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PUBLIC V. PRIVATE ENFORCEMENT IN THE ELECTRONIC COMMUNICATIONS SECTOR

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Abstract

The 2002 Common Regulatory Framework diversifies remedies to competition problems according to the market strength of telecoms providers. One set of remedies is particularly targeted at posing constraints on (pre-)existing significant market power (SMP) in the relevant market. Those remedies are provided for in the Access and Interconnection Directive and in ascending order of intrusiveness they are transparency obligation, non-discrimination obligation, accounting separation, access obligation and price control. A second set of measures are meant to apply to all telecoms providers irrespective whether they have market power or not. This set of measures is introduced by the Universal Service Directive (USD).

This paper provides a comparison between sector-specific and competition law remedies and will examine the regulatory configurations in which either of the two regulatory regimes will give best results (Secion I). Having analysed the likely challenges for SMP remedies, it discusses the potential of number portability (NP) under the USD for enhancement of the state of competition (Section II). Remedies taken under a co-regulatory procedure are presented in Section III. Challenges to private enforcement of the competition rules in the telecoms sector are put forward and respective solutions to possible impediments to it are suggested in Section IV. Section V attempts to outline the predominant standard against which public and private enforcers will define harm from an antitrust violation.

Keywords

Telecoms regulation, competition law, electronic communications, private enforcement, public enforcement, remedies

Introduction[*]

The aim of an enforcement system is to create incentives to comply with the law by detecting violations and sanctioning the violators. Sector-specific regulation and competition law enforcement in telecoms are two means in the attainment of a common goal – effective competition.[1] Either of the two regulatory regimes uses a particular set of remedies in its respective tool box. The sector-specific remedies are exhaustively enlisted in the normative acts forming the 2002 Common Regulatory Framework.[2] The latter diversifies remedies to competition problems according to the market strength of telecoms providers. One set of remedies is particularly targeted at posing constraints on (pre-)existing significant market power (SMP) in the relevant market. Those remedies are provided for in the Access and Interconnection Directive[3] and in ascending order of intrusiveness they are transparency obligation, non-discrimination obligation, accounting separation, access obligation and price control. A second set of measures are meant to apply to all telecoms providers irrespective whether they have market power or not. This set of measures is introduced by the Universal Service Directive (USD).[4]

This paper will provide a comparison between sector-specific and competition law remedies and will examine the regulatory configurations in which either of the two regulatory regimes will give best results (Secion I). Having analysed the likely challenges for SMP remedies, it will also discuss the potential of number portability (NP) under the USD for enhancement of the state of competition (Section II). Remedies taken under a co-regulatory procedure will be presented in Section III. Challenges to private enforcement of the competition rules in the telecoms sector will be put forward and respective solutions to possible impediments to it will be suggested in Section IV. Section V will attempt to outline the predominant standard against which public and private enforcers will define harm from an antitrust violation.

I. Sector-specific v. competition law remedies

Differently from competition law remedies that are horizontally applicable to all sectors of the economy, sector-specific remedies are a tool of industrial policy. The core of the regulatory approach is succinctly described by Commissioner Reding:

∗ Comments and suggestions from Russell Pittman, US DOJ and anonymous reviewer are gratefully acknowledged.

1 M Stoyanova, "*Competition Problems in Liberalised Telecommunications: Regulatory Solutions to Promote Effective Competition*", Kluwer Law International, 2008

2 The 2002 Regulatory Framework comprises 5 Directives: Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108/33, 24.4.2002; Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive), OJ L 108/7, 24.4.2002; Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorization of electronic communications networks and services (Authorization Directive), OJ L 108/21, 24.4.2002; Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), OJ L 108/51, 24.4.2002 and Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on Privacy and Electronic communications), OJ L 201/37, 31.7.2002.

3 Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive), OJ L 108/7, 24.4.2002

4 Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), OJ L 108/51, 24.4.2002

> "We in Europe did not choose the revolutionary method of breaking-up telecoms monopolies by means of competition law. We choose instead the softer, evolutionary, but also more time-consuming path of regulating the former telecoms incumbents by sector-specific rules administered by national telecoms regulators – a process which has been remarkably successful in the past and which is possibly very typical for the special European approach to regulation. However, it is also a process which is not yet completed, but still ongoing".[5]

