. After the Commission initiated these investigations in late 1999, rates decreased by up to 50% for many of the operators involved. Experience proves that operators, when threatened with potential negative decisions, do understand the meaning of competition rules and are very likely to change their behaviour.

The Commission also has launched three sector inquiries on the implementation of Community legislation for liberalisation and harmonisation: for roaming charges in mobile telephony markets; for international leased lines; and for interconnection charges.

As part of its jurisdiction over joint ventures under Article 81 of the Treaty, the Commission has applied Community competition law to undertakings in the markets for corporate data services[7], satellite manufacturing and distribution[8], and mobile services[9]. In general, the Commission has focused on the effect of the concentration on competition in specific markets. The Commission has found, when the joint venture in question creates new service markets, the concentration is compatible with the Treaty. Where the concentration would close off or prevent competition from emerging, particularly in new markets such as next-generation mobile services or media markets, the Commission has imposed conditions (either structural or behavioral) on the undertakings involved, or found the undertaking to be incompatible with Community law[10]. The Commission has also taken into consideration the level of openess of the Member State markets in question, and has in some cases made clearance of the concentrations dependent upon further restructuring or liberalisation in these markets.

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[7] BT/MCI, ISPS, Atlas/Phoenix/Global One, Unisource/Uniworld

[8] Alcatel Espace/ANT, Astra

[9] Konsortium ECR 900, Iridium

[10] Astra, Alcatel Espace/ANT; MSG; Nordic Satellite; Telefonica-Sogecable.

Finally, the Commission remains responsible for the determination of policy issues in competition law affecting telecommunications markets. For example, in 1998 the Commission issued its Notice on the application of competition rules to access agreements in the telecommunications sector (e.g. interconnection). This set out Community policy regarding market definition, abuse of dominance (including essential facilities), and other relevant aspects of Community competition rules in order to clarify where access agreements may contravene Community law. Recently the adoption by the Commission of a communication and recommendation on the unbundling of the local loop is the most important initiative.

The local loop refers to the physical circuit between the customer's premises and the telecommunications operator's local switch or equivalent facility. Permitting 'unbundled access to the local loop' means allowing other operators to use, partially or fully, the local loops installed by incumbent telephone operators enabling them to install new cost-effective technologies such as DSL (Digital Subscriber Loops). Under full unbundled access to the local loop new entrant would have exclusive control of the local loop, and in this way, new market entrants would deploy new technologies to provide competitive services to consumers, including new broadband services and high speed Internet services.

In all cases, **competition rules** apply, and refusals by dominant operators to open the local loop to competitors requesting access may imply various forms of abuses of dominant position under article 82 of the Treaty, such as refusals to deal and limitation of production, markets, or technical development to the prejudice of consumers. Where access is granted, fair and non discriminatory conditions of access are crucial for successfully opening the local loop and the development of a competitive market telecommunications services, in particular high speed services. This requires close monitoring of delays, prices and contractual arrangements between incumbents and new entrants.

3.5. The sharing of responsibilities

The Commission "Notice on the application of competition rules to access agreements in the telecommunications sector" [11](the "Access Notice") deals with the relationship between the application of competition rules and sector-specific regulation as well as procedural issues regarding access agreements in the telecommunications sector. It notably sets out (para 28) that priority should be given to sector-specific regulation applied by NRAs, where applicable and subject to the rights of companies to complain under the competition rules.

In antitrust cases under Regulation 17 [12] , which are clearly national cases, where there are related actions before an NRA and where it has the powers to remedy the competition problems at issue, the Commission will generally not initially pursue any investigation as to the existence of an infringement of EU competition rules. In these cases, the Commission would suspend its own investigation pending the conclusion of the national proceeding. The Commission will then decide to close its

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[11] OJ C 265 p 2, 22.08.1998

[12] Council Regulation N0 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty, OJ 13/204 (1962), as amended

own case, if the competition problems have been solved in line with the case-law of the Court of Justice.

This is however subject to the following points:

-national proceedings must be concluded in a reasonable period of time, typically not more than six months;

- some particular cases might have a substantial Community interest affecting, or likely to affect, competition in a number of Member States.

Moreover, the NRAs must ensure that actions taken by them in application of sector-specific rules are consistent with Community competition law. Indeed, it results from the case law of the Court of Justice, in particular the Ahmed Saeed judgement [13] and the recent "CNSD" [14] judgement, that they must not encourage or reinforce or approve anti-competitive behaviour, for example pricing practices contrary to Article 85 or Article 86.

In competition matters while NCAs have primary jurisdiction over national matters, the Commission has jurisdiction over cases where it finds a Community interest. NCA responsibilities also involve applying Community law to national cases, in addition to national competition law.

4. CONCLUSIONS

The liberalisation of network industries in Europe is a "success story": it has ensured that technological progress has led to new services, lower prices and job creation. Operators, financiers, workers, consumers, regulators, governments, and the European Institutions have all played a part in this success. But the story is not yet over. Setting the rules of the game for fair competition ensures that the work of the national authorities and of the Commission will continue to be important in the near future.

There are also differences between Member States and another, as well as between one sector and another, in the design, scope and approaches of general interest services owing to different national traditions. Many of them take the view that general interest services make an important contribution to economic and social cohesion.

[13] Case 66/86, Ahmed Saeed (1989) ECR 838

[14] C-35/96, Consiglio nazionale degli spedizionieri doganali, 18 June 1998, not yet published

ANNEX 1

Government oversight of network industries in US and EU

	US	**EU**
Telecommunications		
Regulation v. competition – status	No entry restrictions; unbundling for local competition mandated	No entry restrictions; unbundling for local competition not mandated
Decentralization of government oversight	Jurisdiction shared between state PUCs and FCC – all "independent" regulatory agencies	Jurisdiction shared between EU-level regulator and national sector-specific regulators or government body (e.g. Ministry)
Ownership structure	Private	From private to partially privatized
Energy		
Regulation v. competition – status	No entry restrictions; unbundling for local competition not mandated, but majority of states are experimenting with local competition	Full entry liberalisation in process; third-party access regulated by Member States
Decentralization of government oversight	Jursidiction shared between state PUCs and FERC, which are independent agencies	Jurisdiction shared
Ownership structure	Mix of private and some municipal systems at the local level	Seven Member States favor public or mixed public-private ownership; eight Member States feature public ownership of electricity transmission
Air transport		
Regulation v. competition – status	No entry restrictions; US competition authorities investigating possible predatory	No entry restrictions; EU competition authorities have investigated entry via slot allocations and

	pricing by airlines	groundhandling services
Decentralization of government oversight	No federal regulatory oversight (CAB abolished); competition rules and air safety regulation at federal level only	Jurisdiction primarily within Member States, with EU-level authorities setting general policy
Ownership structure	Private, with some municipal aid for airports	Public or partially privatized, state aid allocated to national airlines for restructuring