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Editorial - EU Energy Liberalisation: Coming to a Member State Near You!

Alan Riley[*]

Given the support for a watering down of the third energy package recently in the European Parliament, it could be easily concluded that EU energy liberalisation, if it is to happen at all, will only happen excruciatingly slowly. This argument overlooks the crucial point that the third energy liberalisation package is in fact only part of the liberalisation programme, and even then not the most decisive element in that programme.

What is overlooked in discussion over the scope of the liberalisation legislation is the impact of DG Competition's energy sector review launched in June 2005. During the course of that review DG Comp has obtained a significant amount of evidence of illegal behaviour, partly from complaints from energy customers and competitors and partly through 'dawn raids' which took place in May and December 2006. The outline of that evidence is set out in anonymised form in the Gas and Electricity Market reports published by DG Comp and available on its website. The reports underline the grave nature of the evidence found by DG Comp, from illegal price-fixing and market sharing, referred to by Justice Scalia in the US Supreme Court case *Trinko* as 'the supreme evil of antitrust', to gross abuse of dominance by energy incumbents by denying third party access to their networks in contravention of existing legislation and Article 82 of the EC Treaty. The gas and electricity sectors were found in almost all parts of the supply chain to be riddled with anti-competitive behaviour to the detriment of consumers and energy intensive businesses.

To its credit DG Comp has withstood significant political pressure to deploy the evidence obtained from the review to prosecute energy companies. The number of statement of objections initiated by the Commission against energy companies is unclear, but is understood that approximately 15-20 SOs are in the process of being dispatched. The crucial reality of a detailed evidence-based SO, of several hundred pages, setting out illegal behaviour by an energy company is the key to forcing change in the energy sector. Even the most powerful domestic energy incumbents cannot consider with equanimity the prospect of what the Competition Commissioner Ms Kroes has indicated will be 'sky high fines' for significant breaches of the competition rules.

In addition, and in fact probably more damaging than the size of any fine, is the prospect of the Commission publishing a 200 page prohibition decision which identifies in significant detail the ways in which the energy company in question undermined competition and consequently forced consumers and energy intensive

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businesses to pay higher energy prices. Particularly at a time of very high energy prices, the damage to corporate reputation and the subsequent political damage is more than most CEOs of domestic energy incumbents could reasonably be expected to withstand.

A further connected factor, which reinforces the incentive to settle amongst energy incumbents, is the prospect of damages actions in the national civil courts by energy intensive users, such as chemicals and metals companies, and the prospect, in some States, of class actions by consumers. If the Commission publishes a 200 page prohibition decision listing all the details of illegal behaviour of company X, there is a great incentive, given the very high energy prices energy intensive business users are suffering, to seek to recover some of those costs by deploying the Commission's evidence in national court damages actions. There is a potentially a similar incentive for consumers associations.

Damages litigation on the back of Commission competition decisions has already started to appear in some national courts. Aside from the impact of very high energy prices, one particular reason to sue is that the amount of damages involved are likely to be significantly larger than in a non-energy competition case. The reason for this is that a typical cartel price-fixing case will last approximately 5 years, even then the operation of the cartel may have been intermittent. In most Member States interest on damages is from date of damage, so the compound interest on 5 years worth of illegal profits will be significant but not alarming. By contrast, in the energy field, a powerful domestic energy incumbent may have been able to deny third party access to networks or engage in market sharing for decades. The consequence of paying damages for a very long period of time, together with compound interest represents a core threat to the ongoing financial health of many major energy companies.

If the prospect of prosecution by the Commission, followed by fines, damage to reputation and damages actions in an era of high energy prices were not enough reason for energy companies to agree to unbundle their networks, as E.ON has agreed to do in respect of its electricity network, there is the factor of the growing realisation by shareholders in energy incumbents that unbundling is potentially a very good option for them. The experience in the UK has been that the shareholders of the unbundled British ex-incumbent have benefited enormously from unbundling. The evidence from the British experience is that holding the network and supply or generation together suppresses value which is released when the network is broken up. Furthermore, as most incumbents are at least part-privatised there is the danger that private equity groups will seek to buy up the shares of incumbents, in order to force a break-up to release that value.

These three factors, antitrust prosecution by DG Competition, damages actions and the realisation of shareholder value, put immense pressure on energy incumbents to settle with DG Comp and agree to unbundle. Settlement has the advantage from the energy incumbent's perspective as that as no detailed prohibition decision is published, no fine will be paid and reputational damage is limited. In addition, without a prohibition

decision it is more difficult to sue an incumbent, and the shareholders are satisfied because unbundling takes place.

In this context the papers in this issue make compelling reading Professor Cseres in 'What has Competition Done for Consumers in Liberalised Markets?' argues that while liberalisation may set a useful framework; for it to really deliver it will require flanking policies. They should provide consumers the means to surmounting information available and effective consumer protection legislation are also required. Dr Monti in 'Managing the Intersection of Utilities Regulation and EC Competition Law' considers the cases where antitrust solutions should give way to regulatory ones. Finally Mr Willis and Mr Hughes in 'Structural Remedies in Article 82 Energy Cases' provide a detailed and substantial account of the application of the key recent cases in which Article 82 has been deployed to open up national energy markets.

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What Has Competition Done for Consumers in Liberalised Markets?

*KJ Cseres**

This paper reviews current regulatory approaches designed to correct market failures and distribute the benefits of liberalization to consumers in recently liberalised network industries. Present evaluations of the liberalisation process show that opening up markets to more competition has not yet resulted in either expected levels of competitiveness or in envisaged consumer benefits. Many consumer related failures were little anticipated; legislation to protect and assist consumers was either late coming or inadequate and often lacked effective enforcement. The paper examines market failures primarily related to the demand side; such as information asymmetries, unfair trade practices, unfair standard contract terms, high search and switching costs, and imperfect decision-making processes. It, however, discusses these imperfections in the broader context of market failures related to incoherent regulation and ineffective competition law enforcement and shows how poor coordination between these regulatory fields leads to suboptimal outcomes. The interplay between general consumer protection and specific consumer issues of sector regulation is discussed and elaborates on specific market deficiencies that draw attention to the intersection between consumer protection and competition law. The discussion incorporates theoretical insights from neoclassical and behavioural economics to consumer problems. The paper focuses on what the liberalization process, so far, has done for consumers by looking at and evaluating both the legislative and policy developments and recent proposals at European level as well as actual implementation and enforcement of these legislations at national level. More specifically, it deals with the energy and the telecommunications markets and their recent developments in the EU. Two case studies provide insight on national regulatory approaches: a case study of the liberalization of the Hungarian telecommunications market and a case study of the liberalization of the Dutch electricity market. The paper proposes a new mode of regulation as well as a new mode of coordination among different layers and fields of regulation and enforcement in order to remedy consumer problems and to achieve competitive markets.

1. INTRODUCTION

This paper reviews current regulatory approaches that are designed to correct market failures and distribute the benefits of liberalization to consumers in recently liberalised network industries. Market failures could be, among others, the result of inadequate regulation, ineffective competition law enforcement, insufficient consumer protection or inadequate coordination between the above. Present evaluations of the liberalisation process show that opening up markets to more competition has not yet resulted in either expected levels of competitiveness or in envisaged consumer benefits. Many consumer related failures were little anticipated, legislation to protect and assist consumers was either late coming or inadequate and often lacked effective

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enforcement. In fact, the situation has little changed in this respect. Consumers are often not able to take the advantages made possible by effective competition as a result of information asymmetries, unfair trade practices, unfair standard contract terms, high search and switching costs or imperfect decision-making processes. This paper focuses on what the liberalization process so far has done for consumers by looking at and evaluating legislative and policy developments and recent proposals at European level as well as actual implementation of legislation and enforcement at national level. The paper discusses whether a new mode of regulation as well as a new mode of coordination among different layers and fields of regulation and enforcement is necessary to remedy consumer problems and to achieve competitive markets. The paper is structured in seven sections. The second section briefly introduces the liberalization of the network industries. The third section discusses the interplay between market failures primarily identified on the demand side and competition law. This section elaborates on specific market deficiencies that draw attention to the intersection between consumer protection and competition law. It, moreover, provides theoretical insights from neoclassical and behavioural economics discussing this intersection. The fourth section first describes the overall European framework of the liberalization process and the role of consumer protection issues therein as well as the relationship between sector regulation and consumer protection. It then deals more specifically with the energy and the telecommunications markets and the recent developments in EU policy in these fields. Section five is a case study of the liberalization of the Hungarian telecommunications market and section six is a case study of the liberalization of the Dutch electricity market. Section seven summarizes the issues discussed in the preceding sections and makes further conclusions for policy and law making.

2. LIBERALIZATION OF NETWORK INDUSTRIES: REGULATORY APPROACH

From the 1980s governments tried to limit their intervention in the market mechanism to creating the conditions in which consumers and competition can push markets to socially optimal results by opening markets to competition and simplifying existing regulation. The economic rationale behind this new approach was that by removing barriers to entry, and allowing consumers free choice among several providers of goods and services, competition and innovation will be fostered, leading to cost effectiveness, lower consumer prices and improved quality and variety, and ultimately lead to economic growth. Accordingly, competition has been introduced into markets that previously were dominated by state monopolies. Deregulation has been predominant in the network industries such as telecommunications, post, electricity, gas, transport and water. In the 1980s Britain took a lead in the deregulation and liberalization process and many EU countries followed suit; however, at a slower pace. The EU has gradually taken a role in stimulating and requiring its Member States to follow suit in the liberalization process. These competition enhancing reforms were in the first place focused on introducing and guaranteeing the full operation of competitive forces. However, merely relying on and sustaining effective competition proved to be ineffective to achieve the envisaged goals. Certain framework laws were necessary to

delineate property rights, contracts, firm behaviour, institutional set-up and to assist consumers.

This wide-spread liberalisation has transferred relevant parts of law making and law enforcing to private parties. Consumers have been entrusted with tasks that used to belong to the public law realm. The task of disciplining the market has been shifted from the state to private individuals who became responsible for making decisions and enforcing their rights in markets where previously they were dependent on the state. More competition and less regulation has been expected to lead to increased consumer welfare in terms of price, quality and choice but experience has not (yet) showed evidence of more optimal market functioning for consumers.

The (de)regulatory approach to opening up markets in the network industries has been strongly tilted in favour of the supply side. The legislative tools primarily targeted a competitive market structure by introducing specific regulatory frameworks that complemented existing competition rules and institutions. Market failures were in the first place anticipated on the supply side and therefore (de)regulation was aimed at effective competition through disciplining incumbent and new firms. It seems that it has been assumed that competition and competition law tools will be sufficient to activate consumers to make new choices by lowering prices and widening the range of products and services. Consumers could, however, not make (optimal) use of their newly acquired possibilities. Regulatory approaches strongly focused on supply side market failures and the role and function of private consumers in the liberalization process has been largely neglected.[1]

While consumers were envisaged as the ultimate beneficiaries of the liberalized markets this premise holds only when consumers are responsive to price and output and thus able to seek the best price-quality combination on offers. If demand is inelastic and switching costs are high or unfair trade or abusive practices prevent them acting in their best interest they will not be able to enjoy the advantages of a competitive market. Moreover, empirical studies in recently liberalized markets showed high degree of consumer inertia and indicated that many consumers despite the optimal balance between search, switching costs and expected gains are not taking advantage of beneficial switching and, in some cases, are switching to higher-cost suppliers.[2]

Traditionally utility markets were regulated and it was believed that utilities can be the best distributed through a monopoly. The shortcomings of this approach have lead to the liberalisation and deregulation of these markets worldwide. While potential contestability of these markets are regarded as a strong and often sufficient competitive constraint on incumbents, empirical research implies that the competitiveness of these

[1] HW Micklitz & LA Reisch, 'Consumers and deregulation of the electricity market in Germany' (2006) 29(4) Journal of Consumer Policy 399-415, p 406.

[2] M Giulietti, C Waddams Price, and M Waterson, 'Consumer choice and competition policy: a study of UK energy markets' (2005) 115 The Economic Journal 949-968; C Wilson and C Waddams Price, 'Irrationality in Consumers' Switching Decisions: when more firms may mean less benefit', CCP Working Paper 05/04, ESRC Centre for Competition Policy, University of East Anglia, 2005.

markets is also related to the fact whether consumers are mobile and able to switch suppliers. In the next section the interplay between market failures on the demand side and competition as well as the interplay between consumer protection and competition law enforcement will be discussed.

3. THE INTERPLAY BETWEEN DEMAND SIDE MARKET FAILURES AND COMPETITION LAW

Deregulation and liberalization have the potential to increase competition and benefit consumers but this assumption will only hold when consumers have the legal and economic competence, the capacity, opportunity and motivation to take on the responsibilities shifted from the state to private individuals in the course of liberalization. As a starting point consumers will have the capacity and opportunity to assume responsibility for their own transactions and enforce their rights when markets are transparent, information costs are affordable and abuse of market power and unfair trade practices are controlled.[3]

While it is usually correct to assume that consumers change their behaviour and allegiance in response to price changes, this only holds if the market supplied the necessary information, which businesses and consumers need to behave rationally and conclude efficient transactions. Consumers facing significant information problems will make less rational decisions and might eventually make the market perform sub-optimally. This is especially so in markets of non-homogeneous, complex products such as financial services, where such consumer behaviour can often create significant barriers to entry and therefore influence the way markets operate.[4] The question is whether and to what extent these market imperfections influence competition law enforcement and whether competition law enforcement can remedy these failures.

Imperfect consumer information may affect competition in the market and lead to what former Director General of the OFT, John Vickers, calls 'micro-competition' problems,[5] for example, when sellers with market power exploit information asymmetries which leads to abuse. A poorly informed consumer who is not aware of alternative choices before his purchase and who might be subject to the seller's pressure is in fact subject to market power. Or a consumer entering a contract with unfair contract terms is subject to the exploitation of market power. Consumers' information problems thus can have relevant implications for competition analysis. Imperfect information may make a market that appears competitive behave anti-competitively,

3 Th.B.C Poiesz, 'The free market illusion: psychological limitations of consumer choice in Market regulation: lessons from other disciplines', Ministry of Economic Affairs, 2004, The Hague, p 17; Micklitz & Reisch, op cit n 1, p 405.

4 M Waterson, 'The role of consumers in competition and competition policy' (2003) 21 International Journal of Industrial Organisation 129-150, p 146.

5 Deceit by one group of sellers may lead consumers to doubt the integrity of an entire industry or to distrust markets generally. Therefore competition is not simply fundamental to consumer policy but, as the chairman of the OFT remarked, 'much consumer policy is competition policy'. J Vickers, 'Economics for consumer policy', British Academy Keynes Lecture, 29 October 2003, p 7, 16-17.

because it can provide a basis for market power. Imperfect information-based market power may harm consumers by imposing excessive (unfair) prices or other unfair trading conditions and thus distort consumers' otherwise welfare maximising choice. Sellers may exploit consumers' lack of knowledge about their rights or their inability to understand standard contract terms, complex goods, to conduct direct comparisons and to monitor service delivery.[6]

3.1 Standard contract terms: competition or consumer law problem?

Standard contract terms is an area where both consumer and competition issues might arise and makes it subject to both consumer and competition law enforcement. Standard contract terms can reduce transaction costs for both business and consumers. Market transparency in fact might require some kind of level of standardization in order to guarantee comparability of different offers. They can also reduce switching costs by making comparison and choice between the different providers easier. However, when switching costs are created by the firm itself in order to lock in consumers then standardization can be caught by competition law enforcement as being anti-competitive.[7]

Standard contract terms are generally subject to the control of competition law and consumer law concerning unfair contract terms. Accordingly, standard contract terms should not be abusive and thus should impose unfair disadvantages on consumers as these harm consumer welfare. What amounts to unfair as anti-competitive in competition law and unfair as unlawful in consumer law differs substantially and could lead to different or even conflicting judgments on the basis of one or the other set of legislation. But both cases concern an inequality of bargaining power, economic duress and undue influence and thus they concern a situation where one party uses its stronger position vis-à-vis other market players to obtain terms that it could not have without that disparity in power. This leads to a situation of exploitation in both competition and consumer law.[8] In regulated sectors the sector specific regulators have to control the content of contracts and their compliance with regulatory goals.[9]

3.2. Neoclassical and behavioural economics on information failures and remedies

Information provisions are often considered as effective means to cure information asymmetries and assist consumers in their decision-making process. Neoclassical economics provides useful insights on how information affects the dynamics of markets, the determinants of bargaining and drives regulatory approaches of consumer

[6] Vickers, *ibid*, p 7.

[7] Cafaggi, 'Self-Regulation in European Contract Law', European University Institute Law Working Paper No. 2006/43, p 13.

[8] P Akman, 'A Tale of Three Cities: Fairness, Welfare and Exploitative Abuse under Article 82 EC', unpublished PhD thesis, 2008, and P Akman, 'To Abuse, or not to Abuse: Discrimination between Consumers', CCP Working Paper 06-18.

[9] Cafaggi, op cit n 7, p 13-14.

protection to a more effects and cost-benefit based analysis. The assumptions of neoclassical economics, however, treat key aspects of consumer decision making as exogenous and as such can say little about the amount, the nature of and the way information should be framed and disclosed to consumers. Behavioural economics based on empirical research deals with endogenous aspects of consumer decision-making and questions present policies for consumer protection. Insights from neo-classical economics on information asymmetry, adverse selection, moral hazard, transaction costs as well as recent findings of behavioural economics about systematic cognitive errors of consumers' decision making have relevant implications for designing new regulatory frameworks and setting priorities for regulatory agencies.[10] Both streams will be briefly reviewed below.

Neoclassical economics focus on market failures originating from information failures. It identifies the sources of information deficiencies and thus consumer harm either in the lack of competition or in the fact that information is unavailable, not costless, or the uncertainty of individuals about the quality of product characteristics. The more difficult it is to determine the quality of a product, the more information about the quality of that product will need to be provided in order for the consumer to make an informed decision to offset the market failure of information asymmetry and subsequent adverse selection, which can be relevant to all product characteristics.

Information problems can be solved through uninformed consumers' screening or sellers' signalling. Screening is when uninformed consumers search for information on their own or with the help of third parties with special knowledge or capabilities.[11] In the case of signalling sellers show that they are interested and that they offer high quality. Signals can be warranties, reputation, brands, advertising or franchising, but they will only succeed if sellers of high quality goods use them.[12] Reputation and brands as signals of quality can however act as barriers to new entrants and decrease competition. Product comparison modalities like reviews on the internet can considerably decrease information search costs enabling increased competition and the benefits accruing from that competition to consumers but may at the same time facilitate collusion among firms.

Information asymmetry cannot be solely offset by regulating the mandatory provision of information. The search costs of gathering and evaluating more information to improve a decision about buying a product or a service have to be weighed against the

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[10] G Akerlof, 'The market for 'lemons': quality uncertainty and the market mechanism' (1970) 84 Q. J. Econ. 488-500; GJ Stigler, 'The economics of information', (1961) 69(3) JPE 213-225; HA Simon, 'A Behavioral Model of Rational Choice' in, HA Simon, *Models of man: social and rational: mathematical essays on rational human behaviour in a social setting*, New York: Wiley, 1957.

[11] Insurance brokers or estate agents are good examples. Information suppliers may have special equipment or experience in evaluating goods and their information costs are lower than the same costs of consumers. They can even control the producer's behaviour after the contract has been signed.

[12] T Wein, 'Consumer information problems – causes and consequences' in, S Grundman, W Kerber & S Weatherhill (eds.), *Party autonomy and the role of information in the Internal Market*, de Gruyter: Berlin, 2001, pp 85-6.

benefits of that added information.[13] The search costs of acquiring and using information and the opportunity costs of time have to be weighed against the expected benefits.

Neoclassical economics starts from a number of assumptions such as market players have stable set of preferences and they make consistent and rational choices in order to maximize their own welfare. However, recent empirical findings of behavioural economics challenge these assumptions on the basis of examining what people actually do, how consumers analyse, interpret and use product and service information. Consumer preferences seem to fluctuate depending on the situation in which they have to make their decisions. Individuals lack the ability to build constant and reasoned preferences because they are influenced by the context where they seem exhibit certain cognitive errors related to time or memory or simple miscalculation. Consumer behaviour is context dependent and the form, context, quantity and substance of information have an impact on the ability of individuals to assess that information.[14] Consumers will only look for and process a certain amount of information. As a consequence individuals fail to maximize their welfare under specific circumstances. As a consequence individuals fail to maximize their welfare under specific circumstances[15] and they take short cuts when making decisions leading to choices that might be inconsistent with promoting their own welfare.[16]

The theory of bounded rationality argues that the capacity of the human mind to conceive and process complex information is relatively limited. Behavioural or experimental economics found that consumers may rely on heuristics instead of being guided by rationality.[17] The new research showed that decision-makers systematically fail to deal with information even in situations where the market does not have difficulty in producing the socially optimal amount of information or in distributing it efficiently.[18] In these situations consumer harm is a result of behavioural biases.[19] These biases can take many forms such as misunderstanding small probabilities, pseudo-certainty, hyperbolic discounting, overconfidence, default bias, decision-conflict as a result of information overload.[20]

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[13] This is referred to as rational apathy, a term originating from political science literature explaining why people do not vote.

[14] R Smith, S King, 'Does competition law adequately protect consumers?' [2007] ECLR 416.

[15] RB Korobkin, & TS Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88(4) Cal LRev 1051-1144.

[16] HA Simon, op cit, n 10, pp 261, 270-271.

[17] Th.B.C Poiesz, 'The free market illusion: psychological limitations of consumer choice in Market regulation: lessons from other disciplines', Ministry of Economic Affairs, 2004, The Hague, p.17

[18] TS Ulen, 'Information in the market economy – Cognitive errors and legal correctives' in, S Grundman, W Kerber, & S Weatherhill (eds.), *Party autonomy and the role of information in the Internal Market*, de Gruyter: Berlin, 2001, pp 98-99, 105.

[19] OECD, Roundtable on economics for consumer policy, Summary Report, DSTI/CP(2007)1/FINAL, p 11

[20] Decision-making heuristics cause consumers to underestimate benefits of searching and switching, for example in case of endowment bias consumers value more what they have than what they might have or in

The implications for consumer protection policy and lawmaking differ in the case of neoclassical economics and behavioural economics. Neoclassical economics identifies consumer detriment in the presence of market power of suppliers and encourages remedies such as vigorous competition policy enforcement.[21] However, simply increasing competition and competition law enforcement efforts does not always lead to optimal market circumstances for consumers; as experience in the liberalized markets proves. Information deficiencies are still present and may lead to consumer harm in competitive markets as well. For example, in case a dominant firm exploits its customers by applying unfair contract terms the enforcement agency can intervene but only on the basis of competition law principles and only by taking account of the interests attached to free competition. It will not engage in an assessment how consumers can be assisted to spot unfair contract terms and help them enforce their rights. Neoclassical economics encourages more and better information to remedy market failures on the demand side, such as mandatory disclosure or third-part certification. However, more disclosure may conflict with competition policy as it might lead to collusion and it may not be as useful for consumers either. Behavioural economics suggests that intervention should be imposed with a 'lighter hand'.[22] It suggests remedies aimed at framing effects and thus steer consumers' choices towards welfare enhancing options.[23] Paternalistic guidance towards certain options through framing the way information is provided could assist consumers to de-bias their decision-making and to channel their decisions to socially beneficial options.[24]

The difficulty lies in the fact that the predictions of the neoclassical model are often elegant, but prove to be wrong when empirically tested and evidence from behavioural economics research is difficult to channel into a useable taxonomy for regulation but it is more likely to be accurate.[25] In order to determine whether to intervene and how to intervene to assist consumers a complex array of issues has to be taken into account. Not only the costs of intervention, but also the costs imposed on business and the different groups of consumers (informed, sophisticated, uninformed and vulnerable) have to be considered. Regulatory tools imposing measures that ultimately diminish competition that increases consumer choice should be avoided. Highly complex systems of information disclosure originally aiming at lowering information costs will obviously restrict competition and will have counterproductive effects. Consumers

case of hyperbolic discounting when they rationally do not weigh present gains against future benefits and put too much weight on the immediate. Framing biases originate from the specific ways objective information is provided. OECD, Roundtable on economics for consumer policy, Summary Report, DSTI/CP(2007)1/FINAL, p 12.

[21] R Smith, S King, 'Does competition law adequately protect consumers?' [2007] ECLR 417.

[22] OECD Roundtable discussion on private remedies: class action/collective action; interface between private and public enforcement, United States of America DAF/COMP/WP3/WD(2006)34, p 18.

[23] R Sunstein & RH Thaler, 'Libertarian Paternalism Is Not An Oxymoron' (2003) 70 U Chicago LRev 1159.

[24] OECD Roundtable discussion on private remedies: class action/collective action; interface between private and public enforcement, United States of America DAF/COMP/WP3/WD(2006)34, p 18.

[25] RH Thaler, 'Toward a Positive Theory of Consumer Choice' (1980) Journal of Economic Behavior and Organization 1 39-80.

unable to make informed choices are forced to employ expensive intermediaries and business has to bear the costs of the ineffective disclosure. Some consumer protection measures create barriers to entry that limit the freedom of sellers and might eventually lead to higher prices for consumers.

Interventions therefore should be evidence-based, focused and evaluated to ensure that it is not unnecessarily applied. It should be examined why the market-based solution does not work or why that solution might be socially sub-optimal.[26] It also has to be demonstrated why government regulation is going to be better than markets in providing low-cost information. Even where a relevant market failure has been identified, government should only act when this is feasible and it is cost-effective to do so. The costs and benefits of particular forms of intervention and alternatives thereto should be examined and represented. Consumer regulation will only make consumers better off if it either improves consumer estimates of the value of information or reduces the cost of information to consumers.

In the following section the European framework of liberalization will be discussed from the consumer protection perspective. Special attention will be paid to policy measures and legislation on consumer interests in the telecommunications and energy market.

4. EUROPEAN FRAMEWORK

In the EU the liberalization process has taken place in a number of sectors where services of general economic interest (SGEI) are provided; such as telecommunications, postal services, transport and energy. The Commission argued that it has always promoted 'controlled' liberalisation, i.e. gradual opening-up of the market accompanied by measures to protect the general interest.[27] Still, the legislation on services of general economic interests has evolved on the basis of the principle of an open and competitive internal market and accordingly along the lines of competition law, state aid and sector regulation. While Article 86(2) EC and the case-law since *Corbeau*[28] clearly lays down the right of the Member States to determine and regulate services of general economic interest from the mid-90s the Commission tried to obtain competences in this field. The Amsterdam Treaty introduced Article 16 EC, which did not provide the Community with new competences, but has conferred responsibility upon both the Community and the Member States to ensure, each within their respective sphere of competences that their policies enable services of general economic interest to fulfill their missions. This provision does not provide the Community with specific means of action but it was an attempt to reduce the Member States' leeway to define, organize,

[26] These are self-correcting mechanisms that are based on private law norms of tort, contract and property rights that they are the result of government action. G Hadfield, R Howse, M Trebilcock, 'Information Based Principles for Rethinking Consumer Protection Policy' (1998) 21 Journal of Consumer Policy 131-169, p 155.

[27] Green Paper on services of general economic interest, COM(2003) 270 final, Brussels, 21.5.2003, p 4.

[28] Case C-320/91 *Corbeau* [1993] ECR I-2533, para 14.

finance and monitor services of general interest.[29] Correspondingly, sector specific regulations in the EU have developed on the basis of minimum harmonization. Issues of consumer protection have been identified as key elements in the regulation of SGEI and grouped around a number of principles such as universal access, affordability, transparency choice, safety and security of services, continuity, high quality, redress and compensation mechanisms, representation and participation, independent regulatory authorities and effective enforcement.[30] In the following the discussion will focus on the regulation and the enforcement of these consumer protection issues.

4.1. Consumer protection issues

Alongside competitiveness, consumer interests, and their protection as one of the Community values have been central in the liberalization process and the way policy developed on services of general interest as evidenced in the White Paper on services of general interest in 2004.[31]

There has been no clear cut European policy on consumer issues in the process of liberalization. Issues of consumer policy were largely left to the Member States providing them substantial leeway to upgrade consumer rights that had only marginally been prescribed by EU Directives.[32] However, many of the Member States remained reluctant to do so. Consumer rights and regulation of consumer transactions are dispersed in several pieces of secondary legislation. Preventive measures such as guaranteeing transparency of information and contract terms, access to information, fair contractual terms, choice, affordability and quality of services had already been enacted in the consumer *acquis*. General consumer law and thus contract law related issues are regulated in Directive 93/13 on unfair contract terms and Directive 97/7 on distance selling. More specific sector regulatory legislation such as the Electricity Directive 2003/54 and the Universal Service Directive 2002/22 (Article 3 and Annex II) contain specific rules (Articles 3, 9-11, 20-22, 34) related to consumer protection. These soft law instruments regulate mainly issues such as universal service provision, access to (cross-border) services, affordability of tariffs, physical safety, reliability, security continuity, choice, access to and transparency of information, contractual terms and tariffs as well as quality of services. These issues are mainly related to contract law and especially pre-contractual information disclosure. However, the absence of these sector regulatory issues in general EU contract law as well as any cross-references between general consumer contract law and sector regulations is striking.

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[29] 'The Community for its part has competencies in areas that are also relevant for services of general interest, such as: the internal market, competition and State aid, free movement, social policy, transport, environment, health, consumer policy, trans-European networks, industry, economic and social cohesion, research, trade and development co-operation, and taxation', Green Paper, op cit, n 27, pp 9-10.

[30] Green Paper, op cit, n 27, pp 39-41, White Paper on services of general interest, COM(2004) 374 final Brussels, 12.5.2004, p 9.

[31] White Paper on services of general interest , COM(2004) 374 final Brussels, 12.5.2004.

[32] Micklitz & Reisch, op cit, n 1, p 406, 412.