Competition law remains applicable to the electronic communications sector even when sector-specific regulation aims at correcting a market failure. Promotion of effective competition is only one of the policy aims set by Article 8 of the Framework Directive, the other ones being: development and consolidation of the internal market for electronic communications networks and services; promotion of specified consumer interests; implementation of policies aimed at cultural or linguistic diversity as well as media pluralism. A benchmark for effective competition in the relevant market is the presence or lack of SMP. Differently from the start of the liberalization process when regulators made the traditional distinction between infrastructure and services layers, regulation under the 2002 Common Regulatory Framework structures around the distinction between SMP and non-SMP services.[6] Thus definition of SMP is the tool for determining the existence of effective competition.[7] Given the parallel competences of sectoral regulators and competition law enforcers, the regulatory framework attempts to distinguish the scope of application of either of the two regimes to a particular competition problem. As the idea of regulation is to mimic competitive functioning of a market by designing corrections that competition itself does not yield, SMP in itself does not justify regulatory intervention in the undertakings conduct. Cumulative to it is the requirement that competition law alone is insufficient to constrain possible abusive use of high level of market power. Definition of SMP, similarly to the definition of dominance, relates to a static position at a given time, while abuse of dominance under Article 82 of the Treaty is established with reference to past behavior and is therefore conduct-related. Considering this distinction, sector-specific regulation is applied *ex ante*, before illegal conduct has taken place. The abuse of dominance provision entails *ex post* interference of competition authorities in an attempt to restore the competitive equilibrium.

The temporal distinction between sector-specific and competition law remedies is rather relative. Thus, remedies under merger control are an effective means to model the structure of electronic communications markets in *ex ante* fashion. Their goal, however, differs from remedies under sector-specific regulation. Merger remedies aim at preventing the emergence of significant impediment to effective competition. Although they are typically employed to prevent the creation or strengthening of a dominant position, they might as well apply to a transaction that does not result in the possession of significant market power by the parties to it.[8]

The current 2002 Common Regulatory Framework does not provide a fixed sunset date for sector-specific regulation. The latter will substitute for competition law once competition in electronic communications markets becomes effective. By this time, remedies to competition problems are provided through the complementary application of sector-specific and competition law.

In order to design adequate and timely responses, regulators have to be mindful of their respective weaknesses and strengths in dealing with a specific competition problem. Sector-specific regulators will be better placed to intervene, where compliance with the imposed remedy/ies needs periodic oversight. Sectoral regulators have access to necessary expertise to understand and correctly assess the technical determinants of market behavior and developments. They are likely to be more successful in

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5 V Reding, "Europe's Telecoms Incumbents: Friends or Foes of a Single Telecoms Market?", Speech/08/561, CEO Summit of the European Telecommunications Networks' Operators Associations, Venice, 25 October 2008

6 This distinction underlines the functional separation remedy, implemented in UK and Italy as well as different forms of asymmetric regulation in various telecoms markets.

7 Judgment in case 1043/3/3/04 – Hutchison 3G (UK) Limited from 29 November 2005, [2005] CAT 39

8 Case No COMP/M.3916 –T-Mobile Austria/Tele.ring, 26/04/2006

devising price control and following its implementation.[9] Sector-specific regulation might be the only means to remedy a problem that cannot be dealt with under competition law. Example of the latter eventuality is regulation of Next Generation Network (NGN) access. NGN will allow more efficient provision of multiple services over a single communication infrastructure.[10] NGNs are currently under construction and telecoms providers still do not provide services through them. Thus to apply competition law to next generation network access (NGA) would run into the difficulty of defining the relevant market[11] and as the access layers of NGN are non-operational yet, competition authorities would hardly collect sufficient evidence of past behavior that might constitute abuse of a dominant position. All those uncertainties are irrelevant for sector-specific regulation as the current regulatory framework upholds the principle of technological neutrality[12] and SMP services are subject to regulation irrespective of the technical or transmission means for their provision. This principle sets the focus of regulation on the features of a particular type of service supplied to customers rather than on the technical means or type of technology used for its provision.[13] While the technological neutrality principle does not substitute for the need to properly define and assess relevant markets it suggests the inclusion of access to NGNs in the relevant market despite of the differences in the service providing technology and to the extent that the services provided through the advanced network are substitutable with products delivered through the traditional networks. In its presentation on the 4th ETNO Annual Conference B. Langeheine specified the Commission's position in the following way: 'in cases where the same services are provided over the same or slightly improved networks, like in the case of VDSL in Germany, regulatory remedies should still apply. [...] only provision of indeed new services in indeed new markets in a start-up phase could justify removal of regulatory intervention'.[14]

Competition law remedies would be more advantageous on several occasions. Firstly, where the sector-specific regulatory remedies have not produced the envisaged result and correction of the regulatory outcome is necessary. Exemplary of this type of regulatory intervention is the European Commission's decision in the *Deutsche Telekom*[15] and *Telefonica*[16] price squeeze abuse cases. With regard to such type of intervention, however, academics rightly raise the concern that the European Commission acts like the "regulator of regulators",[17] particularly when the intervention of the European Commission contradicts a favored national regulatory strategy.

