Introduction

It was not by chance that Community liberalisation policy came into being in the 1980s.

At a time when, following the Single Act, the legislative programme for the creation of the single market on 1 January 1993 was being put in place, the establishment of the single market suddenly made this simple fact obvious: whole sectors of the market would be excluded from the internal market and its anticipated benefits because they were characterised by exclusive rights or a monopoly.

At the same time, the European economies had to face up to a new international environment with four main characteristics: faster technological and scientific progress; a demographic explosion with the corresponding increase in the global working population; an unprecedented increase in the output of goods and services and greater dependence caused by the liberalisation of the movement of goods and capital. In this connection the two reports submitted to the European Commission by a group of experts set up at its request under the chairmanship of Mr Ciampi had highlighted the fact that access to high-quality, low-cost network services (telecommunications, transportations, energy, post) was a vital factor for the competitiveness of European industry as a whole.

This led to the setting up, for most network services and to varying degrees and by various legal means, whether autonomous directives under Article 86 or Council harmonisation directives, of a Community liberalisation policy which is based on common general principles but also has characteristics specific to each Member State and/or each economic sector.

I - Common principles, specific regulations

I-1 Focus on objectives of strict economic efficiency

All the liberalisation policies conducted by the European Union and consequently all systems of regulation set up in the various liberalised sectors are based on an intangible fundamental principle, namely that infrastructure management is separate from the provision of services. This principle whereby production, transport and distribution activities are treated differently is based on a simple theoretical observation: only those activities which have the character of a natural monopoly, i.e. activities where yields are increasing sharply and where technical and capital barriers to access are difficult to overcome are likely to be managed in the form of regulated monopolies.

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1 Respectively head of unit in DG Competition, Member of the Cabinet of Commissioner Barnier and Deputy Director General of DG Competition.
This concerns two types of regulation which are found in all sectors covered by Community liberalisation policy:

- Firstly, regulation aimed at ensuring that infrastructure is managed as efficiently as possible. The objective is to avoid on the one hand borrowing, underinvestment and underinnovation and on the other overinvestment, which is typical of this type of situation, and which was highlighted in the 1960s in the US by theorists of the Chicago school, particularly Stigler.

- Secondly, regulation of the interface between network management and the service activity.

Beyond the apparent universality of these characteristics which are common to all sectors in which liberalisation has been initiated by Brussels, political requirements, the characteristics of each sector and the choice of liberalisation by means of Council Directive, which allows Member States considerable room for manoeuvre, have given rise to not only liberalisation but also regulation of variable geometry. Mere observation shows that sometimes systems of regulation are organised differently from one sector to another, sometimes systems of regulation are similar for different sectors and types of liberalisation and sometimes in a particular sector, the type of regulation, and the objectives and instruments of such regulation are not necessarily the same from one Member State to another, even though the Community regulations are identical. This merely reflects the fact that the choice of a given regulation in a given member state for a given market, is widely affected by the specific mix between political acceptance and technical considerations.

Thus, as regards regulations aimed at ensuring efficient management of essential facilities, the regulatory techniques employed are found to vary greatly. In some cases, it has been decided to make the market artificially contestable by granting licences of limited duration for the use of scarce resources (Hertzian frequencies for mobile telephony, aircraft frequencies); in other cases the aim has been to facilitate access for competitors through asymmetric regulation (ban on telecommunications companies controlling cable operators); in other cases still the authorities have opted for regulation by objectives (electricity in the United Kingdom) or by comparison (regulation of water in the United Kingdom). For the same method of regulation, the second choices may vary from one Member State to another. For example, as regards the allocation of Hertzian frequencies for mobile telephony, some Member States have opted for an auction, and others for a so-called "beauty contest". Sometimes, in the same Member State and in the same market, the initial licences are granted in the form of a beauty contest and subsequent ones by auction (mobile telephony in the Netherlands), or even, as in the case of GSM licences in Italy and Spain, licences are granted free-of-charge to the traditional operator and sold to new entrants, which led the European Commission to intervene.