Moreover, the absence of provisions or clear guidelines on enforcement of the substantive rights and access to justice is remarkable. Appropriate redress in case of complaints through effective means of dispute resolution and remedial measures such as injunctions and compensation through private enforcement have been either neglected or only briefly touched upon; as in Article 34 Directive 2002/22 on out-of-court dispute settlements and in Article 23 (5-12) Directive 2003/54 on complaints. These provisions lack references to the consumer legislation in this field such as Directive 98/27/EC on injunctions, Regulation 2006/2004 on consumer protection cooperation and Recommendation 98/527 on out-of-court settlements of consumer disputes or the recent Green Paper on damages actions.[33]

Private enforcement is a powerful instrument to make consumer rights hard and deter future anti-consumer conduct. While compensation has been mentioned no individual or collective rights have been drafted upon which a consumer could claim damages. A legal action, however, could plausibly based on Article 82 EC for abuse of a dominant position through excessively high or unfair prices or applying other unfair conditions *vis-à-vis* consumers.

Similarly no guidelines for institutional framework that guarantee effective enforcement have been set out. Public enforcement in the Member States takes place through a wide variety of agencies either resorting competences to national competition authorities, specific sector regulatory agencies or national consumer authorities.

4.2. Sector regulation and general consumer law

The relationship between general competition law and sector regulation has been extensively dealt with in the liberalization process both at EU and at national legislative levels. The same cannot be said about the relationship between general consumer law and sector regulation. However, this was essential as recent evaluations and new proposals in the EU indicate. These evaluations concluded that the regulatory framework was insufficient to enable consumers to reap the full benefit of the liberalisation process. In many countries liberalisation has led to mixed results. While it improved competition for large users, and provided better prices, new products and services at the same time, it also resulted in much consumer harm. The lack of transparency in prices, the confusing variety of products and services and numerous unfair trade practices raised major difficulties for final consumers in exercising their newly acquired choice. The complexity of product selection resulted in certain cases consumers being disconnected from or disadvantaged in the market.

Consumers' position *vis-à-vis* service providers has traditionally been weak in many Member States and their grip of traditional advertising and retail mediums has considerably weakened over these consumer markets. The problems consumers face in these markets are principally related to information failures. The sources of consumer harm can be found in dominant firms applying unfair contract terms, high search and

[33] Green on damages actions, COM(2005) 672, 19.12.2005.

transaction costs or in the imperfect decision-making process either as a result of incomplete information or because of misleading and unfair commercial practices. Moreover, manufactured confusion is a deliberate tactic some firms use to avoid price competition, especially in the telecommunications sector. All the same, recent empirical studies show that consumers deviate from rational behaviour; even when information is available to them and considerable cost savings are possible they will limit their use of that information and create potential consumer harm. Many consumers are not taking advantage of beneficial switching and, in some cases, are switching to higher-cost suppliers.

The Commission's Consumer strategy 2007-2013 acknowledged that as liberalization further develops transition to liberalized services such as electricity, gas, post and telecommunications poses challenges for consumers and regulators to ensure consumer welfare is maximized. For example, while e-commerce has great potential to improve consumer welfare, by making a greater range of products available, boosting price competition and developing new markets, it also brings significant new challenges and in particular it weakens the grip of traditional advertising and retail mediums over consumer markets. The Commission argued that while the expected benefits of liberalization are considerable, it also challenges traditional modes of regulation, self-regulation and enforcement methods. Traditional consumer rights will be less and less adapted to the digital age.[34]

The Commission in its new proposals for amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and services, and 2002/20/EC on the authorisation of electronic communications networks and services argued that 'regulatory fragmentation and inconsistencies between the activities of the national regulatory authorities were found to jeopardize not only the competitiveness of the sector, but also the substantial consumer benefits from cross-border competition.'[35] 'The current fragmentation hinders investment and is detrimental to consumers and operators. Inconsistencies in the national regulatory authorities' application of remedies, even under similar market conditions, undermine the internal market in electronic communications, do not ensure a level playing field between operators established in different Member States, and prevent the realization of consumer benefits from cross-border competition and services.'[36]

This is a similar line of argument as the one in the Commission's Green Paper on the review of the consumer *acquis* where it claimed that consumers lack the confidence to

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[34] EU Consumer Strategy 2007-2013, COM(2007) 99 final, pp 3-4.

[35] Directive of the European Parliament and of the Council amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and services, and 2002/20/EC on the authorisation of electronic communications networks and services, COM(2007)697 rev1, p 14.

[36] *Ibid*, p 3, 15.

make cross-border purchases because of the fragmentation of national legal rules on consumer protection.[37] The Commission sees a direct link between the lack of consumer confidence and the fragmentation of consumer rules in the Member States and argues that this fragmentation is on the one hand the result of minimum harmonisation and on the other hand, it is the consequence of the inconsistencies between the EC Directives.[38]

The fragmentation and inconsistency between general consumer law and sector specific regulations seems to be a real problem. More coordination by the Commission both in terms of legislation and enforcement between the different DGs, as well as with the Member States, seems indispensable. While the different sectors exhibit different industry features, and thus require different policies and regulation, there are also similarities in market failures on the demand side and in the way regulation can approach them as Commissioner Reding has recently argued comparing the telecommunications and the energy sectors.[39]

The EU regulatory framework is now being revised in order to serve the interests of consumers by strengthening their rights through improving, for example, information provisions and other contractual terms in order to facilitate switching and to make efficient and informed choices.[40] These reform proposals will be further reviewed below.

4.3. EU regulatory reforms in the energy and telecommunications sectors

A common EU energy market has been implemented since 1999 through a number of directives beginning in 1996[41] and the second round of measures entered into force in 2003.[42] Since then, implementation and the practical results of the Directives have been annually monitored and reported through detailed country reviews and the sector inquiry. This monitoring showed that uneven progress has been achieved since 1999. The current European legislation of 2003 had to be properly transposed into national legislation and energy markets opened up for consumers and new entrants by 1 July

[37] Green Paper on the Review of the Consumer Acquis, COM(2006) 744 final.

[38] *Ibid*, p 3.3

[39] The Network Industries in the 21st Century: Regulating for Growth and Competition in the Internal Market, European Government Business Relations Council, Brussels, 5 March 2007.

[40] Commission Press Release, 'Commission proposes a single European Telecoms Market for 500 million consumers' IP/07/1677, 13 November 2007; Commission Press Release, 'Energising Europe: A real market with secure supply' IP/07/1361, 19 September 2007, and DG Competition report on energy sector inquiry, SEC(2006) 1724, 10 January 2007, p 4.

[41] Directive 96/92/EC concerning common rules for the internal market in electricity, OJ 1997, L27/1, and Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, OJ 1998, L204/1.

[42] Directive 2003/54/EC concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ 2003, L176/37, Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ 2003, L176/57, Regulation 1228/2003/EC on conditions for access to the network for cross-border exchanges in electricity, OJ 2003, L176/1, and Regulation 1775/05/EC on conditions for access to the natural gas transmission network, OJ 2005, L289/1.

2007. While the basic concepts of the internal energy market have become embedded in terms of the legal framework, institutional arrangements and the physical infrastructure such as IT equipment, but meaningful competition does not exist in many Member States. Moreover, consumers often do not have any real possibility of opting for an alternative supplier.

Therefore, the Commission has, throughout 2005-06, been conducting an inquiry for the gas and electricity sectors under competition law. The European Commission's recently released Report on energy sector inquiry[43] among others 'has identified a number of serious shortcomings which prevent European energy users and consumers from reaping the full benefit of the liberalisation process.' As a consequence, the Commission has put forward a Draft Charter on the Rights of energy consumers[44] as an attempt to set out the rights consumers have in the areas of electricity and gas supply. The Commission does not consider the future European Charter on the Rights of Energy Consumers to be a legal document. Instead, the Charter should set out, in an easily comprehensible way existing Community legislation and possible elements for future action in relation to universal service, contracts, prices, tariffs, monitoring, free choice of suppliers, information, complaints and dispute settlement, representation, social measures and protection against unfair commercial practices. The role of the Charter seems to be limited to a policy document that intends to inform consumers better and encourage effective enforcement of consumer rights in the Member States. However, such a 'soft' instrument might not be sufficient to enforce consumer rights effectively in the EU.

Furthermore, in September 2007 the Commission has adopted a third package of legislative proposals[45] to ensure an effective choice of supplier and benefits to all EU consumers. The Commission's new proposals put consumer choice, fairer prices, cleaner energy and security of supply at the centre of its approach. The Commission also proposes to establish an Agency for the cooperation of National Energy Regulators, with binding decision powers, to complement national regulators. This will ensure the proper handling of cross-border cases and enable the EU to develop a real European network working as one single grid, promoting diversity and security of supply. The Proposal for a Directive amending Directive 2003/54/EC proposes among others measures that would strengthen the market regulatory powers of national regulatory agencies among others to make consumer protection measures effective and to reinforce substantive rules by effective, appropriate and dissuasive sanctions.[46] The main amendment to the consumer protection provisions are made in Annex A where

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[43] Report on energy sector inquiry SEC(2006) 1724.

[44] Draft Charter on the Rights of energy consumers, COM(2007) 386 final.

[45] Proposal for a Directive amending Directive 2003/54/EC concerning common rules for the internal market in electricity, COM(2007) 0528; Proposal for a Regulation amending Regulation 1228/2003/EC, COM(2007) 0531; Proposal for a Directive amending Directive 2003/55/EC, COM(2007) 0529; Proposal for a Regulation amending Regulation 1775/2005/EC, COM(2007) 0532; and, Proposal for a Regulation, COM(2007) 0530.

[46] Proposal for a Directive amending Directive 2003/54/EC, ibid, Recital 18.

measures for providing consumers with consumption data in the format and procedure Member States define free of charge, proper information about monthly consumption and costs and unrestricted switching of suppliers.[47]

Similarly, in the telecommunications sector the Commission has put forward new proposals for reforming current telecomm regulations in order to bring more competition and better regulation to the telecomm sector as well as to combat the fragmentation of telecomm regulation throughout the Member States and to improve the protection of consumer interests. The Commission proposes to strengthen consumer rights through giving consumers more choice by reinforcing competition between telecomm operators to promote investment into new communication infrastructures and making communication networks more reliable and more secure, especially in case of viruses and other cyber-attacks. Further, a new European Telecom Market Authority will support the Commission and national telecoms regulators in ensuring that market rules and consumer regulation are applied consistently, independently and without protectionism in all the Member States.

The proposed Directive amending Directives 2002/22/EC, 2002/58/EC and 2006/2004 proposes measures targeted at improving the transparency and publication of comparable, adequate and up-to-date information in an easily accessible form for users related to price increase and allowing third parties to use publicly available tariffs (e.g. for the purpose of selling or making available interactive guides) and national regulatory authorities to make such guides available when these are not available on the market (Article 21(2) to (6)). Further, facilitating use of and access to e-communications for disabled users (Articles 7, 22, 26(4),33) facilitating the switching of suppliers by consumers through, among other, strengthened provisions on number portability (Article 30), improving obligations related to emergency services (Article 26), ensuring basic connectivity and quality of service (Articles 20(5), 22). In addition, rules have been proposed to monitor retail tariffs, further information provisions in consumer contracts (Article 20(2h)(4)(6)) and that consumer interests are taken into account in consultations on the regulatory framework for electronic communications (Article 33) as well as a reinforced call to the Member States for transparent, simple and inexpensive out-of-court procedures for dealing with unresolved disputes between consumers and undertakings providing electronic communications networks and/or services, relating to the contractual conditions and/or performance of contracts concerning supply of such networks or services. Moreover, procedures should enable disputes to be settled fairly and promptly and a system of reimbursement and/or compensation could be established (Article 34). These are minimum measures that the Member States may extend to cover disputes involving other end-users.

Most of the new proposals focus on providing more and better information for consumers. However, as explained above increasing the amount of information may not help but rather accelerate consumers' problems. This is the case of so-called inertia

[47] Article 27b, Proposal for a Directive amending Directive 2003/54/EC, ibid.

when people are unable to process complex information and go on to take irrational decisions. Or the oversupply of information may be counterproductive and may deteriorate market transparency, a situation referred to as 'confusopoly'.[48] Empirical studies in recently liberalized markets showed high degree of consumer inertia and indicated that many consumers despite the optimal balance between search, switching costs and expected gains are not taking advantage of beneficial switching and, in some cases, are switching to higher-cost suppliers.[49] Even when comparative information is available to consumers this inertia may be explained by computational difficulties, perceptions that search costs are high, or by possibly misplaced trust in consumers' present supplier. Thus consumer confusion and 'information-overload' are rather the reasons for these mistakes than other 'rational' explanations of consumer mistakes such as perceived differences in firm quality or uncertainty over consumers' own demand.[50] In the light of these theoretical and empirical results the Commission should reconsider the measures proposed for the assistance of consumers. It could encourage Member States to introduce measures, such as model standard term contracts, that frame decisions for consumers without being mandatory for firms, or set up systems that provide tips and tools and functional information that is easy to access and understand.

Moreover, enforcement and institutional matters should be more clearly elaborated. Policy measures should concentrate on, and recommend guidelines for, governance on enforcement distribution and the institutional framework. The imposition of another layer of enforcement agency at central EU level seems to provide little help in this respect when these issues are primarily to be solved at national levels.

In the following two case studies of national developments are presented in order to examine liberalization on a more micro-level where, beyond implementation of EU legislation, enforcement exhibits the actual problems market players and regulators face. First, the liberalization of the Hungarian telecommunications market will be discussed and then the Dutch electricity market. The paper will examine the results of market opening in these two cases with regard to consumer interests and the impact of consumer behaviour on competitive market outcomes. The different regulatory approaches will be analyzed and compared with the regulatory framework suggested by the EU.

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[48] J Gans, 'The Road to Confusopoly', available on the ACCC conference website at www.accc.gov.au/content/index.phtml/itemId/658141/fromItemId/3765.

[49] M Giulietti, C Waddams Price and M. Waterson, 'Consumer choice and competition policy: a study of UK energy markets', (2005) 115 The Economic Journal 949-968; C Wilson & C Waddams Price, 'Irrationality in Consumers' Switching Decisions: when more firms may mean less benefit', CCP Working Paper 05/04, ESRC Centre for Competition Policy, University of East Anglia, 2005.

[50] C Wilson & C Waddams Price, 'Irrationality in Consumers' Switching Decisions: when more firms may mean less benefit', CCP Working Paper 05/04, ESRC Centre for Competition Policy, University of East Anglia, 2005.

5. LIBERALIZATION OF THE HUNGARIAN TELECOMMUNICATIONS MARKET

5.1. The first wave of liberalization

Despite the heritage of the socialist economies the development of economic policy from the end of 1980s in the Eastern European countries has been similar to the Western jurisdictions. From the end of the 1980s over-regulated markets have been deregulated, former state monopolies have been abolished and several sectors have been liberalised. By 2004 Hungary had made reasonable progress in liberalising its electricity, gas and telecommunications markets.[51] Independent regulatory agencies had been established with a mandate to open up markets to competition, prevent incumbents from abusing their position and avoid collusion between operators.

Gradual liberalisation of the telecommunications market started with the 1997 amendment of the 1992 Telecommunications Law, but its pace has not been satisfactory. The main fixed line telecommunication market was opened in December 2001 with some temporary exceptions, notably delay in the expiry of local telephone concessions to 2002. The Telecommunication Act XL of 2001 harmonised Hungarian telecommunication legislation with the European *acquis* and signalled the beginning of the liberalisation of the Hungarian telecommunications market. Nevertheless, restrictions in fixed-line services continued to be much higher than in the mobile telephony sector and higher than in most other EC countries. The opening-up of the telecommunications sector did not result in the introduction of fierce competition in the case of fixed telecommunications. This was partly due to the abusive, exclusionary conduct of Matáv (today Magyar Telekom). Magyar Telekom's strong position partly reflected a tilting of regulations against new entrants. The dominant fixed-line network operator was able to restrict end users' ability to choose the services of other operators. The actual effects of the 2001 liberalisation of the fixed telecommunications market remained almost unnoticed for final consumers until 2003. On the market for business users, alternative suppliers were striving to stay on the market but possibilities for expansion were restricted. Price regulation ceased to exist both in the case of retail and interconnection services. However, in the case of operators enjoying a significant market power, a price-cap mechanism was applied to retail services and the Act prescribed the basis for calculating the cost for their interconnection services.[52]

The reasons for the failure of this initial liberalisation were to be found in regulatory shortcomings and failures that did not enable number portability and restricted carrier pre-selection (CPS). One consequence was that suppliers could create preferential tariff packages that rational consumers opted for and subsequently suppliers concluded long-term contracts with the consumers who were accordingly locked-in and CPS was

[51] OECD, 'Product market competition and economic performance in Hungary', Economics Department Working Papers No. 381, 2 March 2004, p 17.

[52] GVH, Hungarian Competition Authority, Annual Report 2003, p 11.

excluded.[53] Moreover, access charges and interconnection fees remained relatively high, with the latter resulting in price squeezes on new entrants and helping the incumbent retain its market share. Unbundled access to the local loop was provided by law, but was not applied in practice, partly because of price squeezes. Magyar Telekom, the incumbent in the Hungarian telecom market was condemned several times and fined by the Hungarian Competition Authority (Gazdasági Versenyhivatal hereinafter GVH) for abusing its dominant position. For example, in the period February-July 2002 Magyar Telekom charged higher prices for interconnection services than for retail services offered to end users. The margin between the two prices left no room for competitors to enter the market. Magyar Telekom introduced tariff packages for end consumers including preferential prices for local, national and international calls. Certain packages were designed for smaller, while others for larger, undertakings and there were packages for residential consumers as well. In preferential packages designed for undertakings, Magyar Telekom excluded the possibility of CPS in the case of national and international calls. On the basis of these facts the investigators of the GVH concluded that Magyar Telekom had abused its dominant position as the margin between wholesale prices charged for competitors and retail prices provided by Magyar Telekom for consumers was negative and therefore ineligible for effective competition. The GVH also found the exclusion of the possibility of pre-selection illegal.[54]

In the telecommunications sector the expiry of the exclusivity clauses in the concession contracts concluded for telecom services was the most essential change in 2001. Large consumers could benefit from the changes in an indirect way through price decreases, wider choice. These also had some positive effects also for small consumers. Still, the results were modest due to the negative consequences of the recession that begun in 2000 and 2001 and there were also some failures by the legislators and law-enforcers. The regulatory environment was unable to create an appropriate background for a regulatory intervention, which could have been adjusted to market circumstances. In certain cases the regulations were overly rigid, containing inflexible framework and this did not allow interventions that could have served the interest of the market taking into account the existing circumstances.[55]

The first wave of liberalisation of the Hungarian telecom market was clearly a failure in terms of weak regulatory tools to make viable competition possible. The measures that were taken in order to facilitate the liberalisation of telecom markets were often late coming and actions actually taken were incremental. This was mainly because of terms

[53] CPS has been available for long distance calls, international calls and calls to mobiles since 2002. Since mid-2004, following the expiration of the eight-year concessions, Hungarians can use CPS for their local communications. The arrival of CPS operators should stimulate the market, which has been stable for several years. GVH, Hungarian Competition Authority, Annual Report 2003, p 2; GVH, Report 2007, p 13.

[54] Vj-100/2002, GVH, Report 2003, p 10.

[55] GVH, Report 2002, p 15.

of exclusive rights given in concession contracts made at the time of privatisation but also because of technical and market considerations.[56]

Act XL of 2001 delineated the institutional background of the sector by designating the National Communications Authority of Hungary (NCAH) and the Arbitration Committee as bodies mainly responsible for liberalisation. The most important implementing rules have been also enacted; nevertheless, they were not applicable at the time of market opening.[57] Another factor holding back progress in these areas was that even though there was a close working relationship between the telecommunications regulator, the Ministry of Telecommunication and the GVH, the regulator's powers seemed to have been both weak and too carefully used.[58]

5.2. The second wave of liberalisation

The current regulatory framework is governed by Act C of 2003 on Electronic Communications (hereinafter AEC). The AEC replaced the Telecommunication Act of 2001, when it came into effect on January 1, 2004. The AEC intended to reduce the power of the incumbent, Magyar Telekom and to intensify competition in Hungary's telecommunications market as well as to attain EU standards. The main objectives of the AEC were to intensify competition between technologies and service providers, to create transparency on the telecom and internet markets, to offer real choices to customers, to protect consumers against service providers and to accelerate the spread of the internet.

The AEC regulates mainly contractual aspects of consumer protection, standard contract terms, information disclosure, complaints with the supplier (Articles 128-144), universal service (Articles 120-125), quality of services (Article 139) and designated the post of the Representative of Communications Consumer Rights.

The Representative of Communications Consumer Rights is an information and contact centre liaising between the consumers (subscribers) and the market players (service providers, authorities and other organisations). Its chief tasks include investigation of possible solutions for problems affecting considerable user groups, preventive work for the enforcement of consumers' interests, in cooperation with partner organisations if necessary. One of its tasks of particular importance is to keep users well-informed to enable them to use the available resources as efficiently as possible.[59] While the AEC regulates subscriber contracts and information provisions within these contracts, these contracts are further regulated by Government Decree 345/2004. (XII.22.) on the requirements for the quality of the electronic communications service related to customers protection.

[56] GVH, Report 2003, p 2.

[57] GVH, Report 2001, pp 3, 11.

[58] GVH, Report 2001, p 12.

[59] See Article 126 of the AEC.

The AEC lays down cooperation with both the Consumer Authority (Article 21) and the Competition Authority (GVH) (Article 20) as to better coordinate division of competences. This has also been encouraged by the European Commission as a safeguard to allow consumers effective access to the competent body.[60]

The Board of the NCAH may after detecting a violation during the market surveillance, apply sanction progressively, as consistent with the severity of the infringement (Article 68). Accordingly, it may take provisional measures, determine the conditions of the performance of specific activities, adopt a cease and desist order, make public the information obtained in justified cases specified in the AEC to the benefit of consumers, publish its resolution on establishing an unlawful conduct in a daily newspaper of nationwide circulation at the cost of the offender, particularly if it serves the prevention or reduction of serious detriment to consumers, order a service provider to publish a corrigendum in connection with any statement the service provider has made to mislead a large number of consumers, or seize or confiscate, under the procedure governed in specific other legislation, any equipment or instrument that has been used for illegal activities or without proper authorization. In the event of any serious or repeated violation of obligations, if the above mentioned sanctions did not achieve sufficient results, the NCAH shall have powers to suspend or prohibit the related electronic communications activities, or may suspend or withdraw the individual licenses granted for the use of radio frequencies and identifiers.

Fulfillment of the regulatory objectives in Hungary shows a varied picture. Interconnection fees stood at 224 % of the EU average and had to be reduced to the EU level by May 1, 2004. Number portability became possible from January 1, 2004 for fixed-lines and from May 1, for mobile phone numbers. The new law encouraged new market entrants by measures such as granting exemptions from paying into the Universal Service Fund for two years. Still, competition in the telecommunications sector had a double-edged effect. The mobile voice services market is characterized by very strong and intensifying competition and also there is medium-size competition in the data services (internet services) market, although this is mostly not attributable to access-infrastructure competition. But there is limited competition in the fixed voice services and audiovisual content delivery markets. This dichotomy is reflected also along the consumer interests and in respect of certain services; the consumers clearly require wider choice and more information and more transparency of the market. In

[60] European Commission, DG Staff working document Annex to the communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee of the Regions European electronic communications Regulation and markets 2006 (12th REPORT), COM(2007)155 Brussels, 29 March 2007, p 204; Staff working document Annex to the communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee of the Regions European electronic communications Regulation and markets 2005 (11th REPORT) COM(2006)68 final Brussels, 20.2.2006, p 201.

respect of the sector interests the current market was characterized by financial stability, but a relatively low and decreasing level of investment.[61]

The effects of the new regulatory regime on consumers were alleged to be substantial. The protection of consumer interests in their relationship with all players within the electronic communications market has been claimed to be one of the priorities of the reforms. This protection should have been realised, among other things, through guaranteeing consumers a free choice of electronic communications networks, service providers and services, ensuring the ability to communicate with other consumers by way of electronic communications irrespective of the fact whether such consumers have a contractual relationship with the same, or other service providers. Furthermore, consumers were promised the use electronic communications services under publicly available, defined and equitable terms and for the lowest price and at the highest quality and to receive reliable, transparent and up-to-date information concerning the features of electronic communications services and the conditions concerning their use.[62]

Based on HCSO (Hungarian Central Statistical Office) data, telecommunications prices have grown slower than the inflation rate since 2002, and they even decreased for the first time in 2004. The decrease of the fixed line, mobile and Internet tariffs is partly attributable to rising competition. Based on the calculations of the HCSO, the *per capita* telecommunications expenditure has nearly quadrupled in real terms since 1995. On one hand, this considerable growth is attributable to the fact that the services have become available to a wide audience – in parallel with the development of the infra-structure. On the other hand, it is also due to the price increase of electronic communications services, which have fallen below the consumer price index in every year since 2000 and, moreover, turned into a slight decrease in 2004, based on HCSO data. The consumer price of telephony fell by 0.7%, as stated by the HCSO, in 2004, after a 1.2 percent increase in 2003. As of January and May, fixed line and mobile numbers have become portable, and new fixed line services targeting the residential market segment were introduced in the summer of 2004 – extending the positive effects of competition to this segment.[63] In 2006 the reduction in fixed-line interconnection fees, wholesale broadband service prices, mobile termination rates, the monthly rental fee for local loop unbundling and the related one-off charges should be emphasized.

While it seems that after the regulatory changes of 2003 competition is indeed emerging and new entrants appear on the market, the assumption that competition by its nature delivers desirable outcomes and results in the formerly monopolistic telecom market has proved to be wrong. In practice consumers see limited benefits from the changes. Consumers face a number of difficulties on both the fixed-line telephone market as

[61] National Communications Authority, The National Communications Authority's Strategy on Electronic Communications Regulation 2006-2010, 2006/09/07, p 27.

[62] Article 2 b, of AEC.

[63] NCAH Annual Report, 2004, pp 5, 8.

well as on the mobile telephone market. These difficulties are mainly related to information failures and these market failures prevent consumers from switching to a cheaper or a higher quality provider and make use of the possibilities and choices the process of competition offers. At the same time these information failures make it possible for dominant companies to retain their market power in the market without being threatened by considerable competitive constraints. Accordingly, these market failures result in both competition law and consumer law problems and call for active enforcement. Specific cases will be analyzed below in the following section. The expected positive outcomes, which the introduction of competition to the telecom market should have produced especially lower prices, is, on the one hand, not yet perceivable and, on the other hand, they cannot be enjoyed by the ultimate addressees of the changes.

In the fixed-line services market competition is taking off, but real price differences are not yet noticeable. By European comparison in 2004 in the fixed voice market in Hungary the level of competition was among the lowest, while the mobile market was in the medium group in terms of competition. By 2005 the situation improved primarily in the fixed market due to an already perceivable competition generated by the entrance of Tele2 and UPC. In the first half of 2005 Tele2 became the second largest player in terms of originated voice calls and the number of cable telephony subscriptions has grown to tens of thousands.[64]

The incumbent company Magyar Telekom retains its strong market position and competition is not yet present as a result of late introduction and enforcement of sector specific measures. Magyar Telekom holds 60% of the revenues of all market players in the telecommunications market and it is the only company that has both fixed-line and mobile infrastructure. Accordingly, Magyar Telekom's competitive advantage *vis-à-vis* its competitors is significant and is expected to remain so as the company can more easily invest and create bundled services as well as new telecommunications services.[65] The dominant player has an insurmountable competitive advantage resulting from its more efficient and flexible infrastructure with higher transmission capacity and from business integration encompassing the total range of electronic communications services that it has carried out. With the widening market convergence and use of bundled services the dominant operator increasingly leverages its power to the majority of the electronic communications markets and several elements of the value chain as well.[66]

How little consumers can discipline telecommunications providers and how little competitive constraint has been exercised on the incumbent, Magyar Telekom, can be illustrated by cases concerning both abuse of a dominant position as well as misleading

[64] National Communications Authority, The National Communications Authority's Strategy on Electronic Communications Regulation 2006-2010, 2006/09/07, p 26.

[65] National Communications Authority, The National Communications Authority's Strategy on Electronic Communications Regulation 2006-2010, 2006/09/07, pp 25, 44.

[66] National Communications Authority, The National Communications Authority's Strategy on Electronic Communications Regulation 2006-2010, 2006/09/07, p 48.

consumers. Magyar Telekom was fined for abusing its dominant position by setting excessively high wholesale prices for its competitors in its contracts necessary for network access to provide services through the operation of blue and green dial numbers.[67] In another case Magyar Telekom has been fined for misleading consumers and applying a comparative advertising in an illegal way.[68]

In the mobile services market competition has been fierce from the very beginning. Sharp competition has often resulted in unfair commercial practices that were misleading consumers. In the heat of competition mobile operators use advertisements that try to lock in consumers by applying false statements.[69] The choice for consumers is even further impeded by the fact that the tables of tariffs of service providers are impenetrable and subscriber contracts are long and inaccessible for an average consumer. Consumers have major difficulties to get objective and accessible information.[70]

In both the fixed-line and mobile phone markets Hungarian consumers face misleading advertisements, false statements and troubles with invoices. Advertisements of service providers focus on high-sounding fantasy names but lack essential product information. Loyalty contracts have been recently the subject of increased attention as these contracts locked in consumers and significantly limited consumers' choice of provider. Telecommunications providers restricted consumer choice by imposing disproportionate and unfair contract terms. The termination of fixed term subscriber contracts and the change of programme package before expiry of the fixed term contract has been tied to a unilaterally established condition or to an economic condition that could not be justified and was not proportionate to either the provided advantage of the loyalty contract or the obligation of the supplier to perform the contract. Moreover, fixed term contracts after expiry of the fixed period have been automatically prolonged or have been transformed into contracts for undetermined time. After several protests from the national consumers' association, the NCAH issued

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[67] Each fixed line service provider has to offer services through blue and green (coloured) numbers to its business subscribers, otherwise the providers would run the risk of loosing their market presence. In order to provide this type of service they also have to grant consumers from other networks the possibility to get these coloured numbers which are used by their subscribers. This condition is particularly important as far as the subscribers of Magyar Telekom are concerned since the market share of Magyar Telekom (previously MATÁV) is 80%. Magyar Telekom used this situation to set asymmetric wholesale (access) fees in its contracts concluded with its two aforementioned competitors - in order to grant symmetrical (retail) call fees. PanTel on PanTel though Magyar Telekom as a service provider also used these devices. Vj-66/2004/72.