Secondly, competition law is an effective safeguard against regulatory evasion. The case law on refusal to deal provides examples where companies circumvent their regulatory duty to provide their competitors with access to essential infrastructure. Dominant incumbents cannot absolve from liability

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9 The inadequacy of competition law to impose pricing discipline on dominant undertakings was blatantly made evident by the Microsoft case, see for detailed discussion H First, "Netscape is Dead: Remedy Lessons from the Microsoft Litigation", WP N 08-49, New York University School of Law, 2008, available at http://ssrn.com/abstract=1260803

10 Explanatory note to the Commission Recommendation on regulated access to Next Generation Access Networks (NGA)

11 This and related difficulties are discussed in detail in the Explanatory note to the Commission Recommendation on regulated access to Next Generation Access Networks (NGA).

12 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a Common Regulatory Framework for electronic communications networks and services (Framework Directive), OJ L 108/7, (24 April 2002), Article 8 (1) thereof.

13 M Stoyanova, "*Competition Problems in Liberalised Telecommunications: Regulatory Solutions to Promote Effective Competition*", Kluwer Law International, 2008

14 see Cullen International, ETNO 4th Annual Conference, Flash Message 123/2006, (10 November 2006), available at<www.forum-europe.com/>.

15 Commission Decision of 21 May 2003, Case COMP/C-1/37.451, 37.578, 37.579 – *Deutsche Telekom AG*, OJ L 263/9, 14.10.2003

16 Commission decision of 04.07.2007 in case Case COMP/38.784 – *Wanadoo España vs. Telefónica*

17 G Monti, " The Role of Competition Law in European Regulation", Presentation at the EUI, October 17, 2008, Florence

for competition law infringements by claiming conformity of their practices with sectoral regulation. Even when companies comply with the prescribed regulatory remedies their behavior might prevent or restrict effective competition within the scope for autonomous conduct allowed by the regulatory regime.[18] The latter proposition is characteristic of the European approach in regulating the electronic communications sector. It differs from the situation in the US, where in its *Trinko* decision, the Supreme Court clarified that if a regulated incumbent has fulfilled its access obligations to the satisfaction of the sector-specific regulator, the antitrust rules do not apply.[19]

Thirdly, competition law might pre-empt sector-specific regulation when a potential competition problem is likely to arise from a planned concentration. This is usually the case under Merger control when a transaction is allowed under a number of behavioral and/or structural commitments. Possible competition concerns for harm to competition where a party to the concentration is dominant[20] are three-fold:

On the one hand, the traditional concern associated with market power is whether the merged entity will use it to restrict output and increase prices of the relevant products. Market power in this case is viewed as the ability of companies to set monopoly prices,[21] i.e. to exploit their market power to their own benefit.

The second preoccupation relates to openness and access to markets. In this context, the market power equals the ability of the merged entity to degrade or undermine the market mechanisms of effective competition. Emphasis here is on possible unjustified exclusionary practices. The issue of allowing access to dominant telecoms infrastructure was a central concern and was dealt with by imposing access obligation but in most cases by requiring compliance with non-discrimination obligation.[22]

The third concern is about leveraging opportunities following a merger, in particular, when they are "likely to inflate the share of a dominant or a near-dominant firm by empowering it to pre-empt

[18] Commission Decision on Deutsche Telekom margin squeeze case – Case COMP/C-1/37.451, 37.578, 37.579 Deutsche Telekom AG, [2003] OJ L 263/9, recital 54.

[19] *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*, certiorari to the United States Court of Appeals for the 2nd circuit, No. 02-682, decided January 13, 2004 In the words of the Court: "*When there exists a regulatory structure designed to deter and remedy anticompetitive harm, the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny"*.

[20] In *Gencor* the Court of First Instance stated the significance of dominance under merger control in the following way: "*it must be stated (…), that, while the elimination of the risk of future abuses may be a legitimate concern of any competent competition authority, the main objective in exercising control over concentrations at Community level is to ensure that the restructuring of undertakings does not result in the creation of positions of economic power which may significantly impede effective competition in the common market. Community jurisdiction is therefore founded, first and foremost, on the need to avoid the establishment of market structures which may create or strengthen a dominant position, and not on the need to control directly possible abuses of a dominant position*", see Judgment of the Court of First Instance in case T-102/96 – *Gencor Ltd. v. Commission*, [1999] ECR II-00753 (*Gencor*), paragraph 106

[21] Daskin and Wu suggest that "monopoly power can appropriately be defined as the ability to obtain monopoly *earnings* [emphasis in the original], rather than as the power to charge monopoly prices", because "whether we choose to focus on prices or profits, neither economic theory nor the law provide guidance on how high they must be before they constitute antitrust market power or imply anticompetitive effects", see AJ Daskin, L Wu, "Observations on the Multiple Dimensions of Market Power", NERA, *Antitrust Insights*, Fall 2005.