The same is true as regards the regulation of services and of the interface between services and infrastructure. European legislation has not opted to ban those managing essential facilities from also being involved in operating the services which are provided by means of those facilities.
In certain cases (energy, postal services), it has even allowed part of the service activity to be allocated to the infrastructure manager. This choice can be explained by an economic analysis in terms of efficiency or a political analysis in terms of acceptability. Be that as it may, a situation in which the most powerful of competitors on the services market is also a mandatory partner for its competitors as regards access to an essential production factor has to be regulated in two ways. First of all, price regulation, where the access charges to be imposed by the infrastructure manager are fixed. Secondly, technical regulation, to ensure that the technical solutions chosen by the infrastructure manager do not in fact make it difficult, or even impossible, for new players to enter the market. Here, too, it can be seen that the Member States have opted for different solutions, sometimes leading the European Commission to intervene.

It can therefore be stated that although all Community legislation is based on homogeneous fundamental principles, the variants and peculiarities are such that there is no possibility at present of arriving at a single regulatory model in Europe. Some welcome this, observing that this is proof of a laudable pragmatism. Others deplore it, pointing out that systems of regulation in the liberalised sectors have been built up in an empirical way not based on theory, in which each structure and each concept has gradually gained ground. There is then, in some ways, spontaneous organisation of regulation.

Both positions are probably correct. The differences in structure and operation of the various systems of regulation in a particular sector, from one Member State to another, are moreover even more obvious if the analysis takes account of objectives other than strict economic efficiency which are attributed to the various regulators.

I-2 Focus on objectives other than those of strict economic efficiency

Article 86(2) of the Treaty of Rome expressly allows national legislators and regulators to take account of objectives other than those of strict economic efficiency. It states that:

"Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."

What are these interests other than objectives of strict economic efficiency which can and should be taken into account by the public authority? How does this tie in with economic efficiency objectives? What conclusions can be drawn regarding the architecture and operation of systems of regulation, particularly the links between Community and national level?

These issues open up a wide ranging debate on the coexistence of a multiplicity of national conceptions of the Public Service within the European Union and on the conditions governing their compatibility with a body of common rules: the Treaty of
Rome. Beyond this, they naturally give rise to the question of the relationships between national and Community levels as regards systems of regulation.

Article 86(2) (like Article 30) is an exception making it possible to derogate from the rules of the Treaty and thus allowing both the legislator and the regulator to take account of objectives other than strict economic efficiency. However, as it is an exception (a) it is the object of strict interpretation by the Court of Justice2 and (b) it is a matter for the party invoking this exception (enterprise, Member State or regulator) to prove that the conditions for its application have been met.3

I-3 The Commission, keystone of the system of regulation within the European Union

The systems of regulation in force in those sectors which have been the subject of liberalisation at Community level have, then, a number of characteristics: they pursue a multitude of objectives, some of which are to do purely with economic efficiency, while others are not; whatever the case, the formulation of objectives and the means used to achieve them may be relatively heterogeneous; finally, whatever the case, it is the European Commission which is responsible for ensuring that the basic principles of the Treaty or of secondary legislation are respected and that any differences observed are compatible with the functioning of the common market.

This situation reflects the conflict between the need to take account of historical, economic, geographical, political and cultural differences on the one hand and the Community objective of establishing a European “level playing field” which allows proper competition within the internal market on the other. It is, then, the Commission, the guardian of the treaties, which determines, under the supervision of the Court of Justice, to what extent laws on the one hand and regulatory decisions on the other are compatible with the Treaty. In some ways, the Commission regulates the regulators.

This regulation is carried out in accordance with two principles: the principle of conformity with Community legislation and the principle of proportionality of the means used to achieve the stated objectives. The European Commission has therefore been led on a number of occasions to take up decisions taken by regulators, whether in the search for economic efficiency (including those cases where the Commission contested the decisions of the German regulator on interconnection charges or the conditions for granting mobile telephony licences in Italy and Spain) or in pursuit of other objectives (as is the case in the current dispute between the Commission and France as regards the cost and funding mechanisms for the universal telecommunications service).

The Commission’s role is, then, to bring a degree of homogeneity to this diversity by ensuring that common principles are observed and arbitrating between the Community interest and national interests.