[68] Vj-32/2005/20.

[69] Many consumer deception cases before the HCA provide evidence of this negative effect of fierce competition. For example, in Vj-6/2004 where the HCA has fined Vodafone for the advertisement of its 'VitaMAX Duo' price plan, which implied that consumers would be charged on the basis of network minutes. Vodafone has thereby deceived consumers and violated Art.8 (2) a, of the Hungarian Competition Act. Pannon GSM has also been fined recently for misleading consumers: Vj-191/2004, Vj-170/2004.

[70] G Fischer, 'Consumer rights, consumer protection problems after the liberalisation of the telecommunications market, National Association of Consumer Protection', VIII Conference on telecommunications liberalisation, Budapest, 25 April, 2005.

a decision prohibiting this kind of unjustified discrimination among consumers.[71] However, this decision concerns only fixed-line suppliers and the mobile service suppliers.[72]

Tariff packages in the mobile market are also problematic for consumers. There are more than 1000 packages available and this results in confusion and decision-making difficulties for choice on the consumer side. The NCAH has set up a website for information comparisons but the data changes so rapidly that the website cannot provide up to date information.[73]

Consumers should be provided objective and transparent information that helps them to search for and switch to a more efficient service provider. In order to provide them with the assistance they need consumer behaviour should be monitored and studied in the telecom market. In 2004 there was a study on the practice of Hungarian mobile telephone customers.[74] This study shows that 19% of the mobile telephone users has switched to another supplier and the main reason for switching was lower minute fees. From another survey it appears that 37.9% of the respondents were not aware of the fact that switching to another fixed line telephone provider was possible and 28.3% thought they could not switch to another fixed line telephone provider.[75] These surveys do not focus in details on consumers' awareness and willingness to search and switch. More specific surveys would be helpful for tackling the problems consumers face in this market.

They have at this point little solace for their problems. Consumers stand defenceless *vis-à-vis* the price and advertisement wars of service providers. More independent platforms that offer objective and transparent information could be welcomed. One such platform is a monthly journal of the National Association of Consumer Protection, the only civil organisation for the protection of consumers. The above mentioned Tantusz website is a consumer information system that has been set up by the Representative of Communications Consumer Rights (within the NCAH) in order to provide consumers with more transparent information on electronic communications services regarding choice and price comparisons on including fixed, mobile, broadband and cable TV services.

While the NCAH has recently stepped up its enforcement efforts by imposing more significant fines on operators and, in order to enforce its decisions, it participates more actively in regulatory policy making, there are still concerns about the slow course of

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71 Újabb NHH lépés a korrekt hűségszerződések érdekében, Tilos a „röghöz kötés", Press release 2007/09/12.

72 G Fisher, 'Problémák a hírközlés és az informatika területén', 2007, http://www.ofe.hu/inet/ofe/hu/menu/publikaciok/fischer/object/hirkozles_fischer.ppt

73 Tantusz: http://tantusz.nhh.hu/, Fischer, 2007, ibid.

74 Rt Tárki, 'Mobiltelefon szolgáltatások fogyasztói szokásainak felmérése a 14 éves és idősebb magyar lakosság körében', Budapest 2004 (Analysing study on the habits of mobile telephone customers older than 14 in Hungary).

75 Telekommunkációs szokások, Szonda Ipsos, Nemzeti Hírközlési Hatóság, 2004 (Study on telecommunications habits of the the general public).

dispute resolutions and about the fact that its decisions are systematically challenged before the appeals courts. This both slows down the final decision-making process as court procedures can take years and results in legal uncertainty.[76]

There are several administrative bodies who are responsible for consumer protection: the NCAH, the Representative of Communications Consumer Rights, the GVH and the Consumer Authority. The division of powers among these bodies is, however, not always clear. Moreover, dispute settlement between consumers and business entities can be referred to the Consumer Arbitration Boards, independent bodies and they operate at the regional chambers of commerce.[77] Consumers can turn with their complaints to their service providers and on the basis of the AEC to the Representative of Communications Consumer Rights.[78]

Even though, the powers of the Representative are rather limited it has also stepped up its enforcement efforts by imposing heavy fines on operators for misleading advertising.[79] Furthermore, access to court is a possibility, but it is of course a long and expensive procedure and consumers are therefore advised to turn to arbitration boards for the enforcement of consumer rights.[80]

5.3. Relevant cases

The legal problems envisaged during the liberalization of the Hungarian telecommunications market can be the best captured through the case-law of the GVH. The reason for that lies in the institutional setup and its development in Hungary. While several bodies are presently responsible for the enforcement of consumer interests in the telecommunications market, initially it was only the GVH, which

[76] Commission staff working document annex to the Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions, European Electronic Communications Regulation and Markets 2006 (12th REPORT), SEC(2007) 403, p 198.

[77] For a detailed overview see, University of Leuven, 'The study on alternative means of consumer redress other than redress through ordinary judicial proceedings: National Reports - Hungary' (2007) http://ec.europa.eu/consumers/redress_cons/adr_en.htm

[78] See Article 126 of the AEC. The HFJK is an information and contact centre liaising between the consumers (subscribers) and the market players (service providers, authorities and other organisations). Its chief tasks include investigation of possible solutions for problems affecting considerable user groups, preventive work for the enforcement of consumers' interests, in cooperation with partner organisations if necessary. One of its tasks of particular importance is to keep users well-informed to enable them to use the available resources as efficiently as possible.

[79] Commission staff working document annex to the Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions, European Electronic Communications Regulation and Markets 2006 (12th REPORT), SEC(2007) 403, p 204.

[80] The Hungarian arbitration boards form a modern alternative dispute resolution scheme and comprise an out-of-court model of public complaints boards, which are based on administrative law and have been set up and financed by the state.

effectively enforced competition rules and provisions related to consumer fraud[81] The sector regulator was later established and armed with insufficient enforcement powers and the Consumer Authority (General Inspectorate for Consumer Protection) lacked professional and well-prepared personnel; they were mostly unaware of the requirements of a truly consumerist society and at the beginning they could not sufficiently assist consumers with their problems.[82] This institutional tilting is, however, still characteristic as the high percentage of the GVH's decisions evidence. For example, similarly to previous years in 2006 the majority of cases of unfair manipulation of consumer choice are related to telecommunications or financial services.[83] Moreover, still in 2006 the GVH's advocacy was strong on the telecommunications market. The GVH communicated its position about competition policy aspects not only when it was asked by other authorities but it also presented a comprehensive report about competition on the electronic communications market.[84]

The following cases mirror a two-fold approach to protect consumer interests by enforcing the provisions of the HCA on abuse of dominance and the provisions on consumer fraud.

As to abuse of dominance the GVH has been enforcing the competition rules in cases concerning unfairly excessive increase of cable TV prices and the disadvantageous restructuring of programme packages that resulted in unjustifiable detriment for consumers as well as establishing standard contract terms that enable the providers to unilaterally change prices and programme packages. These cases were dealt with under Article 21(a) of the Hungarian Competition Act (HCA) which is equivalent to Article 82(a) EC stating that it is prohibited to abuse a dominant position, particularly in business relations, including the application of standard contractual terms, to set unfair purchase or selling prices or to stipulate in any other manner unjustified advantages or to force the other party to accept disadvantageous conditions. The above mentioned

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81 The Hungarian Competition Act is a comprehensive piece of legislation regulating cartel agreements, abuse of a dominant position, merger control but also unfair competition law and the unfair manipulation of consumer choice. For an English text see the website of the GVH: http://www.gvh.hu

82 The fact that the GICP used to be subordinated to the Ministry of Home Affairs reveals its original role during the communist regime. It was first of all a supervising body and as such its authoritative power was considerable. It was more a political than an economic body. Earlier the GICP's staff consisted mostly of people with an engineering background, with only a small number of lawyers and economists. These people were well-trained bureaucrats within the socialist administration, which meant that they were more used to executing central orders than to assessing the problems on the marketplace. Their legal background was mostly based on administrative law and they were unfamiliar with theories of the market economy and the issues of consumer protection. Before the transition the GICP's work first of all consisted of market control-related duties, such as inspection of product safety, quality control, monitoring compliance with legal regulations and administrative provisions and consumer quality complaint cases. They controlled, supervised and sanctioned smaller private traders, but not the big state companies. The protection of consumers was limited in their actual work. At the beginning they also seemed to be very cautious in declaring the practices of certain traders as damaging for consumers. KJ Cseres, *Consumer Protection and Competition Law*, The Hague, Kluwer International, 2005.

83 GVH, Annual Report 2006, p 5.

84 GVH, Annual Report 2006, p 7.

cases often concerned also the misleading of consumers but have been analyzed and decided under Article 21(a) HCA while establishing that the enforcement of competition rules is in itself not always sufficient. The fact that some of these cases have been terminated without finding an infringement, and without fining the companies, proved the necessity of regulatory intervention instead of competition law enforcement.

One group of cases concerned excessive pricing through unfairly excessive increase of cable TV prices. Excessive pricing is a cautiously and, exceptionally enforced part of Article 82 EC violations by the Commission and even though national jurisdictions more actively enforce this and similar provisions, its enforcement is not without controversy and a solid benchmark of unfair or excessive prices is missing. Uncertainties of enforcement are even greater in the network industries, where *ex ante* tariff regulation is often necessary to create efficiency-driven prices and *ex post* regulation thus is not appropriate in this case.[85] In the practice of the GVH excessive pricing is when it significantly exceeds the economic value of the services, i.e. the sum of the economically reasonable costs and the fair profit attributable to the particular sector.[86] In a proceeding initiated by the GVH against Antenna Hungária Magyar Műsorszóró és Rádióhírközlési Nyrt (AH, the Hungarian broadcasting company) the alleged abusive conduct was excessive pricing on the markets of national analogue terrestrial television broadcast diffusion services, which would enable unfair cross subsidization on the market of television broadcast distribution services thereby excluding competitors from that market or hinder their entry. The GVH established several times that there is no particular prevailing cost allocation method, any deviation from which would entail an infringement of competition law. The GVH also considered that from a competition policy point of view, contractual disputes not affecting long-term consumer welfare or the reallocation between different production levels are indifferent. Potentially excessive prices in television broadcasting are exactly this phenomenon, since consumers do not have to pay for terrestrial reception to the content providers. Finally the Competition Council informed in detail the National Telecommunications Authority about its experience in the case.[87]

Another group of cases that has been typical in the TV cable sector concerned disadvantageous restructuring of programme packages and qualified as unjustified advantages violating Article 21(a) HCA. These cases deal with unfair contract terms and they represent an interesting intersection of competition law principles as envisaged in Article 21(a) HCA and consumer-contract law principles as laid down in Article 209/B Hungarian Civil Code.[88] The GVH has dealt with this issue in details in its decision

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[85] For a more detailed overview see M Van der Woude, 'Unfair and excessive prices in the energy sector', 2007 EU Competition Law and Policy Workshop/Proceedings, European University Institute, Robert Schuman Centre for Advanced Studies.

[86] Vj-27/2005, GVH, Annual Report 2006, p 36.

[87] GVH, Annual Report 2006, p 36.

[88] Article 209/B of the Hungarian Civil Code:

against UPC Hungary Kft's policy concerning the structuring of programme packages.[89] The undertaking changed its programme packages by placing certain popular programmes into a package, which could be received by the consumers only by the use of a decoder. Moreover, the Competition Council challenged certain points of the standard contract terms granting unilateral possibility for the undertaking to increase its prices in a non-transparent way. Consumers were, therefore, unable to predict, calculate and control the price increase. The GVH interpreted the term "unjustified advantage" under Article 21(a) EC as an objective category but in the absence of a separate definition of this term under the HCA it made reference to Article 209/B of the HCC. It emphasized that as an objective concept competition law does not apply the notion of good faith and therefore the condition as laid down in Article 209/B (1) HCC 'in violation of the obligation to act in good faith' does not constitute an element of 'unjustified advantage' under Article 21(a) HCA.[90] This can be explained by the fact that the HCC regulates equal relations while the HCA concerns economically subordinated actors. In sum, the GVH considers a standard contract term unjustified that enables an undertaking in a dominant position to unilaterally change prices as the reasons of price increase are unclear and provide scope for unilateral interpretation by the dominant undertaking.[91] What amounts to an advantage is another issue that has not been defined neither in the HCA nor in the GVH's practice. The GVH has not identified the term advantage as the revenue from the increased price exceeding the consumer price index if this increased price cannot be justified by economically reasonable costs and fair profit of the undertaking. Accordingly, there is presently no clear guidelines on what amounts to an 'unjustified advantage' under Article 21(a) HCA.

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(1) A general contract condition, or the term of a contract between an economic organization and a consumer, shall be regarded unfair if the clause or term, in violation of the obligation to act in good faith, unilaterally and unjustifiably establishes the contractual rights and obligations of parties to the detriment of one of the parties.

(2) The definition of rights and obligations is unilaterally and unjustifiably detrimental, in particular if

a) it substantially deviates from major provisions of the contract; or

b) it is incompatible with the subject matter or purpose of the contract.

(3) When establishing the unfair nature of a contract condition, it shall be necessary to examine all of the circumstances leading to the conclusion of the contract as well as the nature of the stipulated service and the relationship of the condition in question with other contract conditions and other contracts.

(4) Other legal regulations may define the conditions that are regarded to be unfair in respect of contracts concluded with consumers or that shall be regarded as unfair until proven otherwise.

(5) The provisions on unfair contract conditions shall not be applied to a contract clause stipulating the service and the consideration for such, if the phrasing of such clause is clear and understandable for both parties.

(6) The contract conditions defined by legal regulation, or established in accordance with the provisions of legal regulations, shall not be deemed unfair.

[89] Vj-126/2000.

[90] Vj-126/2000 XIV.; GVH, A kábeltelevíziós szolgáltatók műsorjelelosztó szolgáltatásával kapcsolatos versenyfelügyeleti eljárások tapasztalatai alapján megfogalmazott szabályozási javaslatokról, 2003, pp 59-60.

[91] Vj-126/2000 XV.; GVH, A kábeltelevíziós szolgáltatók műsorjelelosztó szolgáltatásával kapcsolatos versenyfelügyeleti eljárások tapasztalatai alapján megfogalmazott szabályozási javaslatokról, 2003, p 61.

In another case MATÁV Kábel TV Kft. was condemned for following the upgrading of its infrastructure and thus changing the programme packages to the detriment of consumers because its new pricing policy was not supported by a detailed and transparent cost calculation.[92] The Competition Council imposed in both cases a fine of HUF 5 million.

The GVH also found restriction of customer switching in the practice of Magyar Telekom Ltd as illegal with regard to the removal of ADSL-modems when customers change their Internet providers. Magyar Telekom, in contrast to Invitel, tried to restrict customers in switching to other providers by subjecting such changes to detrimental conditions rather than by offering discounts. The GVH argued that pursuant to the findings of the investigation, the unreasonably lengthy service disruption in the case of a change of the provider cannot be justified either by technical or economic reasons.[93]

In two other cases the GVH initiated proceedings against two mobile phone operators, T-Mobil Magyarország[94] and Vodafone Magyarország[95], concerning the operation of their voice-mail services. According to their practice the voice-mail service turned on automatically without prior warning. Consumers were therefore unable to avoid the charges of a service, not even with an immediate interruption of the call. Data underlined however that a great number of calls were terminated in the first few seconds of such calls and no messages were left for the addressee. The GVH found that such a practice was against consumer interest and qualified as an exploitative abuse under Article 21(a) of the HCA. The GVH gave 90 days for the operators to amend their system and to enable consumers, in case of such preference, to avoid the use of the voice-mail services. However, it also found that, having regard to the differing practice of the different mobile and fixed-telephony operators, the problem could not be solved through competition supervision proceedings and needed regulatory intervention.

The incumbent, Magyar Telekom, has also been subject to proceedings before the GVH for abusing its dominant position on different segments of the telecommunications market by imposing a unilateral contractual stipulation of the supplier for reviewing and amending the fee without the further justification under review of the consumers. Consumers are obliged to except this unilaterally fixed fee or they terminate the contract by which they exclude themselves from the service. The GVH argued that this practice amounted to unfair advantage for the dominant firm as defined under Article 21(a) HCA, however because the infringement was of a short-term it did not impose a fine.[96]

[92] Vj-61/1999.

[93] Vj-39/2005.

[94] Vj-80/2004/53.

[95] Vj-82/2004/57.

[96] Vj-87/2001, Magyar Telekom abused its dominant position by applying unfair contract terms.

In sum, these cases indicate that the GVH readily enforces Article 21(a) HCA successfully and actively in case of unfair contract terms concerning unilaterally established and non-transparent conditions but is less ready to do so when unfair/excessive prices are at stake.

In the mobile services market competition has been fierce from the very beginning and continues to be lively between the three network owner service providers, which often results in aggressive advertising practices. In the heat of competition mobile operators use commercial practices that mislead consumers such as advertisements locking in consumers by applying false statements.[97] Communication with clients is part of the competitive strategy of mobile phone companies. Apart from shaping and strengthening their image the providers offer consumers from time to time lower prices as a result of price competition. There is a huge variety of products and services. It is impossible for consumers to make an objective comparison between the different services. Between 2004 and 2007 the Hungarian Competition Authority (GVH) fined undertakings providing mobile phone services HUF 380 million as a total because they deceived consumers.[98]

The market is characterised by the asymmetry of information**.** The choice for consumers is even further impeded by the fact that the tables of tariffs of service providers are impenetrable and subscriber contracts are long and inaccessible for an average consumer. Consumers have major difficulties to get objective and accessible information.[99]

From the above the following summary and conclusions can be made. The liberalization of the Hungarian telecommunications market has taken off slowly and went through an initial period with inefficient regulation and weak enforcement and institutional setup. The result was weak with no real competition in the market with significant entry barriers and the incumbent dominant firm was able to maintain its market share and moreover to abuse its position. The effect of the liberalization was insignificant for consumers in this period. The main enforcement work has been focused on the enforcement of competition law and the consumer fraud rules of the HCA. The GVH has been actively and effectively enforcing these rules in this period but has also emphasized the need for proper sector regulation and sector regulator. From 2003 the new Telecommunications Act has partly filled in this gap. The NCAH has taken up its role as a sector regulator and enforcement agency. The division of enforcement areas and competences among the NCAH, the GVH and the Consumer

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[97] Many consumer deception cases before the HCA provide evidence of this negative effect of fierce competition. For example, in Vj-6/2004 where the HCA has fined Vodafone for the advertisement of its 'VitaMAX Duo' price plan, which implied that consumers would be charged on the basis of network minutes. Vodafone has thereby deceived consumers and violated Art.8 (2) a, of the Hungarian Competition Act. Pannon GSM has also been fined recently for misleading consumers: Vj-191/2004, Vj-170/2004.

[98] GVH, 'Mobile phone companies often deceive consumers', Press Release, Budapest, 7 March 2007.

[99] G Fischer, 'Consumer rights, consumer protection problems after the liberalisation of the telecommunications market', National Association of Consumer Protection, VIII. Conference on telecommunications liberalisation, Budapest, 25 April, 2005.

Authority still remains problematic and would need a thorough revision and clear guidance. The GVH is still playing an active part both in the enforcement of competition rules mainly related to abuse of dominant position as well as on misleading and unfair trade practices. This latter represents still a high percentage of its caseload.

While consumers have benefited from lower prices and a substantial increase in service offers, their main problems are still related to information. These information failures are apparent in both cases concerning abuse of dominance as well as consumer fraud. One particular problem consumers have is related to unfair contract terms. Unfair contract terms should in principle be subject to private and individual enforcement on the basis of the Civil Code. However, several of the above mentioned cases demonstrated that the imposition of unfair contract terms by a dominant firm can be subject to competition law control under similar provision as under Article 82(a) EC. The difficulty of enforcing this provision lies in the establishing of what amounts to unfair prices or unfair trading conditions. The Hungarian GVH has partly relied on civil law principles when establishing whether the applied contract terms could qualify as unfair advantages. GVH readily enforces Article 21(a) HCA successfully and actively in case of unfair contract terms concerning unilaterally established and non-transparent conditions but is less ready to do so when unfair/excessive prices are at stake. These cases might indicate that some form of public and collective enforcement against unfair contract terms seems necessary. The question is whether such enforcement should take place on the basis of competition rules and by the competition authority or by other regulatory rules and institutions.

Another concern is that possible information failures on the market have neither been anticipated nor effectively dealt with until very recently. There are now some but not yet sufficient mechanisms to assist consumers to make an efficient choice, close a good deal or switch to a service provider whose offers are more advantageous. Moreover, they lack experience of exercising their choice and switching in other markets. This does not only lead to consumer protection frictions in the market but little consumer activity has also resulted in no or little pressure on incumbents and probably helped to keep entry barriers and thus lead to reduced levels of competition. At the moment a significant group of customers is tolerating the incumbent's prices being substantially above entrants' prices. As a result, the incumbent does not have an incentive to keep prices low and close to marginal costs and contestability of the market is less unlikely also because of substantial economies of scale.

The following section will describe a subsequent stage of liberalisation through the liberalisation of the Dutch electricity market. This example explains on the one hand, why disclosure of information is essential when markets are opened up for competition and, on the other hand, illustrates that even though information has been made available for consumers on a broad scale switching does not take place to the extent it has been previously expected.

6. LIBERALIZATION OF THE DUTCH ELECTRICITY MARKET

That the Netherlands would be one of the pioneers in the liberalisation process was considered almost evident, regarding its traditionally strong belief in the market and its open and active trade and business life. The process of liberalisation and privatisation began in the telecom, gas, water and electricity sectors, where networks play an essential role. These sectors used to be ruled by government monopolies and the new policy wanted to separate and liberalise the competitive segments of these sectors. In the electricity sector restructuring took place through separating network firms from production and retail supply firms. Networks remain regulated by the government, while the competitive segments are fully liberalized. The idea was that the liberalisation of these sectors would result in more innovation, lower prices and more choice for consumers. In order to guarantee that these benefits will indeed be realised independent supervising authorities were established to watch over their further development. Such supervisory authorities are the Netherlands Competition Authority (NMa), the Independent Postal and Telecommunications Authority (OPTA) and Office of Energy Regulation (DTe).

The demand side of the market has been liberalised in four steps, and liberalisation proceeds at a faster pace than the Second Electricity Directive (2003/54/EC) requires. Large users, representing about one third of demand, were given freedom of supplier in 1999 and medium consumers, again representing about one-third of demand, in January 2002. Where competition has been introduced this has led to a comparatively high proportion of large users switching suppliers, indicating that there are benefits to be captured from competition. Already 20 to 30% of large electricity users have switched suppliers. Immediately after liberalisation, some 30% of the middle segment switched supplier. In July 2001, the market for green electricity was opened for all consumers, and the entire market has been opened July 2004. Thus household electricity markets have been opened up to competition and fully liberalised. Since 1 July 2004 small users are also free to choose their supplier and prices are not regulated anymore.[100]

The reform of the electricity and gas sectors was launched with the Electricity Act 1998 and the Gas Act 2000. The responsibility for implementing and enforcing these acts has been assigned to the DTe. Although DTe acts as a chamber within, and thus is organisationally subordinate to, the director general of the NMa, it acts independently and has its own enumerated powers, which were considerably extended in 2001. DTe's regulatory powers include, among others, the issuing of licences for the supply of electricity and gas to captive consumers: setting service quality standards; setting tariffs and conditions for network access; and determining supply tariffs for captive consumers. Since 2005 when the Intervention and Implementation Act amended the Electricity Act the rules for dispute settlements changed and the Director of the DTe may deal with customer and business complaints regarding the performance of network

[100] E Van Damme, 'Pragmatic privatization: the Netherlands 1982-2002', TILEC Discussion paper 2004-07, June 2004.

operators. In accordance with Article 23 of Directive 2003/54 the Dutch consumer now can file a complaint to the DTe with regard to the infringement of information obligations of the network operator, complaints about tariffs or connection to the network.

Dispute settlements for customer complaints regarding the performance of electricity suppliers are handled by the Consumer Complaints Tribunal for Energy and Water within the Foundation for complaints commissions for consumers ('Stichting Geschillencommissies voor Consumentenklachten').[101] Customer complaints reflect a series of concerns, relating, for instance, to information services (delayed notification, lack of information), tariffs and connections to the network.[102]

Rules for consumer protection are to be found in the Electricity Act 1998 in Article 95m. These rules deal with misleading and unfair sales methods by regulating standard contract terms in delivery and transport contracts, information provisions on tariffs and conditions of delivery and transport. Moreover, Article 95b(5) states that General Administrative Order may further determine maximum tariffs or whether tariffs are unreasonable. For example in July 2005 the DTe maximised the cancellation fee of annual contracts to €50. In order to create a level of playing field and to force energy suppliers to operate cost-efficiently the DTe has introduced a so-called price cap regulation. This entails that tariffs have to be reduced with the inflation and have to be increased by a so-called efficiency component, the X factor. The DTe also regulates the quality of the network as well.[103] Moreover, Ministerial Orders regulate the termination of electricity transmission to customers as well as preventive measures to prevent such termination.[104] Further, policy guidelines regulate certain aspects of supply contracts such as reasonable termination fees or invoice terms. The DTe can impose an obligation subject to a penalty (Article 77h) as well as an administrative penalty up to 10% of the turnover of the transgressor (Article 77i 1 (b)).

After a considerable decline in the concentration on the retail market between 2004 and 2006, concentration has slowly increased since the beginning of 2006 due to mergers

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[101] http://www.geschillencommissie.nl/. For a comprehensive overview of how the Compliants Tribunals work in English see University of Leuven, 'The study on alternative means of consumer redress other than redress through ordinary judicial proceedings: National Reports – Netherlands', available at http://ec.europa.eu/consumers/redress_cons/adr_en.htm

[102] The rules for complaints processing procedures are set out in the Policy Rule for the Settlement of Disputes/ Energy (Beleidsregel Procedure geschillen Energie, 30 augustus 2004). Following an application for arbitration, DTe will pass judgment on how to interpret and implement the Electricity Act and the Gas Act in a particular case. DTe's decision should have practical implications, allowing parties to end the dispute. In principle, DTe will draw up a decision within two months after receiving the application. If a dispute makes clear that one of the parties infringes energy legislation, DTe may impose a sanction as part of its enforcement policy.

[103] E Van Damme, 'Kosten-batenanalyse liberalisering elektriciteitsmarkt gewenst', Economisch Statische Berichten, 90e jaargang, nr. 4464, 30 juni 2005 (datum).

[104] Regeling afsluiten elektriciteit en gas van kleinverbruikers, Staatscourant 1 december 2006, nr. 235 / pag. 8, and its amendments Staatscourant 7 maart 2007, nr. 47 / pag. 8, Staatscourant 25 oktober 2007, nr. 207 / pag. 8.

and acquisitions by large energy suppliers.[105] The NMa/DTe has recently concluded that the electricity market is still characterized by limited number of producers and high prices.[106] There are currently 23 market players on the market and there seem to be potential entrants interested in entering the Dutch market and who have required supply licences or indicated their future interest in requiring licences from the DTe.[107] Prices have also shown an increasing trend since the beginning of 2006 due to high oil prices. The Netherlands is still among the first five countries with the highest electricity prices in the EU.[108] The DTe has recently commissioned a report to identify the presently most significant barriers of entry into the Dutch electricity retail market. Concentration in the electricity market is partly due to the fact that large economies of scale are needed for the production of electricity. However, it is also due to the strategic choice of electricity firms by vertically integrating supply and production in order to avoid price fluctuations and bankruptcy. Moreover, concentration has increased due to mergers and acquisitions due to horizontal integration between suppliers as well as due to vertical integration between suppliers and producers. Both can restrict entry to the market. Nevertheless, one of the other barriers is the switching aversion of consumers and the fact that consumers can the electricity market.[109] The role of consumer behaviour in particular switching in the competitiveness of markets will be discussed below.

6.1 "You are stealing from yourself if you do not switch"[110]

The expected welfare effects of the liberalisation were significant. Consumers would first of all profit from lower energy prices. As has been mentioned above prices have shown an increasing trend since 2006. Still, the social costs and benefits of the liberalisation of the Dutch energy market are difficult to measure. Haffner and Meulmeester tried to give a quantitative evaluation of the costs and benefits of the liberalisation and the regulation of the electricity networks by DTe. In 2005 their conclusion was that there are substantial welfare effects in the middle term (around €1.1m in 2005 prices) but in the short term the welfare effects are expected to be lower.[111] In more explicit terms, consumers have seen little change on their energy bills in 2005 as compared to 2000. This is because of the annual inflation, higher transport costs and as a result of a court annulment of the DTe's setting of the X factor in an inconsistent way with the Electricity Act 1998.[112] Altogether, they predicted that the

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[105] NMa/DTe (2007) p.10.

[106] NMa: concurrentie Nederlandse elektriciteitsmarkt stagneert, Press release, 06.12.2007.

[107] NMa/DTe (2007) p 12.

[108] NMa/DTe (2007) p 35; Eurostat.