[22] See for ex. Cases COMP/M. 2803 – *Telia/Sonera*, 10 July 2002, COMP/M.4034 – *Telenor/Vodafone Sverige*, 22 December 2005, COMP/M.1795 – *Vodafone Airtouch/Mannesmann*

opportunities of competitors".[23] Merger control seeks to ensure that concentrations do not alter the market structure in a way to render it conducive to abuse of a dominant position.[24]

Following the adoption of the current ECMR, the role of merger control in oligopolistic markets became even more important as it covers gap cases that do not involve a clear market leader or allow for coordinated behaviour. This is exemplified by the Commission's decision in the *T-Mobile Austria/Tele.ring* merger. The competition concerns derived from the oligopolistic market structure of the mobile telephony provision in Austria and from the elimination of competition from Tele.Ring (with about 12 % market share), whose aggressive pricing had constituted a major competitive constraint to the established mobile operators like Mobilkom (with 42 % market share) and T-Mobile Austria (with 23 % market share).[25] The symmetry between the market shares of the largest two operators resulting from the transaction was considered to create a risk of price increases to the detriment of consumers. The suspicion of the Commission in this case was that the acquisition would lead to the creation of a position of collective dominance in the mobile services provision that would allow the oligopoly members to implement anticompetitive practices. In such setting, horizontal concentrations will be contrary to the competition rules if they result in the "elimination of important competitive constraints that the merging parties have exerted upon each other, as well as a reduction of competitive pressure on the remaining competitors".[26]

The EC Merger Regulation does not exclude from its scope of application concentrations between members of an oligopoly, which will not lead to direct coordination of their respective activities. Thus, if a merger gives rise to non-coordinated anticompetitive effects it is incompatible with the common market.[27] The decisive criterion in such cases is the envisaged effect of the transformation, i.e. whether it gives rise to a significant impediment to competition.

Although sector-specific regulation and competition law enforcement in telecoms have clearly defined scope of application to legally provided sets of factual circumstances, in certain instances both regulators interfere jointly to correct one and the same competition problem. Such type of interaction was seen on the occasion of the European Commission's *Telefonica* abuse of dominance case.[28] The European Commission imposed a 151 million euros fine on the Spanish incumbent for unfair pricing in the Spanish broadband market. Interestingly, the Spanish government strongly disagreed with the decision of the European Commission on the grounds that effective sector-specific regulation of Telefonica's prices was already in force. The Spanish government considered the abuse decision as an interference of the European Commission in the powers of the national regulatory authority and independently from the incumbent launched an appeal of the Commission's decision before CFI.[29] Deriving an argument from this reaction, Telefonica itself commented that:

> "Telefónica finds itself squeezed between two regulators - the national regulator (CMT) 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".

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[23] E Fox, "We protect Competition, You Protect Competitors" (2003), *World Competition* 26(2), pp. 149-165

[24] See Judgment of the Court of First Instance in case T-102/96 – *Gencor Ltd. v. Commission*, [1999] ECR II-00753, paragraph 106

[25] See the Commission's Press Release, "Mergers: Commission opens in-depth investigation into T-Mobil Austria's take-over of Tele.Ring", IP/05/1417, from 14/11/2005

[26] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (The EC Merger Regulation), OJ L24/1, 29.1.2004, recital 21

[27] The EC Merger Regulation, ibid, recital 25

[28] Commission decision of 04.07.2007 in case Case COMP/38.784 – *Wanadoo España vs. Telefónica*

[29] Case T-398/07; R Clotz, "Case note: Spain Appeals European Commission Decision Against Telefonica", eCCP, November 2007