II - Defining alternative regulatory models for the future

The system described above, which may be termed a "Community model", is an empirical model in which responsibility for defining objectives is shared between Community level and national level (economic efficiency objectives are rather defined at Community level while those relating to the general good are rather defined at national level), and in which the regulatory function in the strict sense of the term is rather performed at national level, the Commission intervening only indirectly for the purpose of regulating the regulators (either by taking an autonomous decision pursuant to Article 86(3) of the Treaty or by initiating infringement proceedings for failure to transpose the Community's legislative framework, or else directly by using the powers vested in it by Community competition law).

Can and will this model evolve? If so, in the direction of what type of organisation? Defining the outlines of actual and potential regulatory systems means, inter alia, exploring the relationship between competition and regulation, between the national level and the Community level, and between economic efficiency objectives and other objectives. These reflections can take the form of a number of questions:

- From a strictly economic point of view, which "market failure" problems are solved by opening the sector up to competition? Which are not solved in this way and will continue to require specific regulation other than that deriving from competition law in the long term?

The answers to this first series of questions obviously depend on the economic sector concerned. The problems differ in nature according to whether the area under scrutiny is the postal sector, where the infrastructure consists of manpower rather than cables, as in the electricity or telecommunications sectors, or pipes, as in the gas or water sectors. They also differ according to whether or not the sector concerned is "technology-driven". In the postal sector, for example, the instances of liberalisation which have occurred - generally without any accompanying regulation, as in Sweden and Finland - have demonstrated that this sector was a particularly favourable target for strategies which concentrate on the most profitable segment of the market (cherry picking) and, as a corollary, upset the balance of operators' overall activities. The following finding may also be noted: the distribution and management of scarce resources, such as radio frequencies for mobile telephones or air transport slots or frequencies, are bound to require in the long term public regulation of a technical nature which cannot be replaced by competition law alone. The same is probably true of certain rights of way in the traditional network economies.

- In what areas is it necessary to introduce or maintain specific legislation, in the short or medium term, in order to allow competition to take root and develop in sectors where the network has long been perceived as a natural monopoly, and

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where competition law alone is not sufficient to overcome these obstacles and give competitors effective access?

One naturally thinks of networks which cannot be duplicated or which can be duplicated only with difficulty, and of the conditions of access to these networks. In this connection, the question arises whether permanent specific regulation is justified or whether, once competition is firmly established in the future, such regulation could be assumed by competition law.

- What requirements other than the economically efficient operation of the market in question justify regulation? In these sectors, are restrictions on competition and the continued role of the public authorities in providing an impetus justified by specific factors or by the public interest?

We naturally think of the need to guarantee reasonable economic or social access costs for the consumer or preserve the universal character of the service, but also to take into account externality effects (e.g. spatial planning aimed at maintaining a dense postal network in sparsely populated areas) or negative externalities, the costs of which are not directly assumed by the firms operating on the market (e.g. taking account of environmental and public health costs in the regulatory system for transport).

- What have been, are and will be the economic effects of European integration in these sectors and, in particular, the externality effects on the rest of the economy? What conclusions may be drawn regarding the geographical level at which regulation may be carried out? How is account to be taken of the twofold requirement of creating a level playing-field on the one hand and guaranteeing efficient regulation as close as possible to the market on the other? In other words, should we evolve towards a European regulatory model which is more centralised or more decentralised than at present?

Could the national regulators themselves not carry out the arbitration currently performed by the Commission? Some argue in favour of such a possibility and claim in support of their argument that the case law of the Court of Justice and the Court of First Instance have established the direct effect of the exception contained in Article 86(2) of the Treaty. The national courts, therefore, can validly apply Article 86(2) of the Treaty to the disputes which they are called upon to settle. Why could the national regulators not do what the judge can do? The answer must, of course, be in the negative for a number of reasons: firstly, because, as with state aid control, it is essential that arbitration should be conducted by a body that is detached from national interests; secondly, because the regulator is required, or may be required, to define by means of its decisions a balance between economic efficiency objectives and general interest objectives, and would consequently have to act as its own judge; and, lastly, because it is essential for the future of economic integration in such sectors that the basic

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principles established by Community law should be applied in a consistent and uniform manner throughout the Union.

III - Three alternative regulatory models in Europe

The answer to these questions determines the scope and methods of any regulatory system, but also the balance between the different geographical levels at which regulation is enforced. Such an analysis must necessarily be carried out on a sector by sector basis because the economic features, the degree of integration of the markets and the nature of the problems that arise vary considerably from one sector to another. It must comply with the general principles mentioned above.