[109] SEO, Toetredingsdremepels Kleinverbruikersmarkt energie, SEO-rapport nr. 2007-49, Amsterdam, oktober 2007, p 16.

[110] De Telegraaf 01.07.2004.

[111] RCGP Haffner, P Meulmeester, 'Evaluatie van de regulering van het electriciteitsnetwerk', Economisch Statische Berichten, 90e jaargang, nr. 4472, 2005, pp 432-433.

[112] Haffner, Meulmeester, ibid, p 433.

liberalisation will lead to important benefits for consumers. The question is whether consumers are aware of these benefits and whether they are willing to take advantage of these positive effects.

After an initial survey of the Dutch Consumer Union, which was published in November 2004[113] and examined what consumers knew about and expected from the energy market a couple of months after its full liberalisation the low switching percentage of Dutch consumers became a focus of the regulatory activities of the DTe as well. It has conducted and published its own market monitoring reports in 2006 and 2007. The results of the survey are summarised in Table 1.

TABLE 1 *CONSUMER SWITCHING IN THE ELECTRICITY MARKET SINCE 1 JULY 2004*

	New electricity supplier since 1 July 2004	Reasons
Switched	14 %	Lower tariff
Consider Switching	10%	Price, contract terms, more favourable conditions of the supplier
Not at All	40%	Minor price benefits, high switching costs, administrative burden, low interest product, costs of acquiring comparative information

source: NMa/DTe (2006) (2007)

As of November 2007, 14% switched to a new electricity supplier and the most important reason for switching was a lower tariff.[114] The most relevant reason given by consumers for not switching is that financial benefits of switching are too low. Shestalova and Pomp calculated that 30% of the respondents would switch when the price difference was between €75 and €100.[115] Besides prices consumers make their choice on the basis of the contract terms offered by the supplier and the quality of services. One more aspect that plays a role in switching is the source of energy: green or grey.[116] The barriers to switching can be mainly found in the administrative troubles and the time and costs of accessing comparable information that is necessary for switching and choice of supplier.[117] In 2006 34% and in 2007 27% of the consumers considered switching in the near future. Consumers, however, do not expect to

[113] Consumentenbond, 1-meting, Liberalisering energiemarkt, 24 November 2004.

[114] NMa/DTe (2007).

[115] V Shestalova, J M Pomp, 'Overstapkosten en welvaart', Economisch Statische Berichten, 90e jaargang, nr. 4464, pagina D7, 30 juni 2005, p 10.

[116] NMa/DTe (2006) p 30, NMa/DTe (2007) p 48.

[117] NMa/DTe (2006) p 30, NMa/DTe (2007) p 48.

continue an active switching behaviour probably due to the fact they are satisfied with their present supplier.

Despite the fact that electricity is a low interest product there is substantial product offer in the form of contracts with fixed terms and fixed tariffs besides that standard contracts with undetermined term and variable tariffs. The alternatives vary on the basis of contract terms and tariffs offered. Most of the consumers (59%) still choose for a standard contract of undetermined period and variable tariffs.[118] Moreover, there is an increasing range of product bundling such as gas and electricity (dual fuel contract), where consumers may expect discounts. But while this has been a real stimulant of switching in the UK, in the Netherlands this product bundle has been traditionally offered and thus had little impact on consumers' switching. There are also many consumers who choose green instead of grey energy. Some energy companies try to attract consumers by offering to pay for the switching fee for consumers' old supplier.[119]

In markets characterised by repeat consumption consumers who have previously purchased a good or a service from one firm would incur certain costs if they purchased the competitor's product. In order to avoid these costs consumers remain loyal to their previous supplier and as a result firms retain a certain degree of market power over repeat-purchasers.[120] Switching from one supplier to another costs money and time. Switching costs can be financial, psychological or they can be related to time. Actual or perceived switching costs maybe a reason for consumers' immobility as they remain locked-in to one supplier. Switching costs also influence firms' behaviour. They form the basis of a trade-off firms face: charging low prices in order to attract new customers or maintaining high prices in order to exploit captured customers.[121] This trade-off depends on a number of factors such as the threat of new entry and market growth rates. When firms cannot discriminate between new and old consumers in the presence of switching costs they have an incentive to keep their prices high and exploit their old customers instead of attracting new customers through lower prices. When new markets are opened to competition in the early stage of competition, before consumers have developed switching costs, competition is aggressive to gain market share. This explains price wars.[122]

The role of consumer switching behaviour in the dynamics of competition and to what extent consumer switching acts "as a competitive constraint"[123] on firms and in particular on the dominance an incumbent is not unambiguous. High switching

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[118] NMa/DTe (2007) p 39.

[119] NMa/DTe (2006) p 31, NMa/DTe (2007) p 41.

[120] P Klemperer, 'Competition when consumers have switching costs: an overview with applications to industrial organization, macroeconomics, and international trade', (1995) 62 Review of Economic Studies 515-539.

[121] Klemperer, ibid.

[122] Klemperer, ibid.

[123] M Harker, C Waddams Price, 'Consumers and antitrust in British deregulated energy markets', in 'The pros and cons of antitrust in deregulated markets', Swedish Competition Authority, 2004, pp 29-50.

percentage is not necessary for dynamic competition as the mere contestability of the market suffices. The absence of switching can, in theory, also be a sign of perfect competition.[124] It could also be inherent in the process of transforming a market from state monopoly to free competition, where awareness of the change might not be widespread as well as the fact that energy is a low interest product. Energy markets are characterised by low demand elasticity and little product differentiation. However, low percentage of consumer switching is a barrier for firms who want to enter the market and expand their business activities. Moreover, switching consumers provides incentives for firms to lower their prices and to improve quality of their products and services. The condition for this is, however, the possibility of choice namely that there is range of products or services to choose from.

Giulietti, Waddams Price and Waterson present a 2 stage model of switching behaviour: awareness of the ability to switch is the first stage and searching and switching itself is the second stage. When consumers are aware of the possibility of switching they will search and depending on the ratio of their expected costs and gains they may switch. Giulietti, Waddams Price and Waterson modelled switching suppliers in the UK natural gas market, which has been fully opened to entrants between 1996 and 1999. They found that the main factors of awareness of switching were the stage of competition, prepayment meter use and household tenure. There were some positive effects of previous switching experience for example in the telecom market. For those who could provide information of their bill size (12% was unable) the relevant factors of switching were long-term savings as they believed that the incumbent would be reluctant to match entrants' lower prices. However, price sensitive consumers were more likely to switch than consumers who consider supplier reputation.[125] With regard to search costs previous experience with similar products e.g. telecom had a strong positive influence on the likelihood on switching.

They consider switching suppliers as a consumer investment decision from which they draw conclusions about the incumbent's (British Gas) market power, the development of the British gas market and propose regulatory policy responses.[126]

In the Netherlands problems on the consumer side are related, on the one hand, to consumers being discouraged by misleading information and aggressive sales methods

[124] 'Over transparantie en vertrouwen', Marktmonitor, ontwikkeling van de Nederlandse kleinverbruikersmarkt voor Elektriciteit en Gas, juli 2006 – juni 2007, NMa/DTe, Den Haag, oktober 2007, p 46.

[125] Giulietti, Waddams Price & Waterson, op cit, n 2, pp 960-961.

[126] They concluded that the majority of British consumers were not likely to switch to a new gas supplier, however, the energy market was opened to competition six years ago and thus switching has been possible for that period of time. Although consumers were aware of the possibility they perceived the search and switch costs as too high compared to the benefits they can identify. The main barriers of switching thus lie in the cost of searching and in the perceived switching costs in terms of time and ease of switching. This means that a majority of the British gas consumers do not switch because they perceive search and switch costs higher than they are and therefore they tolerate the incumbent's prices being above the entrants' prices. The incumbent's entrenched position is therefore not being challenged and the incumbent continues to have an incentive to keep its prices high. Giulietti, Waddams Price & Waterson, op cit, n 2, pp 966-967.

of suppliers. The recruitment of customers is still not adequate and often qualify as aggressive and misleading. The recruitment of new customers by energy companies is essential if the market is to work well as it is key to consumer confidence. However, the use of direct recruitment methods, such as telephone sales or door-to-door selling put consumers under pressure to switch suppliers. Such unfair and misleading advertising significantly undermines consumer confidence in the energy market. They discourage switches and provide incorrect information that form major obstacles to the proper functioning of the energy market. The energy companies have to eliminate these problems themselves and therefore the DTe has called upon all energy companies to cease misleading and unfair recruitment practices. The DTe asked the companies to draw up a joint code of conduct in the short term.[127] Another factor that improves consumer confidence is effective dispute settlements. Dispute settlements with and by the energy suppliers have improved in the last two years. Most of the complaints are still related to metering and energy bills and consumers are dissatisfied with the time a complaint handling takes as well as with the compliance of the firms with the agreements.[128]

On the other hand, as the reports also show consumers have major difficulties in figuring out what the exact benefits of switching are and how the procedure of switching takes place. Shortly after the liberalisation consumers who wanted to switch faced a number of problems. They had administrative problems with processing switching, the bills were often unclear and they incurred high cancellation fees and other switching costs. These problems have formed part of the reasons for small customers not to switch. However, these problems have now partly been dealt with as a result of the actions of the DTe. Other problems persist. Transparency of prices is not guaranteed or price comparisons are not objective. Possible savings from switching remain limited, 100 euro being the difference between the most expensive and the cheapest supplier.[129]

It has to be added that Dutch consumers are provided a decent amount of information about the possibilities available on the electricity market. Both the government and industry have set up several websites to assist consumers.[130] Consumers are provided with comparative information through websites about the different suppliers, but the question is whether they can make rational and optimal choices? The way information is transmitted and presented to consumers is essential for sufficiently screening markets and to make optimal decisions. Oversupply of information may be counterproductive and this problem can be aggravated if price and other product and service feature

[127] Moreover, the NMa invited consumers to give notification of any malpractices in relation to recruitment. NMa Demands That the Energy Sector Solve Customer Recruitment Problems 05-19 / 10-21-2005

[128] NMa/DTe (2007) pp 42-43.

[129] NMa en Dte, 2004, p 105.

[130] A website jointly set up by the Ministry of Economic Affairs, the NMa, the Telecommunications Authority (OPTA) and the Consumer Authority for informing consumers is the Consuwijzer (www.consuwijzer.nl)

comparisons are not satisfactory. This may deteriorate market transparency and be the reason behind the lower pace of switching of consumers than expected.

Actual and perceived switching costs play an important role in consumers' decisions. But high switching costs also make it harder for entrants to gain market share after entry and increase the price gap between incumbents and entrants. Consumers who are not switching are actually tolerating this price gap between the incumbent and the lower price of the entrants. High switching costs can benefit the incumbent who will be able to enjoy its position on the market as well as keep prices high.

6.2. Standard contract terms

Switching has been very much the focus of the Dutch energy regulator's attention and finding mostly incentive based measures and remedies to cure this problem. However, considerable legal problems arise in relation to standard contract terms applied by energy suppliers where active enforcement of the DTe seems justified.

In the Netherlands the standard contract terms of energy suppliers are based on model standard contract terms that are agreed on and promoted by bilateral agreements within the Energy and Water Coordination Group for Self-regulation of the Dutch Social and Economic Council (SER).[131] The Coordination Groups are set up in order to promote negotiations between business and consumer organizations and to come to balanced standard contract terms.[132] These model standard contract terms concern among others supply of and connection to energy and gas to the retail market. Since the Liberalization Act of 2004 entered into force and amended the Electricity Act of 1998 electricity is a moveable asset and electricity supply contracts qualify as consumer sale contracts under Article 7:5 of the Netherlands Civil Code (BW). Accordingly, on the basis of Article 7:6(1) BW in consumer sales contracts there may be no limitations on or exclusions of the rights and actions which the law grants to the buyer for failure in the performance of the obligations of the seller.[133] Moreover, consumers can claim compensation, damages on the basis of Article 6:74 BW. In other words the electricity supplier cannot limit or exclude his liability in case of malperformance of the supply agreement

[131] Established in law by the 1950 Industrial Organisation Act (Wet op de bedrijfsorganisatie), the SER is the main advisory body to the Dutch government and the parliament on national and international social and economic policy. The SER is financed by industry and is wholly independent from the government. It represents the interests of trade unions and industry, advising the government (upon request or at its own initiative) on all major social and economic issues. In addition, the SER helps the government to enforce the Works Councils Act (Wet op de ondernemingsraden).

[132] http://www.ser.nl/sitecore/content/Internet/nl/Taken/Zelfregulering/Consumentenvoorwaarden/Praktische%20Informatie/Consumentenvoorwaarden.aspx#energie

[133] Article 7:6 BW – 'In a consumer sale, there may be no derogations to the detriment of the buyer from sections 1 – 7 of this title, and in such sale there may be no limitations on or exclusions of the rights and actions which the law grants to the buyer for failure in the performance of the obligations of the seller'. For example Art. 7:11 (transfer of risk), Art. 7:18 (conformity in consumer sales), Art. 7:24 (nonconformity and product safety), Art. 7:25 (redress) and Art. 7:28 (limitation period). P.P.C. Haanappel, E.Mackaay, *New Netherlands Civil Code*, Kluwer, Deventer 1990.

concluded with a consumer.[134] Any limitation of the statutory right to damages in the standard contract terms of electricity suppliers is null and void. The model standard contract terms agreed on in 2006 between the Dutch Consumer association and the representative of the electricity suppliers, EnergieNed and VEWIN, does include in Article 17 several limitations that conflict the provisions of consumer sale as explained above. The DTe has declared that it is not intending to take action against this standard term as it sees no conflict with the law and will only act in case electricity suppliers regularly act in conflict with reasonableness and fairness.[135] The DTe has declared that it shall assess the justification of the exemption clauses in concrete situations and it shall together with the Ministry of Economic Affairs consider whether the limitation of this exemption clause is necessary from a policy point of view.[136] The recently established Consumer Authority could in this case take up its role of supervisory authority which is otherwise subsidiary to the sector specific authority. On the basis of Articles 2.5 and 2.6 of the Act of Consumer protection enforcement of 2006 the Consumer Authority can enforce civil law provisions of consumer law such as unfair contract terms when consumers' collective interests are at stake.

6.3. Remedies

As mentioned above the DTe in its market surveillance role has focused on consumer switching and the improvement of consumer activity in the Dutch electricity market. The following steps have been already undertaken by the regulator and by the energy suppliers. Some of the administrative backlogs were taken care of by the energy companies themselves.[137] Furthermore, the DTe has required the draft of a code of conduct, which regulates the most important matters in the area of switching to a different supplier (from recruitment to cooperation with regard to switching). This code, drafted by EnergieNed for energy suppliers entered into force in September 2006 and the DTe monitors compliance with the code of conduct closely. If DTe receives reports that a company has infringed the code of conduct, it will intensify its regulation and conduct an in-depth investigation. Where the law is infringed, DTe will take action to enforce the law. In the case of energy companies which adhere to the code of conduct, the code will serve as a 'mark of quality' for good recruitment practices.[138]

[134] M Loos, Verboden exoneraties in energieleveringsovereenkomsten en vernietiging van met de wet strijdige bindende adviezen (Forbidden exemption clauses in contracts for the supply of energy and the avoidance of third party decisions contrary to mandatory law), Tijdschrift voor Consumentenrecht en Handelspraktijken 2006/1, pp 3-6.

[135] M Loos, Reactie op consultatie Consumentenautoriteit, September 2006.

[136] Algemene Voorwaarden 2006 voor de levering van gas aan kleinverbruikers AV CZ/59 april 2006.

[137] On the basis of its investigation the NMa concluded that the six large energy suppliers (Essent, Eneco, Nuon, Delta, Greenchoice and Oxxio) had managed to eliminate their administrative backlogs for the period prior to January 2005 with regard to the processing of changes of address and switches. This is in line with agreements which the suppliers reached with the Minister of Economic Affairs at the beginning of this year.

[138] NMa Demands That the Energy Sector Solve Customer Recruitment Problems 05-19 / 10-21-2005.

However, despite this code of conduct complaints about recruitment have increased during the last year.[139]

Moreover, the DTe publishes a scorecard on its website every three month as part of its investigations into the administrative processes of the large energy companies. This scorecard gives consumers structural insight into the performance of individual energy companies. The scorecard shows what the situation of the company is with regard to the timeliness with which invoices are sent following a change of address or a switch.[140] The scorecard, as well as recent investigations, show that the energy companies have improved their administrative processes. If, contrary to expectations, the performance of the energy companies deteriorates the DTe will request a thorough plan of action and will monitor its implementation closely.[141]

Measures could also be taken in order to reduce firms' costs to acquire switchers. Switching costs as has been mentioned above are not only costs for consumers but also for suppliers. The amount and the framing of information is essential in order to help consumers. When information is provided, but consumers have difficulty in getting access or to process the available information, they might still make irrational choices. Wilson and Waddams Price found evidence of three types of consumer switching decision errors within the UK electricity market: consumers who do not switch despite substantial available savings, consumers who switch from a cheaper to a more expensive supplier and consumers who switch to a cheaper, but not the cheapest available supplier. They found, moreover, that consumers make more efficient decisions in markets with fewer competitors. Thus consumer confusion and 'information-overload' are rather the reasons for these mistakes than other 'rational' explanations of consumer mistakes such as perceived differences in firm quality or uncertainty over consumers' own demand.[142] The lack of consumer switching might be also the result of the bounded rationality of consumers that exists even in fairly competitive markets.

How to deal with these psychological hurdles? In the long run more surveys have to be conducted in order to get to know more about consumer behaviour. These cases imply that the behaviour of consumers is often the source of frictions in markets. Switching

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139 NMa/DTe, 2007, p 44.

140 The timeliness with which the annual invoices are sent is also stated. By means of the scorecards on the website, the performance of the energy companies with regard to their administration is made transparent and this enables consumers to take this performance into account when choosing their energy supplier. The scorecard contains the percentage of invoices dispatched on time (within two months) to customers who indicated in June that they wished to switch or change address.

141 The scorecard was developed in cooperation with EnergieNed and includes all the eletricity and gas suppliers with more than 10,000 customers. The performance of the grid managers has not yet been included in the scorecard. It has since been agreed with the grid managers that they will take the necessary steps of their own accord to ensure that their performance can be compared. DTe will then include the performance of the grid managers on the scorecard in December of this year. As of today, the scorecard can be found on DTe's website (www.dte.nl).

142 Wilson & Waddams Price, op cit, n 2.

only takes place when consumers are aware of the possibilities and when they are willing to switch. Their motivation, capacity and opportunity to switch have to be further analysed. The quality and cost of information should be reviewed and improved if necessary through intermediaries and independent platforms. Although we know little about the process of consumer choice these cases make it clear that understanding how consumers search and choose products and services is the key to protect consumers and at the same time to activate competition. This calls for information that de-frames decision-making. Consumers need tips and tools and functional information to make efficient decisions in terms of swift, easy and effective choice and eventually switch.

In summary, the Dutch market exhibits similar problems though not identical problems as the Hungarian telecommunications market. The liberalization of the Dutch electricity market went more smoothly both in terms of regulation and enforcement including the setup of an institutional framework. Still, the NMa/DTe has just recently concluded that competition in the electricity market stagnates and that it is still characterized by limited number of producers and high consumer prices compared to other EU Member States.[143] The focus of attention with regard to consumer protection has been on switching behaviour. Introducing competition and eliminating entry barriers as well as controlling unfair trade practices such as misleading recruitment methods are the foremost ways to protect consumer welfare and increase their confidence in the market. While considerable progress has been made in both fields, entry barriers still exist preventing new firms from entering the market and offering lower prices and better products or services. Unfair trade practices and problems with administrative processes as well as dispute settlements have been dealt with by both the sector as well as by the regulator. Improvements have been reflected in increased switching and expressed confidence of consumers.

One area where the DTe has been reluctant to enforce its powers is standard contract terms of the energy suppliers that seems to conflict with consumer rules of the Civil Code. Even though there is, since January 2007, a new administrative agency, the Consumer Authority that can also enforce civil law provisions such as unfair contract terms in the collective interest of consumers, it has a subsidiary position. This raises both a substantive as well as an institutional question. The substantive question is how sector regulation concerning consumer protection relates to general contract law provisions of consumer protection and whether primarily private law provisions that are to be enforced by private and individual agents should be complemented by public enforcement for the collective interests of consumers on the basis of civil law provisions. The institutional question is which administrative or private agency has the responsibility or obligation of enforcement to enforce these civil law provisions. It seems to reflect an unfortunate institutional situation where several agencies can enforce the same law. Coordination and consistent application among different

[143] NMa: concurrentie Nederlandse elektriciteitsmarkt stagneert, Press Release, 06.12.2007.

regulatory measures and various enforcement institutions should be revisited and redefined.

7. Implications for Policy and Law Making

It has to be acknowledged that liberalisation needs not only framework laws that specifically target competition issues of the sector but it also needs legislative and policy measures that that help consumers to make efficient choices and accordingly activate competition. While this insight seems to gain sufficient support both at EU as well as at national level, there are three specific points that summarize the research of this paper.

First, empirical surveys and research challenge traditional modes of regulation and enforcement. They demonstrate that information problems consumers face cannot be effectively solved by regulatory approaches based on classical and neoclassical economics. These approaches stipulate more and better information to remedy market failures, for example, in the form of mandatory disclosure and enforcing fair trading rules. Recent findings of behavioural economics explain recorded consumer behaviour as the result of inertia; the incapacity to process the available complex information. In these cases more information leads to 'confusopoly' i.e. information overload when consumers are limited in their ability to make comparisons between the different bundles of offers from utility firms.

Second, the relationship between sector regulation and consumer law as well as between competition law and consumer law should be analysed. Unfair trade practices, unfair contract terms and abuse of a dominant position have traditionally belonged to one single piece of legislation and generally has been enforced by either private or public agents. The demarcation lines seem to have become more hazy between private and public law, between private and public law enforcement and institutions. It is in the first place, the role of the legislator to reconsider the existing law and spot eventual conflicting provisions or add where necessary cross-references between the different bodies of the law.

Third, enforcement and institutional framework has to receive more emphasis. There are several layers of enforcement, EU and national, sector specific, competition law and consumer law. Further layers are formed by private, public or alternative enforcement methods combining the two, for example, in case of dispute settlement. Accordingly, remedies and sanctions can differ significantly. There are, moreover, several institutions enforcing similar or the same rules. There is often no clear guidelines on the division of competences and powers, no overview of the ultimate effect of the different enforcement methods and institutions even if they are complementary to each other.

Caution should be taken when choosing and proposing policy measures in order to avoid regulatory tools that ultimately diminish the very competition that increases consumer choice. Highly complex systems of information disclosure originally aimed at lowering information costs will obviously restrict competition and will have counterproductive effects. Consumers unable to make informed choices are forced to employ expensive intermediaries and business has to bear the costs of the ineffective

disclosure. Some consumer protection measures create barriers to entry that limit the freedom of sellers and might eventually lead to higher prices for consumers. Interventions, therefore should be evidence-based, focused and evaluated to ensure that it is not unnecessarily applied. It should be examined why the market-based solution does not work or why that solution might be socially sub-optimal.[144] It also has to be demonstrated why government regulation is going to be better than markets in providing low-cost information. Even where a relevant market failure has been identified, government should only act when this is feasible and it is cost-effective to do so. The costs and benefits of particular forms of intervention and alternatives thereto should be examined and represented. Consumer regulation will only make consumers better off if it either improves consumer estimates of the value of information or reduces the cost of information to consumers.

These three points boil down to two conclusions. On the one hand, a new method of regulation has to be considered and, on the other, guidelines for governance of enforcement and institutional set-up are necessary.

A new method of regulation could make use of insights from behavioural economics, which suggests that intervention should be imposed with a 'lighter hand'. It suggests remedies aimed at framing effects and thus steer consumers' choices towards welfare enhancing options. Paternalistic guidance towards certain options through framing the way information is provided could assist consumers to de-bias their decision-making and to channel their decisions to socially beneficial options.[145]

In the light of these theoretical and empirical results the Commission as well as Member States should reconsider their measures for the assistance of consumers. Regulatory approaches should not only take account of the fact that some regulation can be ineffective because of poor assessment of its impact, or worse, is costly in terms of imposing high compliance costs on firms. Regulation could actually reduce or simplify consumer choice by providing more effective information and certain options that frame the way information is presented or propose 'tailored provisions' like codes of conduct. They should encourage measures such as model standard term contracts, that frame decisions for consumers without being mandatory to follow for firms, or set up systems that provide tips and tools and functional information that is easy to access and understand. Consumers need tips and tools and functional information to make efficient decisions in terms of swift, easy and effective choice and eventually switch.

Guidance on governance among the various layers of enforcement and institutional framework has received little attention so far. However, taking a closer look at the work and experience of national enforcement agencies this is needed. This might be a concern for the Member States in the first place, but the EU can take the role of

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[144] These are self-correcting mechanisms that are based on private law norms of tort, contract and property rights that they are the result of government action. Hadfield, Howse & Trebilcock, op cit, n 26, p 155.

[145] OECD Roundtable discussion on private remedies: class action/collective action; interface between private and public enforcement, United States of America DAF/COMP/WP3/WD(2006)34, p 18.

initiator and mediator by providing guidelines, best practices or recommendations. Imposing another layer of enforcement at the central EU level does not seem to be justified nor efficient.

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Managing the Intersection of Utilities Regulation and EC Competition Law

*Giorgio Monti**

Utilities regulation in the Member States is always subject to the application of EC competition law. However, this undermines the effectiveness of utilities regulation and the European Courts should deploy a more flexible standard than that which has been confirmed by the Court of First Instance in *Deutsche Telekom*. The grounds for affording greater latitude to regulators are threefold: first the regulator should be free to make decisions on economic grounds that support dynamic over allocative efficiency; second it should also be free to make decisions on non-economic grounds to prioritise other objectives at the expense of competition; and third the present scope of EC competition law is so wide that in several instances the Commission acts in a regulatory manner, stepping over tasks best left to the regulator. No general principle is recommended to demarcate the borderline between competition law and sector regulation but a case-by-case assessment should be carried out to determine whether the application of competition law would cut across the policy choices reached by the utilities regulator, and competition law should not apply when it would harm the regulatory goals.

1. INTRODUCTION

The question addressed in this article can be captured by a recent exchange of views between Telefónica and the Commission – the former had considered its price schemes immune from antitrust action having been subjected to sector specific regulation, and so it reacted with some force when the Commission imposed a fine on it for abuse of a dominant position through a price squeeze:[1]

> Telefónica finds itself squeezed between two regulators - the national regulator and the European Commission - which are at odds with each other. As a result, the decision by the Commission creates enormous uncertainty about the role played by the regulatory bodies and the competition authorities in the telecommunications sector, throwing into question the supervisory functions of the Spanish authorities. The legal uncertainty created by this decision will inevitably affect Telefónica's and other operators' ability to launch new products and services, with a direct impact

* Law Department, London School of Economics. An earlier draft of this paper was presented at the September 2007 meeting of the Competition Law Scholars' Forum. I am grateful for the comments raised on that occasion. Thanks also to Mel Marquis for commenting on a draft version of this paper. Any errors remain mine. An early version of this article which does not take into consideration the CFI's Deutsche Telekom ruling is available as a working paper at: http://www.lse.ac.uk/collections/law/wps/wps.htm (WPS 08-2008 April 2008).

1 COMP/38.784 - *Telefónica SA* (broadband) 4 July 2007; Press Release IP/07/1011 (4 July 2007).

> on the entire European telecommunications sector to the detriment of European consumers.[2]

The Commission was quick to respond to these arguments, in the following manner:

> There is nothing extraordinary or exceptional in the fact that the Commission and the [national telecommunications regulator] found different results: in the telecommunications sector regulators put in place *ex ante* regulatory mechanisms allowing competition to develop, but can only do this on the basis of market and cost forecasts. In so doing regulators lessen, but cannot entirely eliminate the risk of anti-competitive behaviour. Competition authorities act *ex post*, using historical data on effectively incurred costs. Accordingly, in many Member States, competition authorities have investigated and sanctioned *ex post* anti-competitive conducts in the regulated telecommunications markets, including broadband access.[3]

While acknowledging that EC competition law can apply in regulated industries, and that this application is generally beneficial, I shall explore whether some limits on its application may be desirable. The article is organised in the following manner: in Part Two I explain the rationale for the concurrent application of regulation and antitrust as well as its implications. In Part Three I argue that the overlap may not always be defensible, in that action or inaction by the regulator should not always be disturbed by the application of competition law, either because the regulator should be free to trade-off different competition considerations (e.g. choosing to favour dynamic over allocative efficiency) or to undermine competition in favour of other valued non-competition considerations (e.g. energy security over competitive markets). In Part Four I question the breadth of the application of EC competition law from a different perspective, noting that rather than merely applying settled legal principles, the Commission has a tendency to apply competition law in a 'regulatory' manner when challenging conduct in network industries. This serves to increase the overlap between competition law and regulation, an approach that may frustrate a national regulator's efforts further. Accordingly I conclude that there should be some limits placed upon the application of competition law, suggesting that the European Courts should develop the case law so as to allow them and national courts to determine on a case by case basis whether competition law should not apply in a situation where a regulator has already intervened.[4]

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[2] Teleónica Press release, 4 July 2007 available at: http://saladeprensa.telefonica.es/documentos/070704_Press_Release_EU_decision_ing.pdf.