The European Commission disagreed with such allegations and argued that its powers to apply the competition rules to abusive behaviour remain unfettered particularly in cases of sector-specific regulatory failure. A number of legal grounds can be added in support of this position.[30] Irrespective of the contravening arguments, however, *Telefonica* stands as an unfortunate example of disconcerted regulatory initiatives founded on the complementary set of sector-specific and antitrust legal rules. This undermines the undertakings' legal certainty. Another important aspect of regulation of telecoms stands out in the light of the Telefonica case. Regulators both at national and at Community levels face the difficult choice between different remedies under either of the two regimes. A justified question would be whether the European Commission chose the best tool to enhance effective competition in the Spanish broadband market by acting under the competition rules. One remains wondering whether the European Commission overlooked the possible effects of the sectoral remedies notified to it under the Article 7 consultation mechanism provided by the Framework Directive.[31] Even if this was not the case, it has to be borne in mind that under the 2002 Common Regulatory Framework the European Commission's veto powers do not extend also to suggested remedies. *Telefonica* is a good example pointing at the righteousness of the suggested amendment to the current framework to allow the European authority to block remedies that would likely be inefficient, ineffective or distorting competition in the internal market.[32]

Key for the success of regulation of electronic communications are its timeliness, the adequacy of the remedy to the nature of the identified competition problem, the proportionality of regulation to the market failure and consistency of regulation under the sector-specific and the competition rules. Timeliness is crucial particularly for the deployment and use of new technologies. Broadband proliferation, for example, is a top priority on the Information Society agenda and to secure the transition to fibre-based optical access networks, regulation and the respective remedies face two cumulative requirements: efficiency but also timeliness.[33] This is a precondition for the success of the Lisbon strategy and the European Commission's i2010 initiative: "Regulation must keep pace with technological and market developments".[34]

Adequacy of regulatory remedies requires correspondence of the regulatory remedies' design to the nature of the identified problem in the light of the factual circumstances of each individual case and the likelihood of its persistence over time. Thus regulators would avoid either wrongfully condemning (Type 1 error) or wrongfully allowing telecom providers' business practices (Type 2 error).[35]

The importance of proportionality as a principle was emphasized expressly in the 2002 Common Regulatory Framework and in the case law of the European Courts on the application of the Community competition rules. Proportionality as a principle of the current sector-specific framework is an important safeguard against excessive regulatory interference.[36] Thus the Explanatory

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[30] See the reasoning suggested by R Clotz, "Case note: Spain Appeals European Commission Decision Against Telefonica", eCCP, November 2007

[31] On the consultation mechanism see M Stoyanova, "*Competition Problems in Liberalised Telecommunications: Regulatory Solutions to Promote Effective Competition*", Kluwer Law International, 2008

[32] See Commission proposal for a 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 authorization of electronic communications networks and services, COM(2007)697 rev1.

[33] Draft Commission recommendation on regulated access to Next Generation Access Networks (NGA)

[34] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, "i2010 – A European Information Society for Growth and Employment", COM(2005) 229 final, 1.6.2005 ("i2010 initiative", hereafter)

[35] Type 1 error is a situation when regulation is in place while none is warranted. Type 2 error designates a failure of the regulator to detect a competition problem and to react accordingly.

[36] See the Access Directive, recital 28

memorandum accompanying the Commission recommendation on relevant product and services markets states that: "in order to establish that a proposed remedy is compatible with the principle of proportionality, the action to be taken must pursue a legitimate aim and the means employed to achieve the aim must be both necessary and the least burdensome, i.e. it must be the minimum necessary to achieve the aim".[37] According to an ECJ's ruling, a remedy under the competition rules will be proportionate when it is "appropriate and necessary in order to achieve the objectives legitimately pursued (…), it being understood that when 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".[38] Larouche expresses the view that "the principle of proportionality is perhaps the main vehicle used to introduce economic analysis in regulatory issues, with its requirements of rational connection, minimal impairment and proportionality in the strict sense'.[39] This view can be shared.

The need for consistency between regulatory interventions under the sector-specific and the antitrust rules was illustrated above with the controversies on the occasion of *Telefonica* case.

II. USD measures: number portability

A principle premise of the 2002 Common Regulatory Framework is that sustainable competition in the electronic communications sector is likely to emerge out of infrastructure competition between services providers. While claiming that network competition yields long-term gains, the regulatory framework equally allows for services-based competition despite of its short term beneficial effects. The ambivalent view of regulation towards infrastructure v. services-based competition is upheld in distinct legal documents forming part of the electronic communications package. The regulatory remedies provided by the Access Directive aim at promotion of infrastructure-based competition by envisaging measures to counter abusive use of significant market power enjoyed by incumbents. Allowing for asymmetric regulation of incumbents and their non-SMP competitors, services-based competition over the incumbents' networks is viewed as a stepping stone for new-comers to gain the minimum efficient scale to constrain the market power of dominant providers.[40] The idea behind this solution is to provide consumers with increased choice of providers and array of competing services under competitive pricing schemes in the short run. Thus, the benefits of the information society do not remain abstract policy goals but are brought "for real" to their ultimate beneficiaries – the final consumers. Enhancement of consumer welfare is not directly pursued by the provisions of the Access Directive. The latter directly applies to the relations between competitors and their business relations that will lead to the consumer welfare beneficial results.