The broadly empirical "current Community model", as it was termed above, constitutes one possible means of reconciling a general approach with the need to define, on a case by case basis and for each type of public utility, the division of roles between:

- national level and Community level (i.e. and between national interest and Community interest, but also between rule-maker and policy-maker);
- specific regulation and regulation through competition law, i.e. control of the behaviour of monopolists and former monopolists (conduct regulation) and structural regulation;
- objectives geared exclusively towards economic efficiency and broader economic or non-economic objectives in the area of public policy (financing of public network services, taking account of externalities in regulatory systems, balance between safeguarding the interests of consumers and the interests of industry, etc.)

For all that, is it possible to define, on the basis of a single analytical grid, different regulatory models based on general, adaptable principles, taking account of the specific features of the different sectors? Three scenarios may be adopted for future regulation in Europe. These three scenarios are not necessarily alternatives. They could, to some extent, be cumulative, or succeed one another in time:
1- Persevering with the current model

The current model was described in detail in the first part of this paper. It is based essentially on the co-existence of two authorities: one regulatory and the other concerned with competition; there are, however, also national regulators which apply common standards (i.e. the rule-maker operates at Community level) and a European-level regulator for the regulators, viz. the Commission, whose job it is to ensure a level playing field. This set-up has the benefit of clarity: the rule-maker is essentially situated at Community level, while the policy-maker is essentially national.

However, the apparent clarity obscures a number of grey areas. Thus, the Commission, in doing its work of regulating the regulators, itself intervenes occasionally in the process as a prime regulator, sometimes competing with and in opposition to the national regulators, as was the case in Germany over the Deutsche Telekom interconnection charges issue. It is difficult to draw a clear line between the Community and national roles, and indeed, the line can be a shifting one. No clear distinction has been drawn between regulatory law and competition law. The assumptions underlying whatever form of arbitration is chosen – more especially between the national interest and the Community interest, but also between economic efficiency and other public interests – are not explicit.

And yet the system works. It gives the national regulatory authorities a great deal of latitude, provided the way they use this freedom does not contravene the common set of rules and does not upset the internal market. The jumbled roles and the general lack of clarity in defining the objectives for the various players in the regulatory systems in effect give the system the necessary degree of flexibility, while Commission action preserves a minimum measure of overall homogeneity.

It is quite conceivable for this system to continue in much the same way. On the other hand, there are those who think it unlikely that it can continue in its present state. As liberalised markets come to operate within a competitive system, the likelihood is that competition law will prevail over regulatory law. This is a scenario we shall be examining later.

One other possibility is that the system will simply evolve without shedding any of its essential characteristics. The current "radial" system, with the Commission at the centre operating a fairly centralist role as guardian of the Treaties, might evolve into a less rigidly centralised and more cooperative "spider's web" arrangement. This at least seems to be the implication from recent changes on energy regulation under the "Florence" process, and from the telecommunications practice of periodic meetings between national regulators and the Commission with a view to the exchange of best practice. The recent Commission Green Paper on the 1999 communication review seems to take this line too.

The increasingly frequent use of benchmarking techniques and the practice of comparing the decisions taken by the regulatory authorities in the various countries likewise suggest a move towards a more cooperative form of regulation, based increasingly on soft law rather than on hard law. What this would mean is a transfer of powers from the policy-maker to the rule-maker. With the rule-maker function
under the present system being a matter for the Community level, this kind of shift would be an important element in moving towards a more decentralised and more cooperative regulatory system.

A cooperative arrangement along these lines might operate according to rules similar to those set out in the Commission's 1999 White Paper on competition policy concerning relations between the Commission and the national competition authorities. The national regulatory authorities and the Commission would operate in a network based on ongoing contacts and periodic meetings so that all sides were kept informed about problems and could evaluate possible solutions and devise joint action. There would be nothing to prevent the national authorities taking over the proportionality checks which are currently the exclusive preserve of the Commission. The Commission would of course retain the power, in the event of an unresolved dispute, to take the matter to the Court of Justice or to intervene, as it has done in the past, on the strength of the powers vested in it by Article 90(3) of the Treaty. Ultimately, then, it would be up to the European Court to rule on any disputes.