[3] MEMO/07/274 *Antitrust: Commission decision against Telefónica - frequently asked questions* 4 July 2007

[4] The relationship between national regulation and national competition law, in particular the coordination between the National Competition Authority and National Regulatory Authorities is outside the scope of this paper. Different countries have opted for different patterns. The OECD notes the following: in Mexico the competition authority carries out certain parts of the assessment (e.g. analysis of market power) and the regulator then applies SSR; the UK has opted for concurrent powers of the OFT and NRA; in Australia senior officials from regulated industries serve as associates in the ACCC; in Ireland there are cooperation channels between NRA and competition authority; in The Netherlands the NRA and competition authority

2. THE SUPREMACY OF EC COMPETITION LAW

2.1 Legal justifications

One test case over the issue discussed in this paper has been decided by the CFI on 10 April 2008, and arose from the *Deutsche Telekom* decision.[5] In brief, the facts are these: Deutsche Telekom (DT) has an obligation to unbundle the local loop to allow competitors to offer competing services and the wholesale price for this was approved by the National Regulatory Authority. DT's retail prices for PSTN (land line) and ISDN (digital line) subscription were capped too. It transpired that the approved wholesale and retail prices were such that a competitor seeking access to the local loop would have to pay a wholesale price so high that in order to recoup it in the downstream retail market it would have to set a retail price higher than offered by DT, so resulting in a price squeeze, contrary to Article 82. One of DT's arguments was that it had relied on the regulator's directions and so assumed its pricing policies were lawful. This argument was quickly cast aside by the Commission in the following way: 'the competition rules may apply where the sector-specific legislation does not preclude the undertakings it governs from engaging in autonomous conduct that prevents, restricts or distorts competition.'[6] This reasoning follows the instructions in *Ladbroke*, where the ECJ held that '[w]hen the Commission is considering the applicability of Articles [81] and [82] of the Treaty to the conduct of undertakings, a prior evaluation of national legislation affecting such conduct should therefore be directed *solely* to ascertaining whether that legislation prevents undertakings from engaging in autonomous conduct which prevents, restricts or distorts competition.'[7] Note that it is not relevant whether the national law originates from national procedures or is national law which is implementing an EC Directive, the only consideration is whether the undertaking's action was its own or whether it was compelled to act in an anticompetitive way by state law. The Commission's approach was ratified in full by the CFI on appeal. The Court found that the key question was one of attribution: who is responsible for the anticompetitive behaviour: is it the regulator or the dominant undertaking? The finding that the dominant firm was able to influence the level of its retail charges through applications to the regulator meant that the undertaking was able to avoid the price squeeze.[8]

Accordingly, the legal position is as follows: provided the regulator does not compel the undertaking to act in a specific way which is in breach of Articles 81 and 82, then the

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are merged. OECD Global Forum on Competition *The Relationship Between Competition Authorities and Sectoral Regulators – Issues Paper* DAF/COMP/GF(2005)2 (available at: http://www.oecd.org/dataoecd/58/7/34375749.pdf).

[5] *Deutsche Telekom AG,* OJ 2003, L263/9; Upheld in Case T-271/03 *Deutsche Telekom AG v Commission,* judgment of 10 April 2008.

[6] *Deutsche Telekom.* ibid. para 54.

[7] Joined Cases C-359/95 P and C-379/95 P *Commission and France v Ladbroke Racing Ltd* [1997] ECR I-6265, para 35 (emphasis added).

[8] Case T-271/03, op cit, n 5, paras 121-122.

undertaking remains subject to EC competition law, while if the undertaking is forced to act in ways that infringe Articles 81 and 82, then the Member State is responsible for the breach, relying on a combined reading of Articles 3(1)(g), 10 and 81 or 82,[9] and the undertaking escapes without a penalty. When the State is in breach, the Commission may act by way of the procedures in Article 226, or national competition authorities may take action and disapply national law that is incompatible with EC competition law.[10] If state law encourages an infringement of the competition rules, then both the state and the undertakings are responsible, and both may face fines and damages claims in private law.[11]

As Professor Larouche points out, this position is justified by the constitutional structure of the Treaty.[12] His views are confirmed by the *O2* decision where the application of Article 81 in the telecoms sector was considered: '[s]ubject to the principle of the primacy of Community law, the national regulatory framework and the EU competition rules are of parallel and cumulative application. National rules may neither conflict with the EU competition rules nor can compatibility with national rules and regulations prejudice the outcome of an assessment under the EU competition rules.'[13] This is probably the more fundamental justification than the technical reasons discussed in *Deutsche Telekom*, but both are complementary.

The implication of this doctrinal stance is that because DT was not obliged to set prices that resulted in a margin squeeze, it had a duty to return to the NRA and ask for it to approve prices that would not have resulted in a price squeeze. In the Commission's words, 'DT could have avoided the margin squeeze by increasing retail charges for analogue and ISDN connections, because it was entitled to apply to the regulatory authority at any time asking for adjustments to charges.'[14] This obligation according to the Court in *Deutsche Telekom* is a logical corollary of the duty imposed on a dominant undertaking not to abuse one's dominant position,[15] indeed dominant firms may even have to modify their behaviour to avoid abuse regardless of whether the Commission has adopted a decision.[16] Moreover, it may be argued that the obligation on regulated firms to consult the regulator when they can foresee an infringement of competition law is not dependent on the firm being in a dominant position, and applies to Article 81 infringements too, because the question being considered is merely whether the

[9] The case law is summarised in D. Chalmers et al *European Union Law: Text and Materials* (Cambridge University Press, 2006) pp.1116-1122. A more detailed account is J Baquero Cruz, 'The State Action Doctrine' in G Amato and C-D Ehlermann (eds) *EC Competition Law – A Critical Assessment,* Hart, 2007.

[10] Case C-198/01 *Consorzio Industrie Fiammiferi* [2003] ECR I-8055.

[11] Ibid.

[12] Larouche, 'Contrasting Legal Solutions and the Comparability of EU and US Experiences' TILEC Discussion Paper (DP 2006/028), pp10-11.

[13] *T-Mobile Deutschland/O2 Germany,* OJ 2004, L75/32, para 22 (the principle was not challenged on appeal to the CFI).

[14] *Deutsche Telekom,* op cit, n 5, para 164.

[15] Ibid, para 122.

[16] Case T-5/02 *Tetra Laval v Commission* [2002] ECR II-4381, para 157.

undertaking was responsible for the infringement, and so long as there is room for avoiding an infringement of the competition rules, the undertaking has a duty to explore those options. The only concession to Deutsche Telekom was that its fine was reduced by 10 per cent in light of the fact that the national regulator had on several occasions considered the risk of a price squeeze but thought this was not a concern.[17]

The implications of this legal position can be summarised by two trite aphorisms. First, 'the regulator is regulated by the regulated firms.' That is, when the regulated firms are aware that the choices of the national regulator allow them to breach EC competition law, they should go back to the regulator and secure an alteration of the obligations imposed by the regulatory authority. Second, 'the Commission regulates the regulators.' In other words, the market failure which the national regulatory authority (NRA) causes by its intervention is cured by the application of EC competition law. In one sense, this second implication is desirable in light of the weakness of many NRAs, an issue we return to in Part 2.3 below. On this ground, it may be argued that until national regulators can be trusted to act independently of the government and of the incumbent operator, the Commission's ability to use competition law to oversee the markets is necessary to ensure that markets are liberalised and incumbents are not protected by the regulators. However, this argument boils down to saying that the ends justify the means, and it is not surprising that Telefónica, like DT has decided to test the limits of the application of competition law. In its notice of appeal it complains of:

> the ultra vires acts of the Commission, which, in any event, infringe the principles of subsidiarity, proportionality, legal certainty, loyal cooperation and sound administration by intervening where the national telecommunications regulator had already acted, which was set up under European legislation and which acted in accordance with the powers and competences conferred on it by that legislation and under a set of rules based on the Community competition rules.[18]

In light of the observations above and of the *Deutsche Telekom* judgment, it is unlikely that these arguments will sway the CFI, but there should be some scope for limiting the application of competition law, not least when the national regulator is acting in a scheme set up by EC Law, as in the telecommunications sector.

2.2 American lessons?

Some have suggested that in reconsidering the current law Europeans might learn from the *Trinko* judgment of the US Supreme Court.[19] However the legal reasoning deployed by the Supreme Court is not directly comparable to that which the European courts

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[17] Case T-271/03, op cit, n 5, para 312.

[18] Action brought on 10 September 2007, Case T-336/07 *Telefónica and Telefónica de España v Commission,* OJ 2007, C269/55.

[19] *Verizon Communications Inc v Law offices of Curtis Trinko* 540 US 398 (2004). Notably D Geradin, 'Limiting the Scope of Article 82 EC: What the EU Can Learn from the US Supreme Court's Judgment in *Trinko* in the Wake of *Microsoft*, *IMS*, and *Deutsche Telekom*' (2004) 41 CMLRev 1519. See for discussion G Monti, *EC Competition Law,* CUP, 2007, pp 472-4.

could deploy. In *Trinko*, the court was confronted with a situation where the Federal Communications Commission and New York's Public Service Commission (the relevant telecoms regulators) had intervened under the Telecommunications Act 1996 to ensure the defendant complied with his access obligations, and the plaintiff was asking the courts to read established s 2 Sherman Act case law on refusals to deal more widely to embrace his claim. The US Statute in question explicitly provided that the antitrust laws could apply notwithstanding the regulatory scheme (so that for example had there been a cartel among regulated firms, the Department of Justice could have prosecuted this).[20] However, the Supreme Court held that while the conventional antitrust rules applied, courts should be reluctant to develop the common law when this would encroach upon the sphere already covered by the Statute, most crucially because the Statute was designed to create a more competitive market. As Scalia J put it: 'the regime was an effective steward of the antitrust function.'[21] At first blush, this categorical assertion would seem to provide some support for the position taken by Telefónica in its appeal, however a closer look at the statutory framework suggests that *Trinko* is an unhelpful precedent. There are three points that distinguish *Trinko* and *Deutsche Telekom*: first, *Trinko* dealt with the overlap of two Federal Laws (not a state and a Federal Law, like in the European cases where the tension is between Article 82 EC (primary law) and national law that implements secondary Community legislation; second the US Telecommunications Act made express provision for the parallel application of competition law; third *Trinko* merely held that the antitrust laws should not be *extended* to reach the facts at hand. The third point is significant because *Telefónica* and *DT* are not the first margin squeeze cases, although there were certain novel features in the detailed application of the law. Thus the Commission was not reading Article 82 more extensively to reach practices that are also regulated by national law. Therefore the ratio decidendi in *Trinko* has nothing to teach the European courts, because had the same facts occurred in the US, the court would say that US antitrust applies, the matter would be uncontroversial. This is confirmed by the *LinkLine* judgment (involving facts very similar to the European cases: an allegation of a price squeeze by upstream owners of the local loop against competing internet service providers) where the majority of the court found that price squeeze cases had been recognised for six decades so the plaintiff was not trying to expand antitrust law, thus the claim did not fail because of the *Trinko* judgment which merely indicated that the presence of a regulatory scheme should be a factor to take into consideration in deciding whether to impose antitrust liability.[22] Moreover, *Trinko* has introduced a degree of uncertainty that compelled the Antitrust Modernization Commission to issue

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[20] Section 601(b)(1) Telecommunications Act 1996 Act provides that 'nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws.'

[21] 540 US 398, 413.

[22] *LinkLine Communications, Inc. v. SBC California, Inc.* 503 F.3d 876 (9th Cir 2007).

a clarification to explain that the Court only held that statutory duties to deal do not create a cause of action under the refusal to deal doctrine.[23]

One US doctrine that *may* be relevant in the *Deutsche Telekom* and *Telefónica* appeals is that of implied immunity. That is, when a statute is silent on the application or non application of antitrust laws, the courts will consider that the statute implicitly immunises the regulated parties from antitrust laws in scenarios where the statutory scheme is detailed and designed to deter and remedy anticompetitive harm, and where courts might feel hesitant at applying antitrust when it goes against the regulator's plans.[24] The recent case law suggests a structured test to applying this doctrine which is based on four key considerations: (1) whether the practices in question fall squarely within the field covered by the regulator; (2) whether there is a regulatory authority that supervises those practices; (3) evidence that the regulator exercises his authority; (4) a risk that the application of both antitrust and regulation would produce conflicting guidance or standards of conduct.[25]

The question arises whether this doctrine applies, for instance in the context of the Regulatory Framework in Electronic Communications. An answer that might be attempted is as follows: if a National Regulatory Authority (NRA) has acted to regulate a market, this means that the NRA has decided (with supervision from the Commission) that, among other things, the application of competition law is unlikely to be sufficient to remedy the anticipated anticompetitive practices.[26] In these circumstances, it would seem that the NRA's choice to regulate should give the regulated party implied immunity from the application of EC competition law. By the same token, if an NRA does not act, then there is no implied immunity because the Directives seem to implicitly suggest that competition law applies. Accordingly the doctrine of implied immunity would require a more nuanced application than in the United States: in the US the doctrine immunises the application of antitrust always, in the EC, it may do so in cases of regulatory action but not in cases of inaction. However the doctrine of implied immunity has been developed in the context of Federal, not state, regulation; and so long as EC utilities regulation is national in character, then from a doctrinal perspective there is nothing to draw upon here. Nevertheless, both Scalia J's approach in *Trinko* and the implied immunity doctrine provide ammunition for suggesting that applying EC competition law without any regard to the regulatory framework is undesirable, and that good reasons should be provided for doing so, beyond the formalistic legal justifications offered so far.

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[23] Antitrust Modernization Commission Report and Recommendations 2 April 2007, Recommendation 67. (available at www.amc.gov).

[24] The doctrine is discussed in *United States v. National Assn. of Securities Dealers, Inc.*, 422 U.S. 694 (1975); *Gordon v. New York Stock Exchange, Inc.*, 422 US 659 (1975); *National Gerimedical Hospital and Gerontology Center v. Blue Cross of Kansas City*, 452 US 378 (1981) and *Billing v. Credit Suisse First Boston Ltd.* (2007) ___US___

[25] *In re Short Sale Antitrust Litigation* 527 F. Supp. 2d 253, 257 (SDNY 2007).

[26] Recital 27 of the Framework Directive, OJ 2002, L180/33: 'It is essential that ex ante regulatory obligations should only be imposed where there is not effective competition ... and where national and Community competition law remedies are not sufficient to address the problem … '.

The sole indisputably comparable doctrine from the United States that applies directly to the problem canvassed at the start of this article is the 'state action doctrine' developed by the Supreme Court whereby the Sherman Act does not pre-empt state regulation,[27] nor does it pre-empt regulation by non-state bodies (e.g. regulators) when this anticompetitive regulation is clearly articulated as state policy (that is the state has clearly decided that a policy objective trumps competition) and the state actively supervises the implementation of that policy so as to avoid regulatory capture.[28] The question arises whether the EC's own state action doctrine (recently considered in the *Mauri* and *Cipolla* cases for example) should be widened to encompass the application of sector specific regulation when this has anticompetitive effects.[29] However, an objection to this line of inquiry would be that there is little to be gained from a weak doctrine: the American Bar Association, the Federal Trade Commission and the Antitrust Modernization Commission have all expressed concerns that the lower courts have read this doctrine too extensively at the expense of effective competition.[30] A second objection is that comparison and lesson drawing is dangerous given the different constitutional makeup of the US and EC. State-sovereignty seems to provide a good reason for the greater willingness of the Americans to tolerate anticompetitive state laws, while the supremacy of EC Law seems to pull in the opposite direction.[31]

2.3 Policy considerations

So far I have considered the legal arguments surrounding the concurrent application of competition law and sector specific regulation, however beneath these lie two policy considerations that help frame the debate in a wider context: the role of sector specific regulation in recently liberalised utilities, and the institutional makeup of regulators in the Member States.

As regards the role of regulation, a significant corollary of the Commission's views about the primacy of EC competition law over national law is that EC Directives that liberalise utilities strive to avoid requiring Member States to implement a scheme of regulation that places competition second. That is, the directives do not as a rule require Member States to put into place a regulatory structure that privileges say the protection of the environment or of consumers over competition. All policy goals should be achieved within the framework of competitive markets. Even the provision of universal services is increasingly to be achieved through competitive markets rather

[27] *Parker v. Brown*, 317 U.S. 341 (1943).

[28] *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980); *FTC v. Ticor Title Insurance Co.*,504 U.S. 621 (1992).

[29] Case C-250/03 *Mauri* [2005] ECR I-1267; Joined Cases C-94/04 and C-202/04 *Cipolla and Others,* judgment of 5 December 2006.

[30] Antitrust Modernization Commission, op cit, n 23, p 343, citing the earlier reports of the FTC and ABA.

[31] E Fox, 'State Action in Comparative Context: What if Parker v Brown were Italian?' (2003) Fordham Corporate Law Institute (Hawk ed. 2004).

than through restrictions of competition.[32] This policy position draws support from Article 4(1) EC which requires that the Community's economic policy is 'conducted in accordance with the principle of an open market economy with free competition.' Therefore EC Competition Law is also of a higher order to other Community policies, and Directives under Articles 86(3) and 95 can be challenged if they are anticompetitive. Perhaps it is this legal conclusion that so irked President Sarkozy and led him to ask for a modification of the Treaty in an attempt to tone down the supremacy of competition law. Article 2(3) of the Treaty on European Union, as amended by the Lisbon Treaty provides as follows:

> The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment.[33]

In contrast, the Treaty establishing a Constitution for Europe had set out as one of the Union's objectives 'an internal market where competition is free and undistorted',[34] language reflecting the current Article 4 EC. It remains to be seen whether the deletion of competition from this provision is sufficiently significant to modify the current legal position, and whether the EU legislature will now consider tempering the insistence on competition in Article 95 Directives. Admittedly this is what the French president intended, in particular in the face of continuing challenges against France's energy policy.[35] This policy debate about how far competition should be the guiding principle raises the question of whether there are circumstances where the non-application of competition law may be justified when a national regulator chooses to tolerate an anticompetitive solution as a means of achieving other policy objectives.

A second policy implication that may be utilised in particular to justify the Commission's position in *Deutsche Telekom* case is the weakness of the German regulator. For instance it has been noted that the regulator (RegTP) is subject to

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[32] See for example Proposal for a directive of the European Parliament and of the Council amending Directive 97/67/EC concerning the full accomplishment of the internal market of community postal services COM (2006) 594 final which proposed removing the reserved sector altogether, thus abandoning the approach whereby the supply of universal services is financed by monopoly profits.

[33] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community (3 December 2007). Available at http://www.consilium.europa.eu/cms3_fo/showPage.asp?id=1297&lang=en. However, this is qualified by the protocol on the internal market and competition by which the high contracting parties, considering that the internal market as set out in Article 2 of the Treaty on European Union includes a system ensuring that competition is not distorted, have agreed that: to this end, the Union shall, if necessary, take action under the provisions of the Treaties, including under Article 308 of the Treaty on the Functioning of the European Union.' This retains the Community's competence to legislate to further competition in the internal market (Article 308 was used for instance as a legal basis for the EC Merger Regulation).

[34] Article I-3(2), (2004) Cm 6429.

[35] See the GDF and Suez merger that has been agreed recently (*Financial Times* 4 September 2007).

political interference which undermines its independence.[36] Similar influence from government can be detected in the workings of the Spanish regulator.[37] And the Commission has also noted that other regulators in the field of electronic communications are insufficiently independent.[38] Therefore, a 'regulator of regulators' may be necessary as Member States make the transition from state regulation of network industries to independent regulatory agencies. However this argument is really a reflection of the failure of EC Regulation, not of the legitimacy of the concurrent application of EC competition law. The 2002 Regulatory Framework already gives the Commission significant latitude to regulate the regulators; the fact that even more powers are needed to admonish national regulators suggests a somewhat imperfect legislative scheme.

However, one can turn this line of argument on its head and suggest that the reason why the current regulatory scheme leaves space for national variation is precisely because at this stage in the political process Member States have not yet agreed to relinquish political control over utilities regulation. And on this line of argument, the Commission's choice to apply competition law when it disagrees with the regulator's position undermines the choice of the EU legislature to limit the reach of sector specific regulation so as to afford Member States some latitude in their policy choices. One powerful objection to this line of defence however is that regulation which is so dependent on government discretion is highly inimical to the promotion of legal certainty for market players and as a result undermines incentives by existing players and new entrants to invest in these markets. Accordingly, even if one were to agree that the pursuit of goals other than competition is legitimate, a highly discretionary regulatory scheme is counterproductive. This explains why the Commission's current proposals to reform the Directives on telecommunications, electricity and postal services seek to insulate national regulators from government. In telecommunications for example, the proposals to reform the Framework Directive require that Member States 'ensure that national regulatory authorities exercise their powers independently, impartially and transparently', that regulators do not take instructions from other bodies, that appeals from their decisions are to a national court, that the head of the national regulatory authority cannot be dismissed unless guilty of serious misconduct or she no longer fulfils the criteria for appointment published in advance by the Member State, and that national regulatory authorities have adequate financial and human resources to carry out the tasks assigned to them and that they have separate annual budgets.[39] A similar line is adopted in the electricity sector, the draft Directive on

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[36] K Stockmann 'Comment' in H Ullrich (ed.) *The Evolution of European Competition Law,* Cheltenham, Edward Elgar, 2006.

[37] J Jordana and D Sancho, 'Policy networks and market opening: Telecommunications liberalization in Spain' (2005) 44 European Journal of Political Research 519.

[38] E.g. V Reding, 'Why we need more consistency in the application of EU telecom rules' SPEECH/06/795, 11 December 2006.

[39] Article 3(3) Proposal for a directive of the European Parliament and Council amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and services, and

common rules for the internal market in electricity requires that Member States guarantee the independence of the regulatory authorities and that it exercises its powers impartially and transparently. Like in telecommunications, the regulatory authority is independent of government, it has budgetary autonomy and adequate resources to carry out its tasks.[40] Accordingly, once national regulatory authorities are designed in a way that avoids government interference, then the application of competition law in situations where it risks undermining the policy choices of the regulator may be unjustified, but until that moment arrives, competition law serves as a safeguard against political meddling.

Therefore, from a policy perspective, the need for institutional reform serves as a justification for the status quo: competition law applies even when it contradicts national regulatory policy in order to correct the weakness of national regulators today. But this is a temporary solution pending adequate reform of national regulatory authorities. Once these reforms are in place, then the application of competition law can be more sensitive to the policy choices of the independent regulator.

3. QUESTIONING THE SUPREMACY OF COMPETITION LAW BY REFERENCE TO UTILITIES POLICY

Above I canvassed the view that decisions like *Deutsche Telekom* and *Telefónica* are justified in the current climate, characterised by politically dependent national regulators, and that the approach taken in those decisions should be reconsidered once national regulators can be trusted to act in the interest of the market. In this section, I consider whether competition law should not be more deferential to regulators today, by considering examples of what can be described as legitimate attempts to regulate utilities in the public interest.

3.1 Competition versus innovation

A traditionally difficult issue in competition law enforcement is managing the promotion of allocative and dynamic efficiency. While in certain situations ensuring the former serves to guarantee the latter, there are also scenarios where trade-offs may have to be made whereby one sacrifices allocative efficiency in favour of dynamic efficiencies. Antitrust law has long struggled with applying a trade-off when regulating firms with market power, good examples of this can be seen in the debates over the application of the efficiency defence in merger regimes,[41] and the debates about the

2002/20/EC on the authorisation of electronic communications networks and services COM(2007) 697 final.

[40] Article 22a Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity COM (2007) 528.

[41] See generally G Monti, 'Merger Defences' in Amato and Ehlermann, op cit, n 9.

refusals by dominant firms to licence intellectual property rights, most recently discussed in the *Microsoft* judgment.[42]

A similar tension may be observed in the several policy objectives set out in the Framework Directive for electronic communications, which requires national regulatory authorities to promote competition by ensuring that users 'derive maximum benefit in terms of choice, price and quality' while also 'encouraging efficient investment in infrastructure and promoting innovation.'[43] As Professor Larouche notes these two goals are not necessarily complementary and he considers it unusual that there is no more concrete steer towards investment and innovation in light of the Lisbon agenda which is designed to increase investment and improve the competitiveness of European industry.[44]

An example of a mechanism that could be used by a regulator to prioritise dynamic over allocative efficiency is a 'regulatory holiday' that suspends regulatory obligations when a regulated firm develops a new product. The idea behind a regulatory holiday is akin to granting an IP right: the holder is free from competition for a particular time period, and the prospects of this holiday are an incentive to innovate. In contrast the Commission thinks that competitive markets are the best way to encourage investment and is against regulatory holidays. An example suggested by Alexandre de Streel helps us see the conflict, it concerns the roll out of VDSL lines in Germany.[45] Initially the German regulator took the view that VDSL lines were not in the same market as ADSL lines, so there was no need to regulate broadband access obtained through VDSL. (In effect this seems to be a strategic market definition designed to avoid imposing regulations based on the Access Directive.) However the Commission objected to this market definition, taking the view that ADSL and VDSL lines formed part of the same market in that the services that could be channelled through these networks are the same, and urged the German regulator to ensure that there is broadband access to VDSL. In particular the Commission noted that Deutsche Telekom had begun a programme of rolling out VDSL lines and foresaw the risk of foreclosure for competitors if this market went unregulated.[46] This position is now replicated in the European Regulators' Group Revised Common Position on Remedies.[47] The ERG

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[42] Case T-201/04 *Microsoft v Commission,* judgment of 17 September 2007 paras 688-712. And see generally Kanter, 'IP and compulsory licensing on both sides of the Atlantic - an appropriate antitrust remedy or a cutback on innovation?' (2006) 27 ECLR 351; Ritter, 'Refusals to Deal and Essential Facilities: Does Intellectual Property Require Special Deference Compared to Tangible Property?' (2005) 28(3) World Comp 281.

[43] Article 8(2)(a) and (c) Directive 2002/21 Framework Directive, OJ 2002, L108/33.

[44] P Larouche, 'What went wrong: the European perspective' TILEC Discussion Paper DP (2003-001) pp 14-15.

[45] A de Streel, 'The Scope of Economic Sector Regulation in Electronic Communications' (2006) 62 Communications & Strategies 147, 162.

[46] Case DE/2005/262 – Wholesale Broadband Access in Germany: Withdrawal of Serious Doubts (23 December 2005).

[47] Revised ERG Common Position on the approach to Appropriate remedies in the ECNS regulatory framework ERG 06(33), pp.116-118 available at: http://erg.eu.int/documents/index_en.htm

argues that rather than offering a regulatory holiday to the innovator, the access remedy should be designed to reward his investment, so for example the price of access can be higher when one seeks access to VDSL. Two comments are warranted: the first is that the ERG seems to think that it is able to calculate exactly what sort of compensation the innovator should get so that the incentive to innovate is not dented. This seems somewhat optimistic.[48] But besides that practical point I think the ERG position is underpinned by a familiar ideology. Consider this passage:

> It is undoubtedly the case that the investors require a reasonable opportunity to make a fair return on their investments, which properly reflects the risks undertaken. However, a guaranteed monopoly over access is by no means a pre-requisite for such a return.[49]

The innovator is only entitled to a 'fair return' on his investment. Fair according to whose criteria? Fair according to the innovator means 'as much as possible', but fair for the ERG seems to suggest more limited income. More specifically, an inventor will normally have a set of projects on the run, only one of which may be successful – is the reward limited to the costs of developing the one successful product? Surely the inventor needs to recoup all costs sunk in developing new products. Limiting revenue streams dents incentives to innovate. Moreover, the passage quoted above has resonance with the EC's approach in Article 82: that dominant firms have 'special responsibilities' and that excessive pricing is a possible abuse. Compare with the US instead where the successful competitor must not be turned upon when he wins and excessive pricing is not punished by s 2 Sherman Act (the two are intimately related as high prices are the reward for success and also invite entry). The American approach is premised on the belief that false positives are risky and that it is best to allow potentially harmful behaviour than to dent incentives to innovate. There are therefore two competing paradigms for the promotion of innovation, one which tolerates the risks of monopoly and one which does not. In view of the fact that innovation in the EU is low compared to the US, and in light of the Lisbon agenda, might a more lenient position on regulatory holidays be warranted? Or at the very least, might national regulators be given the flexibility to experiment with regulatory holidays? In defence of the Commission's concerns over regulatory holidays, one should note that these would tend to be granted to the incumbent – that is a telecommunications operator that has historically benefited from exclusive rights and state support. In this view, regulatory holidays are a retrograde step when the key policy consideration is increasing competition through asymmetric regulation targeting former state monopolies.

A more general argument against regulatory holidays is that they lead to different regulation across the Member States, thereby harming firms that wish to invest in more than one Member State. The argument goes that if one wishes to promote pan-

[48] On the other hand, a comparable exercise is practised in deciding whether restrictions of competition are indispensable in Article 81(3) proceedings. See Guidelines on the application of Article 81(3), OJ 2004, C101/97, para 80.

[49] ERG Common Position, op cit, n 47, p 118.

European telecommunications services, one should strive for regulatory uniformity.[50] The argument was accepted by the Commission whose reform of the Framework Directive is designed to grant it veto powers over the remedy prescribed by national regulators, which means that every step of a national regulator's tasks would be subject to Commission approval.[51] While uniformity and legal certainty are undoubtedly important to secure investment, it may also be argued that a rigid regulatory framework is less likely to discover the best way to regulate markets than a scheme which allows different regulatory authorities to experiment with divergent forms of regulation. This suggestion has been made by Larouche and de Visser who consider the possible risk of all telecommunications regulators making the same (wrong) decision and contrast this scenario with one of 'regulatory emulation' a process whereby regulators experiment with different models, and through an iterative process the best way of regulating markets is discovered. In contrast, the authors note that at present there is little attempt by regulators to experiment with innovative regulatory tools, instead usually one of the regulators from the larger Member States takes the lead and the rest follow.[52] A balanced approach that favours uniform regulation when there is consensus but also tolerates regulatory experiments when it is not clear how to best regulate markets may be a workable means to determine how to regulate markets in the long term. But for this to work the regulated need to be certain that they will be free from liability under competition law.