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[37] Explanatory memorandum accompanying the Commission recommendation on relevant product and services markets, SEC(2007) 1483 final

[38] Judgment of the Court in Case C-331/88 – *The Queen v.Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa et al.*– Reference for a preliminary ruling.

[39] P. Larouche, 'The Role of Market in Economic Regulation' (2003), lecture delivered on the official acceptance of the office of Professor of Competition Law at Tilburg University, (14 November 2003). According to Larouche the requirement of rational connection stands for adequacy of the regulatory intervention to the nature of the identified competition problem and the likelihood of its persistence over time. The minimal impairment restricts regulation to what is strictly needed in each individual case and negatively obliges regulators not to impose undue obstacles to free competitive behaviour. Proportionality in the strict sense means that 'the results to be expected should stand in proportion to the impact of the measure', see P. Larouche, 'Legal Issues Concerning Remedies in Network Industries' (2002), paper presented on the conference 'Remedies in Network Industries', (25 September 2002).

[40] In economic terms, the possibility of asymmetric regulation arises by application of the so called "ladder of investment theory". The latter term was coined by Prof. M Cave, see M. Cave, "Encouraging infrastructure competition via the ladder of investment," *Telecommunications Policy*, volume 30, 3-4 2006, pp. 223-237

The Universal Service Directive, on the other hand, directly focuses on users' rights in their contractual dealings with electronic communications providers. Thus, as previously mentioned, the obligations provided by the USD are addressed to all telecoms providers irrespective of their market strength. Among the array of obligations under this directive, number portability stands out because of its complex goal. The measure implies that consumers of telecoms services can retain their number on the public telephone network independently from the organization providing the service.[41] Its potential is two-fold: firstly, it creates incentives for telecoms providers to compete on the merits and secondly, it enhances the consumer choice and the consumers' bargaining power vis-à-vis their telecoms providers.

As it consists of consumers switching suppliers, NP inevitably involves a certain amount of switching costs. The success of this measure critically depends on the level of pricing for this service. Pricing of NP did not go undisputed in practice and the ECJ had the opportunity to establish its elements:

1. Set-up costs to implement requests for NP – in a reference for preliminary ruling the ECJ recognized the set-up costs as a component of interconnection pricing referred to in Article 30 (2) USD. The reasoning of the Court goes as follows.

> "The set-up costs represent a large part of the costs which may be passed on directly or indirectly by the recipient operator to the subscriber who wishes to make use of the portability facility for his mobile number.
>
> Although such costs do not fall within the scope of the checks laid down in Article 30(2) of the Universal Service Directive, their fixing at excessive levels by donor operators, in particular those already established on the market which have a large client base, might dissuade consumers from making use of that facility, or even make it in fact largely illusory".[42]

2. Traffic costs of ported numbers.

The amount of switching costs for implementing NP is important, particularly considering that the electronic communications sector is investment and innovation intensive. Thus, where operators incur significant costs, firstly, in the construction of their infrastructure and secondly, in the technical solutions for implementing number portability, allowing suppliers to pass these costs on to consumers might be unavoidable.[43] In such cases, however, there is inevitably need of regulation and it is upheld by the USD, which requires that the switching costs are cost oriented and shall not dissuade consumers from switching. The approach of the USD towards NP is wise, as on the one hand, it draws the attention of regulators on the existence of switching costs and of those costs that incumbent suppliers may seek to impose in a newly competitive industry context. On the other hand, the European legislator chooses a regulatory forbearance as the amount of switching costs is not set out in regulation. The outer boundary for the regulatory interference in the pricing of NP is defined by the ECJ in the *Mobistar* case as a discretion of NRAs to define an effective method for implementing NP as, for example, fixing a maximum amount of the set-up costs:

> "Once it is established that prices are fixed on the basis of costs, that provision confers a certain discretion on the national authorities to assess the situation and define the method which appears to them to be the most suitable to make portability fully effective, in a manner which ensures that consumers are not dissuaded from making use of that facility".[44]

Putting a price cap on the set-up costs in the opinion of the Court can be done under the reservation that "it is genuinely possible for new operators to contest the application of maximum prices by operators already present in the market by showing that those prices are too high in relation to their

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41 USD, recital 40

42 Case C-438/04 Mobistar, [2006] ECR I-6675

43 OECD, "Competition Assessment Toolkit", 2007

44 Case C-438/04 Mobistar, [2006] ECR I-6675

cost structure". This statement of the ECJ has two important implications. Firstly, while regulation sets the upper limit of the pricing, it gives undertakings an autonomy as to the pricing of the individual elements forming the interconnection price. Secondly, the expressed Court reservation opens the way to avoid dependence from obsolete or costly technologies by allowing new comers to contest existing pricing of NP as too high. Thus the interests of consumers are better served as contestability of the market is guaranteed; where more efficient technologies can be employed consumers will benefit from higher quality of service and will derive greater utility at lower cost.