2- Towards a European regulator

Is it conceivable that the current situation, in which the ground rules are laid down in Brussels but their application is largely decentralised, might evolve towards a centralised form of regulation at European level. There are well-known advantages to the fragmented nature of regulatory bodies. Chief among them is the fact that effective regulation is closer to the markets and the perceived problems, respecting the legal traditions of each of the Member States. On the other hand, decentralised application of the rules creates a risk of disparity in the way the rules are applied, to the detriment of free competition in an integrated European market.

Clearly, the more marked the convergence phenomenon (e.g. in the telecommunications sector), the less risk there is of disparities in the way fragmented bodies apply the rules. It is equally clear that the looser the regulatory framework, the greater the risk. But we should be careful not to overestimate the risk. Provided the regulatory framework is sufficiently clear and well-defined, there is no basic incompatibility between a fragmented control system and the harmonised application of rules. This, after all, is the case under the current regulatory model, where it is Commission action and the existence of clear common rules which guarantee a level playing field.

At first sight, then, it would seem that the disadvantages of a centralised regulatory system, i.e. a European regulator, outweigh the advantages, and that there are other, more effective and less disadvantageous, means of guaranteeing the uniform application of rules, due consideration for national specificities, and the need for regulation at the closest point possible to the market.

Having said that, though, there are certain sectors and/or segments of the market where the optimum situation might be a little different in terms of the level of centralisation. A centralised system might be justified where there are trans-border externalities. To take an example: we can reasonably ask ourselves whether Europe should have an air traffic control system which is more centralised than the present
one (e.g. by strengthening Eurocontrol's remit). Similar questions are raised by the regulation of trans-European transport networks, particularly from the energy angle. The recent merger between Vodafone and Mannesmann in the mobile phones sector is a further thought-provoking development, since it opens the way to a truly pan-European mobile phone market. It already seems clear that a number of regulatory issues cannot be addressed properly at national level alone.

To sum up this point, opting for a centralised European regulatory authority might seem logical at first sight, and have the advantage of putting an end to the ambiguous distribution of roles and overlapping powers (and hence the risk of decision-making conflicts between the various authorities) which characterise the current system. And yet, selecting this option might prove counter-productive in practice – by lowering the level of legitimacy and political acceptability of the regulatory system; by creating too wide a gap between the level of regulation and the concrete problems affecting economic players on the ground; and by shedding the flexibility which characterises the current system. Nonetheless, in certain specific cases described above, "European regulation" might prove to be the most effective form of organisation.

3- The gradual demise of sectoral regulation
It is clear that problems to do with market failures requiring sectoral regulation will persist in a number of markets. As was explained in point II above, the scale and nature of such market failures differ from one market to another. In other words, the need to maintain sectoral regulation will depend on the sector concerned.

On the other hand, and in relation to access to essential infrastructures, it is reasonable to believe that, once the market has been opened up by specific regulation (e.g. giving third parties compulsory access to networks; unbundling the local loop; interconnection charges, etc.), questions of network access will eventually become a matter for competition law alone. This is the view clearly taken by the European Commission in the telecommunications sector under its 1999 review. There are also clear indicators in two Commission communications: the "access notice" on the one hand, and the communication on the application of postal competition rules on the other. These two texts give a detailed explanation of the competition rules governing network access issues. The two communications are based in part on an adapted version of the US "essential facilities doctrine".

It is probable, then, that sectoral regulation will gradually give way to the general rule, viz. competition law. At the same time, though, it seems likely that wide areas of network utilities' activity will continue to require specific regulation over the long term.

Conclusion

It is probable, then, that the current architecture of the European system for regulating network utilities will have to change. Generally speaking, this should be in the direction of strengthening the relative position of competition law and reducing the importance of specific regulation. It should also lead to a more decentralised system across the board, based on the current model, as regulators move up the learning
curve. Finally, there are a number of sectors or segments which might require more centralised regulation, although in most cases, this could be done within a cooperative system of European regulation involving the Commission and the national regulators. Only a small number of highly specific cases might have to move towards a centralised European regulatory model (essentially the air traffic control regulatory set-up).