If we turn our attention to energy policy, we see that there are instances where the Commission is prepared to trade-off dynamic and allocative efficiency when granting exemptions from third party access to undertakings that develop new interconnection capacity.[53] New capacity is necessary to help develop the internal market and break down national monopolies by creating an EU-wide wholesale market. Article 7 of the Electricity Regulation sets out six conditions that must be met before an exemption is granted, and establishes a procedure whereby the parties seeking exemption first notify the relevant NRA, followed by consultation with other government bodies, and the decision to exempt must be notified to the Commission that has the power to veto the grant of an exemption.[54] The effect of an exemption is that the firms building the interconnector can then buy electricity cheaply from one end and sell it at the other end where demand is less elastic. These financial rewards pay for the risk involved in building the new interconnector. As Kim Talus concludes, the rationale 'is to favour long-term efficiency gains over short-term advantages.'[55] A similar scheme operates in

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[50] I am grateful to Andy Tarrant for this observation. See *BT The Economic Benefits from Providing Businesses with Competitive Electronic Communications Services – Overview Report* (5 June 2007) available at www.btplc.com.

[51] Proposal, op cit, n 39, Article 7(4).

[52] P Larouche and M de Visser, 'The Triangular Relationship between the Commission, NRAs and National Courts Revisited' (2006) 64 Communications & Strategies 125, 133-135.

[53] See PD Cameron, *Competition in Energy Markets,* 2nd ed, OUP, 2007, paras 5.95-5.105.

[54] Article 7 Regulation 1228/2003 on conditions for access to the network for cross-border exchanges in electricity, OJ 2003, L176/1.

[55] K Talus, 'Monopolies in EC Energy Law – Interconnectors' (2004/2005) 14 Utilities LRev 256, 258.

the gas market for major investments where third party access obligations are suspended;[56] and national regulators here have also provided other national schemes to create incentives to invest in gas infrastructure.[57] Judged numerically the exemption in the gas sector has been utilised significantly more frequently than in the electricity sector, where only one exemption has been granted and another application is pending.[58] These provisions resemble the notification/exemption procedures in Regulation 17/62 and operate in a way similar to Article 81(3) EC.

There are three aspects that distinguish the energy example from the regulatory holiday in the telecoms sector: procedurally, the Commission is heavily involved in the grant of an exemption, substantively the degree of market power that the investors secure is not as significant, and economically the exemption is given when new infrastructure is built while in the electronic communications the reluctance to afford regulatory holidays applies to upgrades to existing infrastructure. Nevertheless in both instances the benefit to the Community is comparable: new facilities are introduced that help strengthen Europe's economy, at the expense of allocative efficiency in the short run.

Now, let us assume that an NRA chooses to award a regulatory holiday to a telecoms firm in spite of Commission attempts to prevent that policy choice. Can Article 82 apply if this holiday allows the firm to abuse its dominant position? As we saw above the answer is in the affirmative because the supremacy of Community law pre-empts any inconsistent judgment call by the regulator – even if the regulator thought there were good economic reasons for favouring dynamic efficiency. What if an NRA grants an exemption in for an electricity interconnector and the Commission does not veto it? Does this immunise the behaviour of the undertakings? The answer should be in the negative because the exemption only excuses the undertaking from the obligations in the energy legislation, it does not create a general derogation from other Treaty obligations. The scenario is analogous to one where an agreement benefits from a Block Exemption may still be subject to challenge under Article 82. So as a matter of law it seems that even a Commission-sanctioned regulatory holiday under the relevant energy rules would remain subject to competition law. However, in practice one might argue that since the criteria to be taken into consideration when granting the exemption in the energy market include those in Article 81(3), then it would be very odd for a competition law claim to succeed.[59] Nevertheless, a person dissatisfied with the exemption seems to be free to choose between appealing the exemption and challenging the undertakings using competition law. In this scenario it would seem that the court should develop a doctrine akin to the 'implied immunity' standard used in the

[56] Article 22 Directive 2003/55 concerning common rules for the internal market in natural gas, OJ 2003, L176/57. For Discussion see, DG Competition *Report on Energy Sector Inquiry* SEC(2006)1724, paras 236-242.

[57] Council of European Energy Regulators I*nvestment in Gas Infrastructure and role of EU National Regulatory Authorities* – 12 May 2005.

[58] DG Competition report on energy sector inquiry SEC(2006)1724, para 346.

[59] Even under Article 82, it may be argued that behaviour that fulfils the four conditions in Article 81(3) may be objectively justified for the purposes of Article 82.

US courts to prevent antitrust law from frustrating the regulator's legitimate choice.[60] Or at the very least, satisfying the requirements of the energy Regulations could be said to create a rebuttable presumption of legality under EC competition law.

3.2 Energy policy: security versus competition

Energy policy is not merely about creating a competitive market; there are non-economic considerations as well. In the final report on the energy sector inquiry the Commission states that European energy policy 'is directed at achieving the three closely related objectives of: a competitive and efficient energy sector, security of supply and sustainability.'[61] Above, I suggested that an efficient market might require a temporary restriction of competition. Here I consider whether restrictions of competition should be tolerated if forbearance helps pursue the other goals of energy policy. Two examples serve to suggest that tradeoffs between competition and security of supply are already made at Community and at national level.

Looking to the Commission's policy, an interesting analysis by Kim Talus has suggested that the regulation of long-term gas supply contracts might be affected by political considerations.[62] Long-term contracts (lasting 15-20 years) between gas producers and the national incumbent foreclose entry by making it difficult for new entrants (who buy gas upstream and resell in downstream markets) to bid for the gas supplies on a regular basis and to compete against the incumbent supplier.[63] Accordingly strict scrutiny seems warranted. The EU imports a considerable amount of gas, in particular from Norway, Russia and Algeria,[64] and Talus notes that the duration of long term contracts that the Russian supplier, Gazprom, has in place with EU customers is longer than that normally allowed in intra-Community trade and suspects that this increased leniency has more to do with a political interest in keeping the Russian supplier happy than in rewarding it for past or anticipated investment. This is not the first instance that Article 81 has been applied (or not applied) in a manner that is designed to achieve other policy goals.[65]

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[60] H Hovenkamp, 'Antitrust and the Regulatory Enterprise' (2004) Colum Bus LRev 335, 345-6.

[61] Communication from the Commission - Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) COM (2006) 851 final, para 6; Communication from the Commission to the European Council and the European Parliament - An energy policy for Europe COM(2007) 1 final, para 1, indicates three goals: sustainability, security of supply and competitiveness (query whether competition and competitiveness are synonyms). In France, energy policy has four objectives: energy independence and the security of supply; protection of the environment; energy at low cost for households and industries; social and territorial cohesion (S Meritet, 'French perspectives in the emerging European Union energy policy' (2007) 35 Energy Policy 4767).

[62] K Talus, 'Long-term gas agreements and security of supply – between law and politics' (2007) 32 ELRev 535.

[63] DG Competition report on energy sector inquiry SEC(2006)1724, paras 121, 123.

[64] Ibid, para 189, noting that gas finds in the EU are unlikely so that dependence on imports will increase. See also House of Lords European Union Committee *The Commission's Green Paper, "A European Strategy for Sustainable, Competitive and Secure Energy"* 41st Report of Session 2005–06 HL Paper 224 para 15 noting that Russia is the largest European gas supplier.

[65] See generally G Monti, 'Article 81 EC and Public Policy' (2002) 39 CMLRev 1057.

Turning to the national level, the regulation of the E.ON/Ruhrgas merger offers a provocative case study. The firms announced a merger in 2001. E.ON (with RWE) held a joint dominant position in the electricity market, and Ruhrgas is the dominant gas supplier in Germany. The German Bundeskartellamt prohibited the move, but it was cleared by the German government under a special procedure in the German antitrust laws that allow the government to authorize ostensibly anticompetitive behaviour if 'the restraint of competition is outweighed by advantages to the economy as a whole following from the concentration, or if the concentration is justified by an overriding public interest.'[66] Among the reasons offered by the German government (against the advice of the majority of the German Monopolies Commission) was that the merger would ensure security of supply in the gas market, particularly important because Germany depended on gas imports and the government considered that the merger would help ensure secure supplies of Russian gas. The merger was cleared on the condition that the firms work towards achieving security of supply. While many economists criticised this as an anticompetitive result designed to create a national champion and as frustrating the objectives of liberalisation,[67] Professor Helm opined that this merger clearance could be read as a regulatory bargain whereby the firms gain market power and in return must invest in ensuring security of supply.[68] This view is not wholly unreasonable given that most energy generation plants in Germany need replacing and that incentives to invest should be created.[69] Perhaps unsurprisingly E.ON Ruhrgas has recently issued a press release to indicate how it is investing in security of supply measures to comply with the political demands placed upon it at the time the merger was cleared. It mentioned the expenditure of €4.7 billion on 'new transmission lines and gas storage facilities in the E.ON markets, the development of transmission infrastructure to Europe, new supply projects and involvement in gas production.' Moreover, the Chairman referred to plans for a terminal for liquefied natural gas in Wilhelmshaven and the Nord Stream pipeline through the Baltic: 'Nord Stream is a project having a European dimension. Gas from this pipeline is intended for the entire EU. The project is being executed by using state-of-the-art technology and applying the highest environmental standards.'[70] Likewise other commentators have noted that E.ON has invested in Italy, thus injecting competition in that national market as well.[71]

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[66] Section 42 Act Against Restraints of Competition.

[67] e.g. E Lieb-Dóczy, 'The E.ON Ruhrgas Merger: The German Government Decides Against Competition' NERA Energy Regulation Brief 14 (August 2002).

[68] D Helm, 'The Assessment: The New Energy Paradigm' (2005) 21 Oxford Review of Economic Policy 1, 11.

[69] G Brunekreeft and D Bauknecht, 'Energy Policy and Investment in the German Power Market' TILEC Discussion Paper DP 2005-031 (October 2005) pp 34-35.

[70] Press release 23.5.07 available at: http://news.eon-ruhrgas.com/ArtikelDetail.aspx?KategorieID=3&ArtikelID=14679&Kultur=en

[71] AJ Padilla, et al, 'The Proposed Acquisition of Endesa by Gas Natural' (2004/2005) 14 Utilities Law Review 268, 269.

Granted, some will argue that security of supply is best achieved by an integrated market, however this argument is unconvincing given that the sources of energy are located outside the EU, so while an internal market can solve some security issues, it can do less towards ensuring adequate supplies of gas. Moreover, when faced with a fairly concentrated supply side of gas production, it may well be that a comparably strong set of buyers are better able to guarantee security of supply than a more workably competitive market.[72] Whatever the substantive merits of the German government's decision (and in this paper I take no view as to whether the decision was right) the general point that arises from this discussion is that competition and security of supply may not always be achieved by always prioritising competition law. Even the House of Lords European Union Committee, whose views on the Community's energy policy favour a market-oriented policy recognised that some compromise between the three objectives are necessary an that the cost of energy may have to rise in order to ensure security of supply and reduced carbon emissions.[73]

The question of how to guarantee energy security is laden with uncertainty, in particular given the role of Russian gas supplies in the EC.[74] It is likely that a variety of policy responses are required, from liberalising markets to providing subsidies for the production of energy in different ways. Among the many policy options, it may be that occasionally suspending the application of competition law might be necessary to achieve energy security too. My criticism of the current legal position is that this policy option is not tolerated: EC competition law takes precedence as a rule (except when, tacitly, as Talus notes anticompetitive agreements are tolerated) without the possibility of debating whether, in given instances, less competition might lead to more energy security.

4. QUESTIONING THE VALUE AND LEGITIMACY OF REGULATORY ANTITRUST

In part three I suggested there may be good reasons for not allowing antitrust to interfere with policy choices of the regulator. In contrast, the current policy seems to be the obverse: regulation is carefully circumscribed with the aim that it should recede,[75] while antitrust is allowed to grow. In this part I offer a critique of the growth of antitrust law, in particular drawing upon the Commission's justification (articulated in its response to the *Telefónica* case quoted in the introduction), that sector specific regulation is an *ex ante* means of regulating markets, while competition law is an *ex post*

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[72] This is the view put forward by the incumbents in the energy report, op cit, n 57, para 626.

[73] *The Commission's Green Paper, "A European Strategy for Sustainable, Competitive and Secure Energy"* 41st Report of Session 2005–06 HL Paper 224, paras 55 and 57.

[74] For an interesting overview see D Finon and C Locatelli, 'Russian and European gas interdependence: Could contractual trade channel geopolitics?' (2008) 36(1) Energy Policy 423.

[75] M Monti, 'Competition and Regulation in the new Framework', Speech of 15.7.2003; E Liikanen, 'Accelerating Broadband in Europe', Speech of 28.1.2003: 'Competing network infrastructures are essential for achieving sustainable competition in network and services in the long term. When facilities-based competition is effective, the new framework will require ex-ante obligations to be lifted. Investment in new and competing infrastructure will bring forward the day when these obligations can be relaxed.'

mechanism for regulating markets. This point is made regularly by the Commission and some of its implications are elaborated upon in the Guidelines on market analysis and the assessment of significant market power. Here the Commission notes that parallel proceedings under SSR and EC competition law are possible but that these would address different kinds of problems. [76] However elegant this distinction is in theory, it has been noted that remedies in merger cases, under Article 81(3), and in settled cases can be labelled as ex ante interventions.[77] It is even arguable that Article 82 is often applied *ex ante*; in *France v Commission* for example, the CFI reaffirmed that a finding of predatory pricing does not require proof that the predator is likely to recoup his losses (arguably a necessary step for predation to be economically rational), nor that predatory pricing is likely to exclude rivals, once it is shown that the practice has an anticompetitive object.[78] And in *Microsoft v Commission* the CFI explained clearly the rationale behind not requiring the Commission to show that exclusionary abuses have exclusion as their likely effect:

> Article 82 EC does not apply only from the time when there is no more, or practically no more, competition on the market. If the Commission were required to wait until competitors were eliminated from the market, or until their elimination was sufficiently imminent, before being able to take action under Article 82 EC, that would clearly run counter to the objective of that provision, which is to maintain undistorted competition in the common market and, in particular, to safeguard the competition that still exists on the relevant market.[79]

The difficulty with the CFI's attitude in both of these cases is that the Commission is relieved of even the burden of showing that the practices are likely to have exclusionary effects merely because there is evidence that the practices have an anticompetitive object. This reads across from Article 81(1), which distinguishes between agreements anticompetitive by object and effect, and turns Article 82 into an *ex ante* provision.

The key problem of ex ante competition law that I wish to emphasis here is that, as others have noted, competition law has been applied, *ex ante*, in a regulatory fashion.[80] Two examples from the utilities sector can be mentioned to give a flavour of the nature of 'regulatory antitrust'. The first is the settlement that the EC Commission reached with Gazprom and ENI in October 2003 concerning the supply of natural gas from Russia into the EC.[81] The agreement contained a clause preventing ENI from exporting

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[76] OJ 2002, C165/6, para 31.

[77] See P Larouche, *Competition Law and Regulation in European Telecommunications,* Hart, 2003, ch 3.

[78] Case T-340/03 *France Telecom SA v Commission,* judgment of 30 January 2007, para 196.

[79] Case T-201/04 *Microsoft v Commission,* judgment of 17 September 2007, para 561.

[80] E.g. M Cave and P Crowther, 'Co-ordinating regulation and competition law – ex ante and ex post' in Swedish Competition Authority *The Pros and Cons of Antitrust in Deregulated Markets* (2004); G Monti, *EC Competition Law,* CUP, 2007, pp 474-485; A Christiansen, 'Regulation and EU Merger Control in the liberalised energy sector' (http://ssrn.com/author=369349).

[81] Commission reaches breakthrough with Gazprom and ENI on territorial restriction clauses 6 October 2003 (IP/03/1345).

gas it purchased from Gazprom, and a clause that required Gazprom to seek ENI's approval for any sales to other wholesalers in Italy. The settlement went beyond the two parties deleting these offending contractual clauses (both patently in breach of Article 81 EC), in addition ENI undertook (1) to offer significant gas volumes to customers located outside Italy over a period of five years, a measure designed in particular to help increase competition in the Austrian and German markets; and (2) to increase the capacity of is TAG pipeline which runs through Austria and carries Russian gas into Italy, and to promote improved third party access to this pipeline. The concern of antitrust purists in these two limbs of the settlement is that they are not closely related to the infringement that triggered the investigation, and that the Commission is using competition law settlements to resolve a series of structural issues designed to create competitive markets. The concerns over this approach are confirmed when hearing the opinion of the then Commissioner for competition. In his view, the decision:

> goes to show that during the initial delicate transition phase from monopolised to liberalised energy markets, the focus should lie, in some occasions, on Commission's interventions improving effectively the market structure, rather than on formal procedures imposing fines. […] I consider this settlement to be a major breakthrough for the creation of a gas market in the European Union.[82]

These sound like the words of an industry regulator, not those of an antitrust authority. The policy justification for this aggressive approach is clear: as Member States continue to dither and prevaricate over energy liberalisation, the Commission uses alternative techniques to create competitive markets and to cajole Member States to agree to further liberalisation.

A second example of regulatory antitrust is the price squeeze case law introduced at the start of this article. The justification for finding that a price squeeze is an stand-alone abuse begins from the premise that a system of undistorted competition requires equality of opportunity as between undertakings;[83] the upshot of this premise led the Commission in *Deutsche Telekom* to suggest that the dominant firm's retail prices should have been higher for it to avoid its abuse of dominance and place all retail competitors on an equal footing.[84] Apart from the obvious criticism that the Commission and CFI have in effect encouraged a dominant firm to set high prices, this reasoning seems designed to facilitate collusion among retail market actors as the leading player becomes a price leader. Moreover, in reaching this conclusion the Commission dismissed the thinking behind the German telecommunications regulator, whose view was that while the regulated prices did put competitors at a disadvantage, they still had opportunities to compete effectively by cross-subsidising low prices in this market with high prices in

[82] M Monti, 'Applying EU Competition Law to the newly liberalised energy markets', Speech at the World Forum on Energy Regulation Rome, 6 October 2003, available at: http://ec.europa.eu/comm/competition/speeches/.

[83] Case T-271/02, op cit, n 5, para 198.

[84] Ibid, para 131.

other offerings. The CFI however treated this as evidence of the anticompetitive nature of the price squeeze.[85] However what appears to have taken place in this case is that the Commission disapproved of the German regulator's policy and chose to substitute it with its own: rather than forcing competitors to work hard at finding ways to stay in the market, the Commission took the view that market access should be made easier, even if this appears to mean higher prices in the short run.

Some have questioned the legitimacy of regulatory antitrust,[86] while others have taken this as a natural evolution of a maturing system of competition law.[87] One remarkable feature of this approach is that in stark contrast to the limitations imposed on telecommunications regulators, few limits apply to fetter the discretion of the competition authority: it may choose to act when in the Community interest,[88] and in reaching settlements with undertakings it does not even bear the burden to prove the infringement, only to raise enough evidence to issue a statement of objections and this brings the party to the negotiating table, offering what remedy the Commission wishes – and as the *Gazprom/ENI* settlement shows, these remedies can go well beyond those necessary to solve the competition problems. These decisions have been analysed from a number of perspectives. Political scientists for example have noted how certain decisions in the telecommunications sector in the late 1980s were useful in creating incentives for Member States that were reluctant to liberalise the sector to participate in the legislative process, a process which they note was less successful in the energy markets because the Commission lost some test cases in the late 1990s.[89] From a legal/economic perspective Cave and Crowther raise three issues: first whether negotiated settlements risk a sub-optimal result given that the firms are unlikely to wish to cooperate fully. In response it can be argued that the Commission has strong powers against non-cooperation: fines may be imposed if the parties do not abide by the terms of a commitment decision and if there is non-compliance with commitments in merger cases a fine or dissolution of the merger are possible remedies.[90] Second, they question whether the application of competition law may lead to sub-optimal outcomes, perhaps especially because in contrast to a sector-specific regulator the competition authority lacks expertise, but they conclude (with little analysis) that '[i]n energy, where the political process for passing adequate sector-specific legislation at the EU level has been far more intractable, the benefits of a ex ante intervention under competition law seem clearer.'[91] It is submitted that this conclusion is intuitively appealing but cannot be supported without more evidence. In contrast to their view, one US commentator has noted two key objections to re-regulation through antitrust: the duplication of efforts

[85] Ibid, paras 116-117 and 268.

[86] P Larouche, *Competition Law and Regulation in European Telecommunications,* Hart, 2000, pp 112-127.

[87] D Goyder, *EC Competition Law,* 4th ed, OUP, 2003, pp 529-30.

[88] Case T-24/90 *Automec II* [1992] ECR II-2223.

[89] For an overview M Cini and L McGowan, *Competition Policy in the European Union,* Palgrave, 1998, ch 9.

[90] Article 14(2)(b) ECMR (fines); Article 8(4) ECMR (de-merger).

[91] Cave and Crowther, op cit, n 80, p 28.

and the lack of institutional capacity on the part of Commission and courts to adjudicate how to make the market work best, especially when contrasted with the greater skills of sector-specific regulators.[92] The upshot is that sub-optimal outcomes are foreseeable when competition law takes over the regulatory task, a criticism that can be made of the *DT* decision.

Third, and most significantly for the purposes of this article, they question whether regulatory antitrust may be disproportionate. This question can be answered by considering the occasional signals from the legislature and the Courts that the concept of proportionality may serve to delimit the scope of the Commission's interventionism. First, while the Commission may impose structural remedies for antitrust infringements, this can only occur if three conditions are met: the remedy must be proportionate, necessary and effective[93]; second in the context of formal settlements under Article 9 of Regulation 1/2003 the CFI has held that the commitments must be proportionate, that is they do not go beyond that which is necessary to remedy the anticompetitive risk;[94] finally in the field of merger control the CFI and ECJ have taken the view that proportionality also applies when considering the Commission's acceptance of commitments.[95] Proportionality means that the measures adopted must not exceed the limits of what is appropriate and necessary to attain the relevant objective and the least onerous remedy must be selected. However, if in a merger case the parties offer a set of commitments that is more than necessary to resolve the competition problem at hand, then the Commission is not bound to advise the parties that fewer commitments would suffice, the Commission merely judges whether the commitments solve the problem.[96] It suggests that 'proportionality' is a criterion that applies to the offers made by the parties, not to the Commission decision. Therefore, as AG Kokott notes, '[e]xtraordinary circumstances would therefore have to exist before it could be accepted that a Commission decision based on voluntary commitments given by the undertakings concerned is not compatible with the principle of proportionality.'[97] Matters might be different if the parties offering commitments were arbitrarily forced to make certain commitments which turned out to be disproportionate;[98] this for example was what seems to have occurred in *Alrosa*. Drawing these disparate strands together, there seems some scope for challenging regulatory antitrust at least when it takes the form of a settlement by the undertaking

[92] JG Sidak, 'Abolishing the Price Squeeze as a Theory of Antitrust Liability' (4/11/2008). Available at SSRN: http://ssrn.com/abstract=1119308

[93] Article 7 Regulation 1/2003. See G Monti, *EC Competition Law,* CUP, pp 336-7; A Tajana, 'If Had a Hammer … Structural Remedies and Abuse of Dominant Position' (2006) 1 Competition and Regulation in Network Industries 3.

[94] Case T-170/06 *Alrosa v Commission*, judgment of 11 July 2007.

[95] Case T-177/04 *easyJet,* judgment of 4 July 2006, paras 133-134; Case T-202/02 *Cementbouw,* judgment of 23 February 2006, paras 306-320 (Affirmed on appeal, Case C-202/06, judgment of 17 December 2007).

[96] Case T-202/02, op cit, n 95, para 308.

[97] Ibid, para 69.

[98] Ibid, para 319.

(as in *Gazprom/ENI*) on the basis that the remedy is unnecessarily wide. However, it is not particularly clear how far 'proportionality' can serve as a tool to challenge regulatory antitrust. For starters, any legal challenge requires a complainant, and when the Commission settles with the parties, it is unlikely that they will challenge the result. As settlements normally improve market access for competitors, there is no likely challenge from that quarter either. Accordingly the Commission retains the upper hand. Moreover, even when an appeal is heard, it is unlikely that the courts will reject the Commission's stance, first because in many cases it is the parties who 'agree' to make concessions, and second even when they don't a decision will only be quashed if it is patently disproportionate, leaving a wide margin of discretion to the Commission. Furthermore, proportionality would do little to test the legitimacy of the *DT* decision where no behavioural or structural remedies were imposed, unless one were to deploy the principle to challenge the decision of the Commission to act in spite of regulatory oversight, and suggest that double regulation is disproportionate – this might force the Commission to justify its intervention in more substantive ways than its current formalistic reliance on the supremacy of EC Law.

In spite of the limitations of using the principle of proportionality to curtail the antitrust powers of the Commission, it may be argued that if one wishes to insist upon the parallel application of EC competition law and sector specific regulation, that then the overlap between the two fields should be reduced by challenging antitrust decisions that appear regulatory. This sentiment was expressed in Scalia J in refusing to apply S.2 Sherman Act in a regulatory manner:

> The 1996 Act is in an important respect much more ambitious than the antitrust laws. It attempts "to eliminate the monopolies enjoyed by the inheritors of AT&T's local franchises." Section 2 of the Sherman Act, by contrast, seeks merely to prevent unlawful monopolization. It would be a serious mistake to conflate the two goals. The Sherman Act is indeed the "Magna Carta of free enterprise," but it does not give judges carte blanche to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition.[99]

One surprising matter is how this view is shared both by those on the 'right' (e.g. the author of the quote) and those supposedly on the 'left' (e.g. Professor Hovenkamp) of the antitrust debate.[100] The opposition to regulatory antitrust is much weaker in the EU, nevertheless its continued application risks undermining national regulatory efforts further because it gives the Commission wide powers to intervene even when there is no breach of the antitrust laws. In sum it is unlikely that regulatory antitrust will go away, and so the size of the overlap between competition and regulation remains significantly larger than in the United States.

[99] 540 US 398, 415-416.

[100] Hovenkamp, op cit, n 60, p 377.

5. WAYS FORWARD

The consensus view seems to be that less regulation and more antitrust is better. This view reflects that taken in the United States since the late 1970s when there was a reaction against the cost and ineffectiveness of regulation.[101] In America, this might be acceptable in that antitrust is primarily litigation-based and pro-defendant. In the EC, however, the 'less regulation and more antitrust' aphorism does not have the same impact at present, given the slowness by which utilities markets move from monopoly to competition, and the concomitant need for aggressive regulation. Nevertheless even the EU's de-regulatory strategy is designed to phase out regulation once competitive markets have been established. Moreover, the aggressive stance taken by the Commission in stating that EC competition law always applies even in the presence of regulation can be justified by the concern that utilities regulators in Europe are weak and that even with so much legislative input to liberalise and Europeanise markets, there are considerable national variations (even when Member States ostensibly comply with the EC Directives)[102] that the tough application of competition law is necessary to liberalise utilities and attempt to create an internal market.

In this article I have argued in favour of a qualification to this position: there should be instances where competition law gives way to regulation, either because suspending competition law can yield greater efficiency or because it can allow the pursuit of other non-economic policy objectives. If one agrees, then what ways forward might there be? One possible solution is for greater consultation among regulators and antitrust agencies. Normally networks of regulators are seen as avenues to ensure uniformity and consistency in regulatory approach; but they can easily serve to allow arrangements whereby DG Competition is consulted and will not intervene to frustrate the objectives of national regulation. The problem is that this 'soft law' approach does not constrain national courts (not does it guarantee consistency of response from DG Competition) and so would need to be complemented by the development of a hard law principle that can be applied by courts when the application of competition law would frustrate regulatory policy. The sort of doctrine I suggest is akin to that applicable in negligence law, where the courts have developed a principle whereby the claimant is unable to seek damages for negligence if that action would 'cut across' an existing regulatory framework. That is, if the court feels that tort liability would skew the regulatory balance that has been struck, then liability is not imposed.[103] Negligence law in its modern form developed at the end of the Nineteenth Century at a time of sparse regulation (similar to the Sherman Act in 1890), the concern that negligence liability

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[101] See generally S Breyer, *Regulation and Its Reform,* Cambridge, MA, Harvard University Press, 1982; AE Kahn, 'Deregulation: Looking backward and looking forward' (1990) 7 Yale Journal on Regulation 325.

[102] See for example J Jordana, D Levi-Faur, and I Puig, 'The Limits of Europeanization: Regulatory Reforms in the Spanish and Portuguese Telecommunications and Electricity Sectors' (2005) European Integration online Papers (EIoP), European Community Studies Association Austria (ECSA-A), vol 9, 07.

[103] For a particularly good example, see *Marc Rich v Bishop Rock Marine* [1996] AC 211; see generally WVH Rogers, *Winfield and Jolowicz on Tort,* 17th ed, Sweet & Maxwell, 2006, pp 155-158; D Howarth, *Textbook on Tort,* Butterworths, 1995, pp 229-234.

would cut across other spheres of regulation was not as urgent when the tort of negligence was consolidated by Lord Atkin in 1932;[104] rather it emerged as a response to the growth of regulation in the 1980s. Similarly, antitrust cuts across all economic sectors unless specifically excluded, and a similar judicial doctrine might help prevent its application when it would frustrate the achievement of policy goals pursued by other regulators. This suggestion may be implemented by extending the rationale behind the judgments of the court in *Wouters* and *Meca Medina* which seem to allow the non-application of competition law when this might damage certain other valued public interest considerations.[105] The Lisbon Agenda's focus on competitiveness, the Reform Treaty's de-emphasis on competition as a key principle, plus the related calls for a greater emphasis on solidarity,[106] combined with the policy arguments canvassed here, combine to suggest that consideration should be given to developing ways to restrict the application of competition law in those limited circumstances where the Community interest is best pursued by other means.

[104] In the seminal judgment *Donoghue v Stevenson* [1932] AC 502.

[105] Case C-309/99 *Wouters* [2002] ECR I-1577; Case C-519/04 P *Meca-Medina* [2006] ECR I-6991.