However, even if switching costs that undertakings have to bear are high, "the pro-competitive impact of reducing or eliminating the switching costs is sufficiently large that the regulator will wish to prevent suppliers from explicitly recovering such switching costs from consumers".[45] At the other spectrum of the regulatory scale lies the possibility that "in the case of switching costs imposed in an attempt to reduce transaction costs, consideration should be given to whether the reduction in transaction costs that may result in introducing the switching costs justifies its likely anticompetitive impact in reducing the actual incidence of switching".[46]

The duty of NRAs to secure competitive pricing of NP is a daunting task as the extent to which interconnection charges are cost oriented is difficult to assess. This is more the less so because pricing of this service depends to a large extent on the technology that operators have used for implementing NP. This understanding expressly emerges from the suggested by the European Commission changes to the USD under the current review process.[47] Misinterpretation of costs can also arise because of uncertainty about the number of consumers that might use NP to switch suppliers. Underestimating the number of portings would lead to charges above cost.[48] Economists suggest that "a price cap regime starting from the average cost of porting is likely to provide appropriate incentives for operators".[49]

The success of number portability can be compromised due to additional hazards. One of those is what the economic literature designates as the "customer ignorance problem".[50] When NP takes place, end users can no longer correctly identify the network on which their call will be terminated. Thus, if calling prices differ across networks, customers will be unaware of the exact charges for placing calls to 3rd operator's network.[51] In such circumstances, telecoms providers have incentives to set the termination charges above the average costs, profiting from the unawareness of consumers. And as terminating a call on the network of the operator to which the called party has subscribed has no substitute, operators are unobstructed to make (abusive) use of the SMP enjoyed in call termination over their proper networks.

Another factor that has the potential to decrease the success of NP is the time within which the NP is carried out. Timing matters, as from the time a consumer has declared its request to change the provider the ported number is not active till NP procedures are completed. Taking into account this hazard, in the current review of the 2002 Common Regulatory Framework, the European Commission suggested amendments to the USD aimed at "facilitating the switching of suppliers by consumers

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45 OECD, "Competition Assessment Toolkit", 2007

46 OECD, "Competition Assessment Toolkit", 2007

47 Proposal for a Directive of the European Parliament and of the Council, amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) N 2006/2004 on consumer protection cooperation, COM(2007) 698

48 S Buehler, R Dewenter, J Haucap, „Mobile Number Portability", Telecommunications Policy 30 (2006) 385–399

49 S Buehler, R Dewenter, J Haucap, „Mobile Number Portability", Telecommunications Policy 30 (2006) 385–399

50 Gans, J. S., & King, S. P. (2000). Mobile network competition, customer ignorance and fixed-to-mobile call prices. Information Economics and Policy, 12, 301–328.

51 S Buehler, R Dewenter, J Haucap, "Mobile Number Portability", Telecommunications Policy 30 (2006) 385–399

through, among other things, strengthened provisions on number portability".[52] The Commission proposes to set the maximum time limit for effective porting of numbers at one working day.

Consumers might be dissuaded from using number portability due to contractual arrangement with their current suppliers. One example for that is found in Buehler et al.: "In Germany, subscribers only have a relatively small timeframe of 5 months in which they can actually port their number (up to 4 months before their contract expires and until 1 month after expiry). Within this timeframe, portings usually take 6 days".[53] To deal with such undesirable situation the European Commission suggests another change to Article 30 of the USD: "(6) Without prejudice to any minimum contractual period, national regulatory authorities shall ensure that conditions and procedures for termination of contract do not act as a disincentive for changing suppliers of services".[54]