[106] M Ross, 'Promoting Solidarity: From Public Services to a European Model of Competition?' (2007) 44 CMLRev 1057.

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Structural Remedies in Article 82 Energy Cases

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Issuing the final report on its energy sector inquiry, the European Commission pointed to a range of competition concerns across the EU energy sector, including a lack of integration and transparency. In particular, however, the Commission identified the high degree of vertical integration in energy markets as an obstacle to competition. The Commission's suggested remedy is the separation of ownership and/or operation of gas and electricity transmission networks from other energy supply activities; the 'unbundling' of transmission and other activities that control market access. While the Commission strongly favours full ownership unbundling, other possible models are under consideration. Unbundling faces considerable political opposition from a number of Member States. Even if the Commission is successful in its objective of securing unbundling, it will be some time before the necessary legislation takes effect. Meanwhile, however, the Commission has been pursuing a number of investigations into individual energy companies. A key theme of those investigations has been the alleged abuse of transmission network activities in order to restrict competition on energy supply markets. Practices under investigation by the Commission include 'strategic under-investment' in network infrastructure. Remedies under consideration include the divestment of network activities. Any such remedy is likely to take effect ahead of legislative unbundling. Ordering unbundling as a remedy in individual competition cases would be a development for which there is little precedent. This raises the question whether the Commission has demanded concessions which it would not have done in the absence of wider concerns about the energy sector, or whether its work on the sector inquiry has simply provided it with a deeper understanding of the issues. There are also questions about the power of the Commission to order such divestment remedies. This article examines the background and the issues.

1. INTRODUCTION

The European Commission's inquiry into the energy sector between 2005 and 2007[1] uncovered issues that led it to launch investigations into the conduct of a number of individual companies in the sector. If these investigations confirm its suspicions, the Commission has, in addition to the power to impose fines, the power to impose wide-ranging behavioural or even structural remedies (or to accept commitments).

The sector inquiry also revealed a number of features of the sector that the Commission views as restricting competition, and that it hopes to remedy by legislative means. In particular, it proposes to secure the full separation of transmission grid activities from other energy activities, known as unbundling.

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[1] Final Report on the Energy Sector, SEC(2006)1724, 10 January 2007.

However, the legislative route is controversial, and will take some years to achieve – if it is not blocked altogether by those Member States that oppose it. It is therefore possible that the Commission will seek to secure the same outcome in a manner that will not be subject to the same degree of political pressure, by ordering unbundling as a remedy in certain of the individual cases currently under investigation.

This paper will examine the extent of the Commission's powers to impose such orders in individual energy cases (which it has never exercised before), conclusions that can be drawn from the way in which these powers have been exercised in similar cases in other sectors or under other legal frameworks in the past, and on the arguments against the exercise of these powers..

2. VERTICAL FORECLOSURE IN ENERGY MARKETS

The Commission's final report summarised the principal findings of the sector inquiry as follows:

a. high concentration levels exist in most geographic markets and at all levels in the value chain;
b. there is a high degree of market foreclosure, with incumbent undertakings having a high degree of control over infrastructure and the ability to reserve energy capacity;
c. there is an absence of market transparency;
d. doubts exist about the degree to which wholesale prices are set competitively;
e. balancing occurs in respect of small geographic markets with balancing charges being non-transparent;
f. long-term contracts with customers contribute to market foreclosure; and
g. liquefied natural gas is an important potential source of competitive energy supply, with prices converging with those of pipeline gas.

In the Spring 2007 edition of the Competition Policy Newsletter, Philip Lowe, Director-General of DG Competition, identified vertical foreclosure as one of the most important of these issues.[2] He stressed that this was not a new phenomenon and that the problem had been identified as early as the late 1990s following the adoption of the first electricity and gas Directives[3] which had enabled large energy users to choose their suppliers. However, it had become apparent that competition in supply could be curtailed by owners of the transmission networks. Regulated third party access had been introduced with a second package of Directives in 2003.[4] These Directives had also imposed an obligation on Member States to create national regulators and introduced the ability to adopt legally binding guidelines.[5]

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[2] Available at http://ec.europa.eu/comm/competition/publications/cpn/cpn2007_1.pdf.

[3] Directive 96/92/EC, OJ 1997, L27/20, concerning common rules for the internal market in electricity and Directive 98/30/EC, OJ 1998, L204/1, relating to common rules for the internal market in natural gas.

[4] Directives 2003/54/EC, OJ 2003, L176/37, and 2003/55/EC, OJ 2003, L176/57.

[5] Articles 23 of the Electricity and 25 of the Gas Directives, op cit, n 3.

Article 10 of the Electricity Directive and Article 9 of the Gas Directive (respectively Directives 2003/54/EC and 2003/55/EC)[6] provide that where the transmission system operator is part of a vertically integrated undertaking, it is to be independent in legal form and organisation and is to take its decisions independently from those relating to non-transport matters. Articles 15 of the Electricity Directive and 13 of the Gas Directives apply similar principles to distribution operations in vertically integrated undertakings.

Vertical integration occurs where the upstream and downstream operations are performed within the same company or by separate companies, one of which is controlled by the other. For these purposes, control is defined by reference to the EC Merger Regulation and the relevant Commission guidance.[7] In either case the Directives require a separate company to be set up to perform the distribution or transmission functions independently of its former parent company. The independent transmission or distribution network company need not own the network assets over which it exercises its independent decision-taking.

3. IMPETUS FOR FULL UNBUNDLING

However, the energy sector inquiry concluded that existing unbundling under the second package directives did not go far enough in remedying the problem of vertical foreclosure that had been identified. Mr. Lowe wrote that[8]:

> Whilst the Directives have already sought to address these issues by introducing a minimum level of unbundling, the Sector Inquiry has demonstrated that the current unbundling regime is inadequate.

A few months before that, in her speech 'A new energy policy for a new era' at Lisbon on 30 October 2006,[9] Competition Commissioner Neelie Kroes had remarked:

> Our sector inquiry has shown that the current level of unbundling is insufficient. Stakeholders tell us that network companies still favour their own supply or generation businesses.
>
> ... I see only one way forward if we are to restore credibility and faith in the market. Europe has had enough of "Chinese walls" and quasi-independence. There has to be a structural solution that once and for all separates infrastructure from supply and generation. In other words: ownership unbundling. Then we will finally see an

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[6] Ibid.

[7] Regulation 139/2004, OJ 2004, L24/1; Consolidated Jurisdictional Notice: http://ec.europa.eu/comm/competition/mergers/legislation/jn_en.pdf

[8] Op cit, n 2.

[9] Available at : http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/648&format=HTML&aged=0&language=EN&guiLanguage=en .

> end to discrimination, and we will also have laid the ground for a system of proper investment incentives.

And in a speech at Essen on 5 February 2007[10] Neelie Kroes had added:

> the fundamental problem with the current system of legal unbundling – where companies control energy networks as well as production or sales – is that it creates a conflict of interest inside a company
>
> ... fully unbundled operators see clearer incentives for investment in interconnectivity, and act on those incentive, because they are focused on optimising the use of the networks.

Her view was that reliance on independent system operators (whereby vertically integrated companies own the network assets but are not responsible for their operation or development) involves complex regulation and a heavy administrative burden. In contrast, full ownership unbundling would remove the root cause of the current problems of under-investment and discrimination and was 'the most simple and effective way forward'.

The Commission believes that even where a group involved in supply holds only a minority stake in a transmission business, its exercise of powers at board level, or its commercial influence as the major supplier or customer of the network operator, can still influence the conduct of that business, to the detriment of competition. For example, in its *Gaz de France/Suez* decision,[11] the Commission found (at paragraphs 631 to 633 of its decision) that the 27.45% shareholding held indirectly by Suez in the Belgian electricity transmission operator Elia conferred legal control and that the shareholdings which Electrabel held in mixed public- and private-sector utilities in Wallonia (which legally could not exceed 30%) conferred de facto control 'or at the very least... a position to bring considerable pressure to bear on them'.

In his Competition Policy Newsletter article[12] Philip Lowe defines ownership unbundling as the 'separation of the previously common ownership structure between network and supply activities', and he too describes this as the most effective solution for the foreclosure problems caused by vertical integration, with remedies of a behavioural nature being inadequate to address the concerns identified by the Commission. He notes that there are a number of possible legal obstacles to unbundling as a remedy, namely the legal requirements of proportionality, the neutrality in relation to national property rights required by Article 295 EC Treaty, and the need to address the principle of subsidiarity and to respect the rules on protection of property contained in the European Convention on Human Rights. However, in the

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[10] Available at: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/63&format=HTML&aged=0&language=EN&guiLanguage=en .

[11] Case COMP/M.4180 *Gaz de France/Suez*, decision of 14 December 2006.

[12] Op cit, n 2.

opinion of the Commission, none of these concerns would prevent the introduction of a full unbundling remedy.

The Commission therefore advocates full unbundling, rather than operational independence, with independent companies owning and operating the network infrastructure. The third package of Directives proposed by the Commission would involve the amendment of the existing gas and electricity Directives[13] in order to confer on integrated energy companies a choice between full ownership unbundling and the independent system operator (ISO) model, in which an integrated energy company would retain ownership of the network assets, and would appoint an independent system operator. The ISO would be independent of supply and generation interests. The system owner would have very little control over the use of or investment in the network. The ISO model appears sufficiently unattractive that many commentators suggest that it was included merely in order to make full ownership unbundling appear more attractive.

One feature of the proposed draft package which has disappeared in the published version is that of an independent monitoring trustee. This may be as a result of the Court of First Instance's rejection of such arrangements in it relation to Microsoft in its recent judgment.[14]

The Commission also envisages the establishment of an 'Agency for the Cooperation of Energy Regulators'. The Agency could (as could the Commission on its own initiative) open a certification procedure to verify compliance by the network operators with the new unbundling or independent operation requirements.

The Directive would enter into force within 18 months of the publication of the Directive in the Official Journal of the EU. Unbundling would be required within a year of entry into force. Given the likely timescale for the adoption of the Directive, it is therefore highly unlikely that its provisions would take effect before 2010.

4. INDIVIDUAL INVESTIGATIONS

The issues identified as a result of the sector inquiry confirmed concerns that the Commission had held for some time. One investigation which pre-dated the sector inquiry[15] related to Distrigaz (prior to liberalisation the only wholesale gas supplier on the Belgian market).[16] The Commission accepted commitments from Distrigaz to reduce the volumes of gas tied up in long-term contracts with customers. Distrigaz will enter into no new contract with gas resellers lasting longer than two years. New contracts with other large gas customers, such as industrial consumers and electricity

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[13] Op cit, n 3.

[14] Case T-201/04 *Microsoft v Commission*, judgment of 17 September 2007.

[15] Op cit, n 1.

[16] COMP/B-1/37.966. See http://ec.europa.eu/comm/competition/antitrust/cases/decisions/37966/nccd.pdf.

generators (other than new gas fired power plant owners), will be limited to five years, with 70% of the total gas volume contracted to these customers being open to competition each year. This wide-ranging decision is designed to open up the Belgian gas market, previously considered to be foreclosed. It can be seen as a strong signal by the Commission to energy companies as to the permissible foreclosure levels (in terms of duration and volumes) which long term contracts may impose.

Relying on intelligence developed during the course of the sector inquiry,[17] the Commission identified for further investigation a number of specific instances of the systemic problems that it had encountered. Following Commission inspections of ENI's premises and those of its subsidiaries in Italy, Austria and Germany and those of RWE in 2006, in May 2007 the Commission sent statements of objections to ENI[18] and RWE,[19] accusing both groups of infringements of Article 82. The Commission accused ENI of capacity hoarding and strategic underinvestment in network infrastructure that resulted in the foreclosure of gas supply markets in Italy. The proceedings against RWE focus on the creation of obstacles by RWE to third party access on the regional gas market in RWE's core area in North Rhine-Westphalia.

At the end of July 2007, the Commission announced the issue of a further set of statements of objections,[20] alleging that Electrabel, the incumbent electricity company in Belgium and part of the French Suez group, and EDF, the incumbent electricity supplier in France, had infringed Article 82 by introducing long-term exclusive purchase obligations in their supply contracts with industrial customers that made it difficult for new entrant electricity suppliers to acquire those customers as clients in Belgium and France. It will be recalled that the foreclosing effect of long-term contracts was one of the key obstacles to the development of a competitive market that the Commission identified in the sector inquiry.

In addition to these investigations into alleged vertical foreclosure of energy markets, the Commission is investigating a number of other types of alleged infringement. For example, in July 2007, it issued a statement of objections[21] alleging that E.ON and Gaz de France had infringed Article 81 by entering into an agreement and/or concerted practice whereby they agreed not to sell gas in each other's home market. The Commission believes that this agreement and/or concerted practice concern, in particular, supplies of natural gas transported over the MEGAL pipeline, which is jointly owned by E.ON and Gaz de France and transports gas across Southern Germany between the German-Czech and German-Austrian borders on the one side

[17] Op cit, n 1.

[18] COMP/39.315, Commission Press Release MEMO/07/187, 11 May 2007.

[19] COMP/39.402, Commission Press Release MEMO/07/186, 11 May 2007.

[20] COMP/39.386 and COMP/39.387, Commission Press Release MEMO/07/313, 26 July 2007.

[21] COMP/39.401, Commission Press Release MEMO/07/316, 30 July 2007.

and the French-German border on the other side. Unlike the other investigations mentioned above, this statement of objections alleged infringement of Article 81

On the publication of the Commission's final report, Commissioner Neelie Kroes indicated that the Commission would consider imposing structural remedies in addition to possible fines:

> … if companies are found to have violated the anti-trust rules, the Commission cannot only impose fines of up to 10% of the global annual turnover, but also impose – under certain conditions - *far-reaching structural remedies*' (emphasis added).

Other Commission officials have also highlighted the possibility of structural remedies being imposed in the event that the Commission concludes that infringements of Article 82 have occurred. The ultimate structural remedy is unbundling of network infrastructure activities from generation and supply activities – the same remedy that is proposed as part of the Commission's third legislative package.

In the light of the likely timetable for unbundling to become a reality as part of the Commission's third package – even if it overcomes the significant political obstacles being thrown up by a number of Member States – the Commission will be tempted to consider ordering unbundling as a remedy in individual cases.

The remainder of this paper will therefore consider the legal issues raised by the Commission's possible use of divestment or other deep structural remedies under Article 82. We conclude that the Commission does have the power to order full unbundling as a remedy in specific cases, provided that it has first conducted a thorough economic analysis and that the remedy is proportionate to the alleged infringement. We conclude that the Commission is likely to be able to defeat any legal challenge based on arguments that it has infringed the European Convention on Human Rights, Article 295 or the principle of subsidiarity, again provided that it can demonstrate that the unbundling remedy is proportionate and necessary to achieve EC competition policy goals.

5. PRECEDENTS FOR STRUCTURAL REMEDIES

Although, as we have noted above, the Commission has not previously ordered unbundling in energy cases under Article 82, there is some precedent for structural remedies, in behavioural cases in other sectors, and in merger cases in the energy sector. In the following section, we examine how these remedies have been applied.

5.1 The power to order unbundling in non-merger cases

Articles 7 and 9 of Regulation 1/2003[22] confer power on the EC Commission to take a decision or, in order to avoid the lengthy procedures that can accompany a decision, accept commitments from any undertaking accused of infringing Articles 81 and 82 EC

[22] OJ 2003, L1/1.

Treaty. Article 7(1) of the Regulation empowers the Commission to impose on the relevant undertakings:

> any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. Structural remedies can only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy

5.2 Examples of past access remedies under Article 82

On a number of occasions, the Commission (with the approval of the European Court) has mandated interference with the proprietary rights of dominant undertakings, by requiring the grant of access or a licence, in order to remedy infringements of Article 82.

Some of the highest profile cases have resulted from refusals to license intellectual property rights. The remedies in these cases have come close, at least in terms of the intrusiveness of the remedy ordered, to the divestment that is contemplated in the ongoing energy cases. The key cases are those of *Volvo AB v. Erik Veng,*[23] *RTE & ITP v. Commission,*[24] *Tiercé Ladbroke SA v. Commission,*[25] and *IMS Health GmbH & Co OHG v. NDC Health GmbH & Co KG.*[26]

Most recently, in *Microsoft*,[27] the CFI confirmed the Commission's Decision that Microsoft should license interface information to competitors. The CFI judgment marked the end of a long-running battle between the Commission and Microsoft, in which the Commission was at one time reported to be considering ordering the separation of Microsoft's operating systems and applications businesses – a move that would have been comparable to the unbundling of network activities in the energy sector. Instead, the Commission settled for the less intrusive remedy of ordering Microsoft to license its Windows Server protocols to competitors on 'reasonable and non-discriminatory' terms.

However, it was not long after the publication of the Commission's energy sector inquiry report that Neelie Kroes, frustrated at what the Commission saw as Microsoft's continuing obstinacy over the issue of the royalties payable in the context of the licensing, told the American Bar Association[28] that '[i]t could be reasonable to draw the

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[23] Case 238/87 [1988] ECR 6211.

[24] Cases C-241 & 242/91 P, [1995] ECR I-743.

[25] Case T-504/93, [1997] ECR II-923.

[26] Case C-418/01, [2004] ECR I-5039.

[27] Case T-201/04, judgment of 17 September 2007.

[28] Transcript available from the European Commission and reported at http://www.pcpro.co.uk/news/111169/updated-eu-threatens-microsoft-with-new-antitrust-penalties.html.

conclusion that behavioral remedies are ineffective and that a structural remedy is warranted'. The Commission's experiences in *Microsoft* suggest that it may be less willing to give the energy undertakings the benefit of the doubt, and to be more resolute in its imposition of structural remedies.

Of more obvious relevance to the current energy cases are the cases relating to 'essential facilities', involving the granting of access to physical assets.

For example, in *Sealink/B&I Holyhead*[29] Sealink owned, controlled and itself used the port of Holyhead, which the Commission found to be an essential facility (defined by the Commission as 'a facility or infrastructure without access to which competitors cannot provide services to their customers'). It subjected B&I, a user of the port, to timetable changes and a degree of movement due to passing vessels which would oblige it to disconnect its ramp to the port more frequently, causing increased disruption,. The Commission found that a dominant company infringed Article 82 where it refused its competitors access to an essential facility, or granted access to competitors only on terms less favourable than those which it gave its own services. Similarly, in *Sea Containers v. Stena Sealink,*[30] Sea Containers intended to launch a new SeaCat fast ferry service at the port of Holyhead on the central Irish Sea corridor to Dun Laoghaire. Sea Containers was prepared to construct, at its own expense, temporary facilities at the port in order to launch the service and in order to overcome objections raised by Stena Sealink Ports. Stena stalled and instead gave rapid approval for its own fast service. The Commission concluded:

> (75) ... an independent harbour authority, which would of course have had an interest in increasing revenue at the port, would at least have considered whether the interests of existing and proposed users of the port could best be reconciled by a solution involving modest changes in the allocated slot times or in any plans for the development of the harbour

This case makes it clear that the dominant owner of an essential facility may be required to take decisions in the interests of competing users of the facility, and not merely to act in the interests of its own operating arm.

The parallels with energy transmission infrastructure are obvious. A key accusation against integrated energy companies is that they have placed the interest of their supply businesses above the interests of their transmission businesses.

Nowhere is this more apparent that in the *ENI* case referred to above, where the Commission argues that ENI failed to invest in additional capacity for which there was clear demand, a failure which was contrary to the interests of the transmission business.

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[29] [1992] 5 CMLR 255, at para 41.

[30] *Sea Containers Ltd/Stena Sealink,* OJ 1994, L15/8. At para 66 the Commission described the port owner, Stena Sealink Ports, as owning an 'essential facility'.

In *Port of Rødby*[31] the Danish Government had refused to allow Euro-Port A/S, a subsidiary of Stena, either to build a new terminal in the immediate vicinity of the port of Rødby or to have access to the existing terminal at the port with a view to operating a ferry service between Rødby and Puttgarden.

The Rødby-Puttgarden route was operated jointly by DSB, a public undertaking with the status of a department within the Danish Ministry of transport, and DB (Deutsche Bundesbahn), a German public undertaking. They jointly sold tickets, fixed timetables and rates, and granted identical discounts. There were no other companies providing ferry services on the sea route in question. Scheduled ferry services between Rødby and Puttgarden were an essential link between the ports on the east coast of Denmark and the west coast of Sweden with Germany and the rest of western Europe.

The Commission held that port operations at a single port could constitute a relevant market and a substantial part of the EU for the purposes of Article 82. DSB was dominant in port operations and DSB and DB jointly dominant in the provision of ferry services on the route. The refusal by the Danish Ministry of Transport to allow Stena to construct a new private port was an abuse of a dominant position and infringed Articles 82 and 86. The Commission ordered that the infringement be brought to an end, in essence requiring that Stena be allowed to construct a new private port at Rødby.

In *Frankfurt Airport*,[32] Flughafen Frankfurt/Main AG ("FAG") held a dominant position on the market for the provision of airport facilities for the landing and take-off of aircraft at Frankfurt airport. The Commission regarded the provision of ramp-handling services as being complementary or ancillary in that respect and found that it constituted a neighbouring but separate market. The Commission required FAG to end its ground handling monopoly and ordered it to grant access to third parties.

In *Disma*,[33] the Commission concluded that oil and gas pipelines are capable of being essential facilities. It applied Article 81 (there were a number of undertakings involved) and the essential facilities doctrine to the jet fuel storage facilities and pipes transferring jet fuel to supply points at Malpensa Airport in Milan.

So in all of these cases, the Commission found that refusal to give fair and non-discriminatory access to an essential facility constituted an abuse of a dominant position. In each case, the remedy amounted to grant of mandatory access to the facility – essentially depriving the owner of the facility of its right to do as it wished with its facility. Having said that, it will be noted that deprivation of ownership rights in all of these cases was only partial: the essential facility owner retained ownership of the asset in each case. It was only the owner's right to control access of the facility that was restored. Admittedly this right to control access is one of the key ownership rights.

[31] OJ 1994, L55/52.

[32] OJ 1998, L72/30.

[33] See the Commission's XXIIIrd Report on Competition Policy (1993) at pp 141-143.

Nevertheless, it is clear that divestment goes further still than requiring the grant of access.

5.3 Examples of divestment remedies under the ECMR

A rather more immediate model for unbundling in individual energy cases – and a demonstration of the Commission's policy in this area – can be seen in the Commission's acceptance of unbundling commitments in a number of recent energy merger cases. The Commission will undoubtedly use its experience in these cases when shaping any future behavioural divestment decisions.

It should be noted that divestment commitments under the EC Merger Regulation are essentially voluntary remedies given in order to secure clearance from the Commission. There is a qualitative difference between such voluntary commitments, which the merging parties can decide not to offer provided that they forego their merger proposals, and a mandatory divestment order in the context of a behaviour investigation. A closer parallel is seen in those rare jurisdictions (such as the UK) where obtaining prior merger clearance is not mandatory and where the competition authorities have in some cases ordered divestment, following completion of an acquisition.

5.3.1 E.ON/MOL

This case involved the acquisition by E.ON from MOL of sole control (75% less one share) in each of MOL WMT and MOL Storage, with options in favour of MOL to require E.ON to acquire MOL's remaining 25% (plus one share) stakes within 5 years.[34] E.ON is a German supplier of electricity and gas. In Hungary, E.ON was active on the gas and electricity retail markets through its control of several regional distribution companies. MOL was the incumbent gas supplier in Hungary. MOL WMT was active in the wholesale and trading of gas and supplied natural gas to regional gas distributors (RDCs), industrial customers and large power plants in Hungary. MOL Storage operated 5 natural gas storage facilities in Hungary.

MOL was also granted a put option under which it could require E.ON to purchase a minority (25% plus one share) or majority (75% less one share) interest in MOL Transmission. As part of the transaction, MOL retained its upstream gas exploration and production division (MOL E&P) and MOL E&P agreed a new long term gas supply contract with MOL and MOL WMT.

Prior to the transaction, MOL had 'an almost exclusive control over the Hungarian gas infrastructures and supply contracts'. It owned all the Hungarian gas storage facilities and had a quasi-monopoly on the gas wholesale markets. Since E.ON had equity stakes in three gas RDCs and was involved in gas trading, this would result in E.ON achieving vertical integration on the whole gas supply chain. This would strengthen the new entity's control over all Hungarian gas resources, both domestic and imported. The

[34] Case COMP/M.3696.

Commission concluded that MOL WMT held a dominant position in the market for wholesale supply of gas in Hungary.

The Commission did not allege that the concentration would lead to the creation of a further dominant position downstream or to the enhancing of the existing upstream dominance. Instead, the Commission concluded that the vertical integration would lead to the new entity having the incentive and an enhanced ability to determine prices and other trading conditions on the downstream markets for:

(a) the supply of gas to industrial, commercial customers and residential customers. MOL WMT had a dominant position in the wholesale supply of gas in Hungary. Although MOL E&P was not a party to the concentration (and hence the domestic gas resources belonging to MOL E&P would not be controlled by E.ON), nevertheless the long-term supply agreement that it had entered into with MOL WMT would effectively deny third parties access to Hungarian domestic gas. Whilst the supply contract was not exclusive, it was for volumes which were largely equal to anticipated production. Gazprom would have no incentive to increase exports since it would displace or out price the supplies it was already committed to providing to MOL WMT

(b) the generation/wholesale supply of electricity and the supply of electricity to industrial, commercial customers and residential customers: E.ON had made significant investments in the electricity sector and was active in generation, wholesale and retail. It owned an electricity trading company, E.ON EK. Gas fired power plants were important in electricity generation in Hungary. MOL was a 'gatekeeper of gas resources in Hungary'.

Under both current market conditions and following liberalization of the Hungarian gas and electricity markets in 2007, without the undertakings offered by the parties, the concentration would have significantly impeded effective competition in the Community. The Commission concluded at paragraph 549 of its decision that:

> MOL Transmission is likely to have the ability and the incentive to discriminate against E.ON's competitors in granting access to the gas transmission network, owing to the structural link resulting from the 25%+1 minority shareholding of MOL into MOL WMT.

In order to address the Commission's concerns, the parties offered an extensive package of remedies. This included:

(a) the divestment by MOL of its remaining shareholdings in MOL WMT and MOL Storage. As a consequence, gas production and transmission would be unbundled from gas wholesale and storage. This eliminated the incentive for MOL Transmission to favour MOL WMT. In addition MOL agreed not to exercise its put option or sell its stake in MOL Transmission to E.ON in a way that would avoid triggering a merger notification under the EC Merger Regulation; and

(b) a gas release programme, entailing the release by E.ON of significant volumes of gas on the market on competitive conditions over an eight-year period and the

divestment to an independent gas trader of half of E.ON's ten-year supply contract with MOL's retained gas production business. These measures would release an amount equivalent to 14% of Hungarian annual gas consumption. This offered market participants the possibility of concluding gas supply contracts on equal terms.

Unbundling of gas production and transmission activities was therefore an essential part of the remedial commitments accepted in this case, and it is notable that the Commission views the decision as something of an indicator of its likely approach in other similar cases in future.

5.3.2 DONG/Elsam/Energi E2

In this case, the Commission granted conditional clearance to the acquisition by DONG (the Danish state-held gas incumbent) of Elsam and Energi E2, two Danish regional electricity generation incumbents, and of Kobenhavns Energi Holding A/S and Frederiksberg Elnet A/S, two Danish electricity suppliers.[35] DONG is active in:

(a) the exploration, production, off-shore transportation and sale of oil and natural gas;

(b) the storage and distribution of natural gas; and

(c) to a lesser extent, in wind electricity generation as well as the supply of electricity and heat. ELSAM and Energi E2 are the incumbent electricity generators in east and west Denmark, respectively. Both produce and trade electricity (financial and physical) on the wholesale market as well as producing district heating.

The Commission's concerns focused on the lessening of competition along the gas supply chain in Denmark. Potential competition issues relating to the Danish electricity markets had been pre-emptively addressed by DONG's sale of various Elsam and Energi E2 power plants to Vattenfall, the Swedish electricity incumbent, and by virtue of the fact that the Danish electricity sector was quite fragmented.

The Commission focused on two issues;

(a) post merger, the essential absence of competition from Elsam or Energi E2 in the markets for gas 'flexibility' and wholesale retail gas supply; and

(b) with Elsam and Energi E2 being operators of gas power plants (the largest users in Denmark) the potential foreclosure of wholesale and retail gas supply due to the vertical integration of DONG.

The first noteworthy point of this case was the Commission's consideration of a possible market for 'gas flexibility', which included all mechanisms allowing gas operators to balance supply and demand in order to compensate gas price volatility, for example by the use of storage facilities or flexible supply contracts. The Commission considered that competition problems would arise whether the market was defined

[35] Case COMP/M.3868.

separately as that of flexibility or as a market for storage and the market definition was left open. DONG owned the only two gas storage facilities in Denmark. Elsam and Energi E2, as major gas customers benefiting from flexible long-term supply contracts, were found to be the most important independent sources of alternative flexibility. By eliminating the competitive constraints imposed upon DONG by Elsam and Energi E2, the transaction therefore increased customers' dependence on DONG's storage facilities and DONG's incentives to raise the storage costs of rival electricity producers and gas suppliers. Under the Danish Natural Gas Supply Act, DONG was obliged to give third parties access to its storage under the negotiated third party access scheme which required its access to be on the same terms as other users. However, the Commission found this regulatory regime to be relatively weak, with DONG not being obliged to decrease its revenues even when interest rates had fallen significantly. The Danish law allowed DONG to recover more than a fair return on its historic costs. Allowing DONG to use the integrated flexibilty resources of Elsam and Energi 2 would decrease its own storage needs and allow it to lay off more storage costs on to its competitors through increased tariffs, as they would be proportionately greater users of the storage facilities and there would be decreased economies of scale.

The second point of interest was the Commission's focus on the competitive constraints posed by electricity operators on gas suppliers, in particular heavy relyiance on gas power electricity plants. The Commission considered that the transaction removed Elsam and Energi E2, the two largest users of natural gas in Denmark, as the most credible potential entrants on the Danish gas wholesale market. Furthermore, since they had access to large quantities of natural gas at competitive prices, Elsam and Energi E2 would have had, according to the Commission, the ability and incentive to implement active gas procurement strategies for the sourcing of additional quantities in order to serve retail customers. As a result, the Commission considered that the transaction removed a major competitive constraint upon DONG in the markets for retail gas supply to large business customers, small businesses and households, respectively.

The third point of interest was that the Commission was concerned that the transaction would raise barriers to entry to the Danish gas wholesale and retail markets, by removing Elsam and Energi E2 from the customer base potentially available to new entrants. In contrast, it would enable DONG to secure large volumes of supplied to the country's two largest customers.

To ensure sufficient liquidity of the Danish gas wholesale market while maintaining sufficient incentives for third-parties to enter the markets for retail gas supply, DONG committed to implement a gas release program of 400 million cubic meters – the equivalent of 10% of Danish total demand for natural gas (2005) – for a total duration of 7 years. This gas release would encourage entry into the market as well as freeing up contractually locked-in customers.

To remedy the Commissions' flexibility concern, DONG agreed to divest the largest of its two gas storage facilities at Lille Torup in Jutland. The Commission regarded this

divestment as sufficient to create a second, independent player in the Danish gas storage market.

Ownership unbundling of the storage facility in Lille Torup would compensate for the loss of independent flexibility provided by Elsam and Energi 2 and was made necessary by the weaknesses which the Commission had identified in the existing Danish regulatory regime. Respondents had:

> suggested that the ownership by an operatator not involved in downstream supply activities would lead to an improvement of the products offered as the new owner would have an increased incentive to be fully responsive to the market's needs.[36]

The Commission considered this a strong likelihood.

5.3.3 Gaz de France/Suez

Gaz de France is an energy group active at all levels in the energy chain and in a number of European member states.[37] In France it is active in exploration, production, storage, distribution and natural gas sales. In Belgium, Gaz de France had, with Centrica, joint control over SPE. SPE was active in the Belgian electricity and natural gas markets and provided energy services.

The Suez group is active in the utility sector, providing energy and utility services. Suez's main subsidiaries are Electrabel which provides electricity and gas, Distrigaz which supplies gas, Fluxys supplying gas storage and transport and Elyo (renamed Suez Energy Services), Fabricom, GTI, Axima and Tractebel Engineering, all of which were active in the energy service sector. Suez Energie Europe holds a 27.5% stake in Elia, which operates the Belgian electricity transmission network. The parties argued that Fluxys was not controlled by Suez, but the Commission rejected these arguments.

Gaz de France had agreed to take over Suez. The Commission was concerned about the impact of the merger on a number of French and Belgian markets.

Belgium imports all the natural gas it consumes either through gas pipelines or as LNG. It uses high calorific ("H gas") and low calorific gas ("L gas"). It is technically impossible to transport L gas on the H network and vice versa. There are 15 entry points for H gas and three for L gas.

The Belgian gas network is used for international transit as well as domestic transmission. Fluxys owns the domestic gas transmission network, sells transmission capacity and operates the network.

The natural gas transit entry points were at Zeebrugge, at Gravenoeren on the Dutch border and at Blaregnies on the French border. The natural gas pipelines used for transit were owned by Distrigaz, SEGEO (owned as to 75% by Distrigaz and 25% by Gas de France) and Fluxys. There was only one underground storage facility for gas in

[36] At para 723.

[37] Op cit, n 11.

Belgium (managed by Fluxys) and a buffer storage facility at Zeebrugge, owned by Fluxys. There was no storage facility for L gas in Belgium.

L gas was supplied exclusively from the Netherlands. Gaz de France and Suez were the only Belgian importers, with long-term import contracts with Dutch exporters for L gas. They had reserved all capacity at the two key entry points at the Dutch border. Gaz de France was the only competitor of Suez's subsidiary, Distrigaz, in the supply of L gas in Belgium. It also had high flexibility due to gas storage facilities in France. The L gas network was primarily located in Brussels and the provinces of Antwerp, Limburg, Flemish Brabant, Wallooon Brabant and Hainault. There are no L gas transport networks in the Belgian provinces of West Flanders, East Flanders and Luxembourg.

H gas was supplied from the UK, the Netherlands, Germany, France and the Zeebrugge LNG terminal. The principal H gas transit routes were those owned and operated by SEGEO and Distrigaz. The H gas network covered the whole of Belgium.

The local authorities in Belgium had exclusive power to distribute natural gas once it had left the transmission network. As part of the liberalization of the gas market, mixed public and private sector companies had been set up, and Electrabel had equity stakes in these companies. Even though, under both Belgian law and their corporate statutes, these mixed public-private-sector companies were to be controlled by the local authorities (whatever the size of the private sector entity's shareholding), the fact that Suez/Electrabel could appoint directors and the companies' reliance on Suez group technical expertise led the commission to conclude that, 'Suez is currently in a position to exert at least significant influence on, and possibly control over, the local authority mixed public-and private-sector companies'.

The Commission concluded that Gaz de France had the following competitive strengths in the Belgian market:

- the merged entity would have very high combined market shares in Belgium. Suez had 80% to 90% in most gas supply markets (supplies of gas to electricity producers, gas dealers, large industrial customers, small industrial customers and households). The merger would remove Gaz de France (with market shares of around 10-15%) as the main competitor to Suez. The parties' market shares in L gas were even higher due to their highly developed operations in the sector, with competitors' market shares being only around 0-5%;
- no competitor in Belgium could exert the same level of competitive pressure as Gaz de France;
- the Belgian gas markets were characterised by high barriers to entry. The merged entity would have access to most of the gas imported into Belgium and would enjoy vitually all the long-term import contracts. The importation of gas into Belgium depended on the availability of gas and was subject to the prices that importers were prepared to pay. The Commission doubted that there would be additional gas supplies available from other Member States above that committed

to the existing import contracts, and considered that there was little liquidity in the Belgian gas market; and

- the merged entity would have privileged access to supply infrastructure and storage in Belgium and access to L gas storage capacity in France, providing greater flexibility and reserved capacity.

As regards the French market, France has five gas entry points, Taisnières (on the border with Belgium), Dunkirk (connected to the Norwegian gas pipeline), Obergailbach (on the German border), Montoir and Fos-sur-Mer (methane terminals on the west and south borders of France respectively). There are two exit points on the border with Spain and Switzerland.

There are two natural gas transmission system operators in France. The Gaz de France transmission system operates most of the gas network. Total operates the network in the south west of France. There are five balancing zones, four within the Gaz de France network and one within the Total network. H gas is carried in all five zones and L gas in the northern ones. Transmission costs between zones are very heterogeneous.

Gaz de France's national distribution system handled 96% of all gas consumption. Gaz de Bordeaux and Gaz de Strasbourg accounted for 1.5% of gas consumption, with 20 other distributors having less than 1%.

The Commission found that Gaz de France's dominant position in the gas markets in France would be enhanced by the merger, as Distrigaz was one of Gaz de France's best placed competitors. The merger would significantly hinder effective competition following liberalization of gas markets on 1 July 2007. Although not an incumbent operator in France, having only entered the French gas supply market in 2002, Suez was one of the main competitors to Gaz de France, 'having played an active role in the liberalisation of the gas markets in France via its subsidiary, Distrigaz'.[38] Suez had a number of advantages which allowed it to apply competitive pressure on Gaz de France, namely its dominant position as incumbent operator in Belgium (through which part of France's H gas and all of its L gas supplies were routed via Taisnières) and range of large and diversified gas resources. The merger would also significantly impede effective competition in the supply of gas to electricity producers in the north (H and L gas) and East zones by eliminating a potential competitor.

There were high barriers to entry to gas markets and infrastructure in France, which further strengthened Gaz de France's dominant position.

As regards electricity, the Commission concluded that in the Belgian wholesale electricity market, the parties would have a combined market share of around 80-90% of electricity generated in Belgium and between 0-5% of Belgian electricity imports. In 2005 Suez (Electrabel) had 70-80% of Belgian generation capacity and Gaz de France (SPE) controlled 5-10%. Barriers to access to generation and the construction of

[38] At para 478.

generation were high. Suez was dominant and Gaz de France its best placed competitor in the Belgian wholesale electricity market. The merger would eliminate Gaz de France as Suez's only effective competitor in the Belgian market for ancillary srvices and balancing power leaving Suez with a dominant position, which would be strengthened by the merger. Similarly Gaz de France was the best placed competitor in the markets for electricity supply to large industrial and commercial customers and the merger would strengthen the dominant position of Suez in supplying electricity to eligible households.

The Commission expressed concern about the parties' access to confidential information on competitors, a factor which, according to the Commission, emphasised the need for clear ownership separation.[39] It also expressed concern about the competitive strength engendered by the merged entity's ability to make dual gas and electricity offers.[40]

The electricity supply market was also characterised by high barriers to entry, and electricity trading was illiquid

Finally, the Commission found that there would be further concentration in the district heating market in France by virtue of the combination of Suez, the largest operator in this market, with Gaz de France, the second largest operator.

The parties offered remedies, which the Commission market-tested. Those third parties who were consulted expressed serious doubts, as a result of which the parties offered wider final remedies, comprising:

- the full divestiture of Distrigaz;
- the full divestiture of Gaz de France's holding in SPE;
- the restructuring and relinquishing of all control over Fluxys, in particular ensuring that the parties would not hold more than 45% of its capital, that they would not have the right to appoint more than 7 of the 21 directors, would not nominate the seven independent directors, would ensure that no Fluxys director would exercise gas supply responsibilities, would set up an executive committee within Fluxys with exclusive powers of management (including commercial strategy) in respect of regulated infrastructures and the overall investment plan for regulated infrastructure in Belgium and would not control the executive committee;
- undertakings by the parties to invest in an increase in the Belgian and gas infrastructure capacity; and
- the disposal of Gaz de France's subsidiary operating in the French district heating market.

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[39] At para 855 et seq.

[40] At para 861.

In its assessment of the commitments, the Commission remarked that the divestiture of Distrigaz would remedy the loss of competitive pressure in the French and Belgian gas markets and foreclosure problems in the Belgian electricity market which would otherwise have arisen as a consequence of the merger. The divestment of SPE would eliminate horizontal overlaps in the Belgian gas and electricity markets and restore effective competition in those markets. The commitments on investments and the restructuring of Fluxys would ensure that necessary investments would occur. Third parties would be able to invest in Fluxys and the parties would not be able to block its investment decisions. Thus although the remedies were structural (in the sense of requiring divestment), they were also behavioural, as the Commission anticipated that they would influence the behaviour of the parties and, for instance, would enhance access to and the emergence of new players on the affected markets. The restructuring requirements in relation to Fluxys (as with those in relation to the *E.ON/MOL* decision) were more extensive than those contained in the legal unbundling requirements under the second liberalization pakcage, foreshadowing the full unbundling required by the proposed third package.

5.3.4 EDF/ENBW

EDF, the former French monopolist and one of its leading electricity generators, agreed to acquire EnBW, a member of the group of the four largest German electricity generators (formed through the VEBA/VIAG merger).[41] EnBW, with its historic supply area adjacent to the French-German border, was well-placed as a potential entrant to the French market. Through a Swiss generation subsidiary, WATT, it had even participated in tenders launched by French eligible customers. The Commission concluded that the merger would shield the merged company from competition in France, as it would be able to use its presence in Germany to deter rivals from pursuing aggressive competition in the French market. It also found that:

(a) the entity would control a large proportion, if not all, of Swiss generation and the supply of peak load, through WATT,

(b) EDF would gain entry into the German market, further strengthening its already outstanding position as a pan-European supplier of large business customers with production sites all over Europe; and

(c) eliminate EGL, a German downstream electricity provider, as a potential competitor.

The Commission approved the transaction after accepting commitments by EDF-EnBW, namely:

(i) the divestment of WATT, the Swiss generation subsidiary, in an effort to avoid any improvement of EDF's access to Swiss peak supplies; and

[41] Case COMP/M.1853.

(ii) the innovative commitment to make available to its competitors, via auction, access to generation capacity located in France which amounted to between 30 and 32% of the volume of the national market for eligible customers. It was the Commission's intention that access to virtual power plants in France would facilitate foreign suppliers to become active in the market, especially German suppliers who would be able to cope with EDF's anticipated increased retaliatory behaviour in the French and German markets post-acquisition.

5.3.5 Neste / IVO

Imartan Voima Oy (IVO), Finland's largest company in the energy sector, active in power and heat generation, power trading, electricity distribution and supply, operation and maintenance of electricity-generating plants as well as a host of other smaller interests, proposed to merge with Neste, active in oil, energy (natural gas through its control via majority shareholding of Gasum) as well as the chemical sectors.[42] The Commission considered that the merger would strengthen IVO-Neste's position in the market for the wholesale sale of electricity in Finland, due to Neste's position in the upstream market resulting from its control of Gasum. IVO-Neste would inherit the de facto monopoly in natural gas enjoyed by Gasum. Given the importance of natural gas for electricity production in Finland, the parties' complete vertical integration and the strong position they enjoyed in natural gas and electricity markets, the merged entity would exert significant influence over electricty and gas prices in Finland.

The parties offered to relinquish complete control of Gasum. IVO-Neste would, reduce its shareholding in Gasum to a non-controlling 25% stake. It would sell its 50% shareholding to the Finnish State (as to 24%) and to Finnish and other EU entities independent of IVO-Neste (as to 26%). Gazprom would retain a 25% stake.

5.4 Conclusion on the energy divestment commitments

It is clear from the cases outlined above that the Commission is ready to extract commitments that amount to divestment or ownership unbundling wherever it believes that they will remove specific competition concerns in individual merger cases. In particular, *GDF/Suez*[43] and *DONG/Elsam/Energi E2*[44] demonstrate that the Commission is particularly alive to the foreclosure issues raised by common ownership of supply and network infrastructure activities.

6. WORKABILITY AND EFFECTIVENESS OF STRUCTURAL REMEDIES

One issue not raised by Philip Lowe in his article in the Competition Policy Newsletter was the question of whether unbundling remedies would be workable and effective.[45]

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[42] Case COMP/M.931.

[43] Op cit, n 11.

[44] Op cit, n 35.

[45] Op cit, n 2.

While we are awaiting the Commission's Article 82 Guidelines, some guidance can be had from the Commission's Notice on Merger Remedies,[46] paragraphs 7, 9 and 10 of which stress that any remedies offered in a merger clearance must be capable of eliminating the competition concerns which have been identified, and must be workable. It is easy to see that in the case of some unbundling remedies there may be difficulty in overcoming competition concerns with sufficient precision and without increasing the cost to the consumer. Will there be adequate bids for the networks from parties who will be both effective as operators and as investors? In the context of structural remedies in respect of mergers, some commentators have questioned whether, in seeking to achieve greater competition in a given market, competition authorities have tended to 'over-fix' the problems associated with a proposed merger with resultant loss of efficiency gains.[47]

The Commission has shown a marked preference for structural remedies in its merger decisions and guidance notices.[48] However, Recital (30) of the Merger Regulation[49] provides that 'commitments should be proportionate to the competition problem and entirely eliminate it'. The Court of First Instance has reviewed the issue of whether the Commission is right to be predisposed towards structural rather than behavioural remedies. In the case of *Gencor v Commission*[50], for instance, it concluded that under the then applicable Merger Regulation:[51]

> 318. ... the Commission has power to accept only such commitments as are capable of rendering the notified transaction compatible with the common market ...
>
> 319. The categorisation of a proposed commitment as behavioural or structural is therefore immaterial. It is true that commitments which are structural in nature, such as a commitment to reduce the market share of the entity arising from a concentration by the sale of a subsidiary, are, as a rule, preferable from the point of view of the Regulation's objective, inasmuch as they prevent once and for all, or at least for some time, the emergence or strengthening of the dominant position previously identified by the Commission and do not, moreover, require medium or long-term monitoring measures. Nevertheless, the possibility cannot automatically be ruled out that commitments which prima facie are behavioural, for instance...to

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[46] The Commission's Notice on remedies acceptable under Council Regulation (EEC) No 139/2004 and under Commission Regulation (EC) No 802/2004 - available at: http://ec.europa.eu/comm/competition/mergers/legislation/draft_remedies_notice.pdf

[47] Penelope Papandropoulos and Alessandro Tjana, 'The Merger Remedies Study - In Divestiture We Trust' [2006] ECLR 443; H.Vasconcelos, 'Efficiency Gains and Structural Remedies in Merger Control', 17th March 2005 No 6093, CEPR Discussion Papers.

[48] Op cit, n 46, paragraph 18 of which provides that, 'commitments which are structural in nature, such as the commitment to sell a business unit, are, as a rule, preferable'.

[49] Regulation 139/2004, OJ 2004, L24/1.

[50] Case T-102/96 [1999] ECR II-879.

[51] Regulation 4064/89/EC, OJ 1989, L395, as amended by Regulation 1310/97/EC, OJ 1997, L180.

> make part of the production capacity of the entity arising from the concentration available to third-party competitors, or, more generally, to grant access to essential facilities on non-discriminatory terms, may themselves also be capable of preventing the emergence or strengthening of a dominant position.
>
> 320. It is thus necessary to examine on a case-by-case basis the commitments offered by the undertakings concerned.

This judgment is also relevant to the issue of whether a structural or behavioural remedy would be proportionate in the context of Article 82. In their review of DG Competition's 'Merger Remedy Study'[52] Papandropoulos and Tajana[53] conclude, 'that divestiture remedies have been effective in 56% of the cases, partially effective in 25%", mainly due to the particular problems associated with transferring businesses which will remain viable, competitive and which do not further distort the market, for instance by increasing market symmetry.

7. Limits on the Power to Order Structural Remedies

As Philip Lowe acknowledged in his article in the Competition Policy Newsletter,[54] there are a number of limits on the power to order unbundling whether on a sector-wide or individual basis. They include:

- proportionality;
- subsidiarity;
- human rights; and
- Article 295

These are addressed in turn.

7.2 Proportionality

It is inherent within Article 7 of the Regulation that Commission enforcement decisions should impose remedies which are proportionate. In *Alrosa v Commission,*[55] the Court of First Instance made it clear that Commission decisions to accept commitments under Article 9 are also subject to the general principle of proportionality, and provided some useful guidance which is relevant not only to commitment decisions but also to 'hard' decisions under Article 7. Although Article 9 of Regulation 1/2003[56] is silent on whether commitments need to be proportionate, the CFI held that it is a fundamental principle of EU law that the Commission should act

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[52] Available at: http://ec.europa.eu/comm/competition/mergers/others/remedies_study.pdf.

[53] Op cit, n 47.

[54] Op cit, n 2.

[55] Case T-170/06, judgment of 11 July 2007, not yet reported in ECR.

[56] Op cit, n 22.

in a proportionate manner, taking only such steps as are necessary to achieve its objectives. The CFI held that where there is, 'a choice between several appropriate measures, recourse must be had to the least onerous and the disadvantages caused must not be disproportionate to the aims pursued'. In the *Alrosa* case the EC Commission's decision to accept a commitment from De Beers to reduce and then wholly end its purchase of rough diamonds from Alrosa in order to avoid an infringement of Article 82 was manifestly erroneous. The Commission had not assessed what proportion of Alrosa's production needed to be available to third parties in order to ensure that the foreclosure difficulties posed by the original exclusive arrangements between the parties were eliminated. The CFI concluded that the aim pursued by the Commission was to bring an end to practices which prevented Alrosa from establishing itself as an effective competitor and providing third parties with an alternative source of supply in the EU. The commitments offered were disproportionate to this aim. It was clear that other less onerous solutions were possible and would have sufficed.

In *Alrosa* the Commission opted for a rather extreme form of commitment in deciding to accept De Beers' offer to cease purchasing rough diamonds from Alrosa entirely. The Commission decisions to accept merger commitments reviewed above appear more surgical in their approach and seem more likely to survive a challenge on proportionality grounds. Nevertheless, the Commission will need to ensure that any structural remedies imposed in any of its current energy investigations go no further than is required in order to address the competition concerns that it has identified.

7.2 Subsidiarity

The second paragraph of Article 1 of the Treaty of the European Union provides that the European Union is created on the basis that 'decisions are taken ... as closely as possible to the citizen'. The test, according to the second paragraph of Article 5 of the EC Treaty, is whether in areas where the EU does not enjoy exclusive competence, 'the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community'. The European Court of Justice has tended to review the question of whether the EU institutions have considered the matter of subsidiarity and whether it is really necessary for them to enact measures at the EU rather than the national level. It has to some degree avoided 'second-guessing' the decision itself. If the judgment of the ECJ in *R v. Secretary of State, ex parte BAT and Imperial Tobacco*[57] is followed then the Commission will have little to fear. On the issue of whether the Tobacco Control directive had infringed the principle of subsidiarity the ECJ held that it had not. It was not possible for Member States to control tobacco advertising as effectively nationally as the EU could at the EU level. The Court defined the principle of subsidiarity as follows and appears to regard the issue as also involving the principle of proportionality:

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[57] Case C-491/01 [2002] ECR I-11453

> 177. The principle of subsidiarity is set out in the second paragraph of Article 5 EC, according to which, in areas which do not fall within its exclusive competence, the Community is to take action only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved at Community level.
>
> …
>
> 184. Second, the intensity of the action undertaken by the Community in this instance was also in keeping with the requirements of the principle of subsidiarity in that ... it did not go beyond what was necessary to achieve the objective pursued.

The principle of subsidiarity is therefore equally unlikely to constrain the Commission's exercise of its powers under Regulation 1/2003. The Commission will undoubtedly argue that the failure of the existing second legislative package shows the need for action at Community level and that the Member States have accepted that Community action is necessary to create an internal market for energy. National courts have always tended to accept the need for action at Community level in such matters and in *Telefonica O2 Europe PLC and others v. Secretary for State for Business and Regulatory Reform*[58] Mitting J, whilst agreeing to refer the European Court of Justice questions relating to the legal basis and compatibility with the principle of proportionality of the Roaming Regulation[59] regarded the arguments of the mobile telephone operators regarding subsidiary as unarguable.

7.4 Human Rights

The European Convention on Human Rights, Protocol 1 Article 1, states:

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

Property expropriation frequently occurs at a national level (compulsory purchase orders) and limits are placed on the exercise of property rights (compulsory licences of patents).

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[58] [2007] EWHC 3018, 7 December 2007.

[59] Regulation 717/2007, OJ 2007, L171/32, imposing a cap on wholesale and retail network operators' tariffs.

The issue was tested in *James and others v UK,*[60] an action brought by a major private landowner in London against laws that allowed tenants to buy their flats. The Court remarked that, in a democratic society, opinions about expropriation will vary greatly but that governments have a wide discretion to implement social and economic policies. The Court indicated that it 'will respect the legislature's judgment as to what is "in the public interest" unless that judgment be manifestly without reasonable foundation'.

Marius Emberland has observed that:

> the court's deferential stance is nearly tantamount to the inclusion of a "right to regulate" within the right to property protection under the Convention.[61]

The ECJ has said it recognises the issue of human rights on the basis of a general principle. So for example in *Orkem v Commission,*[62] the ECJ held that where the Commission's powers of investigation undermined the right of the company to defend itself this infringed the 'need to safeguard the rights of the defence which the court has held to be a fundamental principle of the Community legal order'.[63] This decision acknowledged the protection of human rights as a general rule of law rather than a right emanating from the European Convention on Human Rights ('ECHR'), Article 6(1) of which entitles anyone 'charged with a criminal offence' (within the autonomous meaning of that phrase in Article 6 ECHR) to remain silent and not to incriminate himself.[64]

In dealing with property rights (rather than criminal matters) the European Court of Justice has drawn a distinction between expropriation and limitations on use of property in line with the second paragraph of Protocol 1 Article 1 of the Convention, focusing on the issue of *impairment* of property rights. In *Hauer v Land Rheinland-Pfalz*[65] the Court considered an EC Regulation which limited new planting of vines for three years as part of a common organization of the EC wine market. Mrs Hauer, a grower, challenged the Regulation as interfering with her fundamental property rights. The European Court of Justice held that:

> 17. The right to property is guaranteed in the Community legal order in accordance with the ideas common to the constitutions of the member states, which are also reflected in the first protocol to the European Convention for the Protection of Human Rights.

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[60] Series A No 98, (1986) 8 EHRR 123.

[61] M Emberland, *The Human Rights of Companies: Exploring the Structure of ECHR Protection*, OUP, 2006, at p 192.

[62] Case 374/87 [1989] ECR 3283.

[63] See para 32 of the judgment.

[64] See also (Case A/256-A) *Funke v France* [1993] 1 CMLR 897, 25 February 1993.

[65] Case 44/79 [1979] ECR 3727

> 18. Article 1 of that protocol ... envisages two ways in which the rights of a property owner may be impaired ... In this case it is incontestable that the prohibition on new planting cannot be considered to be an act depriving the owner of his property, since he remains free to dispose of it or to put it to other uses which are not prohibited. On the other hand, there is no doubt that that prohibition restricts the use of the property. In this regard, the second paragraph of Article 1 of the protocol provides an important indication in so far as it recognizes the right of a state "to enforce such laws as it deems necessary to control the use of property in accordance with the general interest". Thus the protocol accepts in principle the legality of restrictions upon the use of property, whilst at the same time limiting those restrictions to the extent to which they are deemed "necessary" by a state for the protection of the "general interest".

The Court went on to note that the constitutional rules and practices of all the then nine Member States permitted the introduction of legislation to control the use of private property in accordance with the general interest. The right to property had a social function and was accordingly constrained thereby. The restrictions on the new planting of vines could not therefore be challenged in principle. The Regulation imposed, 'a type of restriction which is known and accepted as lawful, in identical or similar forms, in the constitutional structure of all the member states'.[66]

The Court observed that it was still necessary to examine whether the restrictions introduced by the Regulation corresponded to objectives of general interest pursued by the Community or whether, having regard to the aim pursued, they constituted a disproportionate interference with the rights of the owner, 'impinging upon the very substance of the right to property'.[67] The claimant considered that the Regulation should have taken a more targeted approach. She argued that only the pursuit of a qualitative policy would permit the legislature to restrict the use of wine-growing property based on its suitability for wine growing. The Court held that it was 'therefore necessary to identify the aim pursued by the disputed Regulation and to determine whether there exists a reasonable relationship between the measures provided for by the Regulation and the aim pursued by the Community in this case'.[68] The Court considered the Regulation and concluded that the measure was proportionate and not unduly restrictive.

7.4 Article 295 EC Treaty

Article 295 acknowledges that national property rights will be respected. This has been held to be subject to the principal objectives of EC law, both in the context of the tension between nationally conferred intellectual property rights and EC competition law and also where national; property rights or state conferred monopolies infringe

[66] See para 21 of the judgment.

[67] See para 23 of the judgment

[68] See para 23 of the judgment.

Article 82. However, both the essential facility principle and the *Magill* and *IMS Health* jurisprudence confer a narrow mandate on the Commission to interfere with national property rights in line with its powers under the EC Treaty and relevant Regulations enacted by the Council.[69]

In *Van den Bergh Foods v. Commission*[70] the Court of First Instance ordered that Unilever's subsidiary, Van den Bergh Foods, should make its freezers available to corner shops in Eire on a non-exclusive basis, holding that:

> 170. It is settled case-law that, although the right to property forms part of the general principles of Community law, it is not an absolute right but must be viewed in relation to its social function. Consequently, its exercise may be restricted, provided that those restrictions in fact correspond to objectives of general interest pursued by the Community and do not constitute a disproportionate and intolerable interference, impairing the very substance of the rights guaranteed ... Article 3[(1)(g)] of the EC Treaty ... provides that in order to achieve the aims of the Community, its activities are to include a system ensuring that competition in the internal market is not distorted. It follows that the application of Articles 8[1] and 8[2] of the Treaty constitutes one of the aspects of public interest in the Community ... Consequently, pursuant to those articles, restrictions may be applied on the exercise of the right to property, provided that they are not disproportionate and do not affect the substance of that right.

Advocate-General Cosmas in *Masterfoods*[71] *v HB Ice Cream* similarly was of the opinion:

> 105. ... There is no doubt that Articles 85 and 86 of the EC Treaty occupy an important position in the system of the Community legal order and serve the general interest which consists in ensuring undistorted competition. Consequently, it is perfectly comprehensible for restrictions to be placed on the right to property ownership pursuant to Articles 85 and 86 of the EC Treaty, to the degree to which they might be necessary to protect competition. Article [295] ... may in no event be used as a shield by economic operators to avoid application of Articles 8[1] and 8[2] to their detriment.

8. CONCLUSION

The above review of the energy merger cases in which divestiture was required, the general legal principles applicable to the Commission, the limits on its powers under Regulation 1/2003, Articles 5 and 295 EC Treaty and the ECHR demonstrate that, provided that the Commission fully investigates any infringement of Article 82 and applies a proportionate remedy, there is no reason why Article 82 remedies should not extend to an order equating to full unbundling. The Commission will need to act with

[69] Regulation 1215/99 [1999] OJ L148, p.1.

[70] Case T-65/98 [2003] ECR II-4653.

[71] Case C-344/98 [2003] ECR I-11369.

transparency and clarity, avoiding knee-jerk reactions to adverse comments from those parties which are canvassed on commitments. Finally, it will need to ensure that it does not create adverse welfare consequences from an over-zealous application of Article 82 and Regulation 1, a matter beyond the scope of this paper[72] but which nevertheless could leave consumers worse off.

[72] As to which see, for instance, "The cost of inappropriate interventions/non-interventions under Article 82" an Economics Discussion Paper September 2006 prepared by Lear for the United Kingdom Office of Fair Trading.