III. Co-regulatory mechanisms for remedies' design

1. Functional separation

The UK approach

Notwithstanding the implementation of remedies where SMP is found in the relevant market, reviewing the effect from their regulatory efforts, in a number of Member States, regulators noted that infrastructure-based competition was slow to appear and remained limited to specific network levels, while other parts of the incumbents' infrastructure remained persistent bottlenecks.[55] Economies of scale and high level of sunk costs rendered duplication of certain parts of the fixed network "either economically impossible or highly economically inefficient to try to replicate".[56] Thus, in order to promote sustainable competition regulators imposed remedies on incumbents aimed at securing access to the bottleneck facilities under non-discriminatory terms. Despite the regulatory endeavors to counter the market power of incumbents in the provision of access to their bottleneck facilities, the regulatory results pointed towards a regulatory failure to secure sustainable competition. While trying to prescribe to incumbents a competition enhancing mode of behavior, regulators' success was limited due to impossibility to order structural remedies where behavioral remedies did not give the desired results. Against such background, UK was the Member State which came up with a workable solution to the difficulties faced by the regulator. Under its Strategic Review of the telecoms sector, OFCOM proposed a number of regulatory options for securing access to the enduring bottleneck. For its future work, it expressed a preference for an approach termed as "real equality of access", which had two dimensions:

- "requiring BT's own downstream operations [to] use the same products, processes, and prices as those used by their retail rivals – equivalence of input in the jargon;

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52 Proposal for a Directive of the European Parliament and of the Council, amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) N 2006/2004 on consumer protection cooperation, COM(2007) 698

53 S Buehler, R Dewenter, J Haucap, „Mobile Number Portability", Telecommunications Policy 30 (2006) 385–399

54 Proposal for a Directive of the European Parliament and of the Council, amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) N 2006/2004 on consumer protection cooperation, COM(2007) 698

55 OFCOM, "Strategic Review" and AGCOM, , Allegato B alla Delibera n. 208/07/CONS, "Consultazione pubblica sugli aspetti regolamentari relativi all'assetto della rete d'accesso ed alle prospettive delle reti di nuova generazione a larga banda

56 OFCOM, Telecommunications Statement

> • and alongside that, operational separation within BT that would ensure that those responsible for overseeing BT's bottleneck assets had real incentives to wish to serve other operators in practice and on the ground with the same zeal, efficiency and enthusiasm as they served the remainder of BT's downstream activities". [57]

This regulatory option was foregone au lieu of market investigation reference of BT to the UK Competition Commission under the Enterprise Act, which could eventually order the structural breakup of the incumbent. This latter possibility urged BT in cooperation with OFCOM to craft a set of structural and governance reorganizations that would respond to the regulator's concerns. Thus BT suggested a functional separation between its units responsible for the provision of SMP and non-SMP services and products. Functional separation as a remedy does not exist among the set of remedies provided by the Access Directive but it was considered acceptable as a complement to the available sector-specific remedies. It was not designed and imposed by the regulator but came as a result of a co-regulatory procedure giving voluntary character to BT commitments. The alternative consideration of the two regulatory options, i.e. long and cumbersome market investigation, which could have resulted in breakup of BT v. functional separation through the suggested commitments reveals considerable efficiency of the second to the first. A prolonged market investigation, apart from engaging considerable resources of the regulator, would have put a burden not only on the incumbent but also on all market participants because of detailed requests for information and reporting requirements. It would have resulted in a withholding of investment and innovation for lack of legal certainty about the evolution of the competitive environment driven by regulation at a later point in time. In the absence of functional separation, OFCOM would have also come up with heavy remedies designed to counteract the incentives of the incumbent to discriminate between its retail divisions and its competitors. Compliance with cumbersome regulatory remedies would have induced such a high level of compliance costs that the benefits of the vertical integration of the incumbent might have been forgone.[58] For the benefits that it displays and for its good results, functional separation was put forward for inclusion among the set of remedies that can be imposed by NRAs under the prospectively revised Community regulatory framework.[59]

While the undertakings offered by BT detailed the SMP services and the supporting organizational changes, they also extended to the provision of those future services that BT intended to provide through the next generation network that it planned to construct. Thus applying the "equivalence of inputs" also to NGA, OFCOM acquired from BT commitment for interconnection with its prospective network.

In this spirit of co-regulation, OFCOM declared an expectation that functional separation would lead to greater deregulation:

> "Ofcom expects that the introduction of effective equivalence in upstream markets may warrant deregulation of downstream markets in two ways:
>
> • through the removal of remedies in downstream markets where BT has SMP; and
>
> • in some cases, through a finding that BT no longer has SMP in downstream markets".[60]

OFCOM carried out a review of the state of competition in those retail markets where BT was defined as SMP operator and lifted some regulatory remedies: the price cap on prices of residential calls was

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57 OFCOM, Telecommunications Statement

58 AGCOM, Allegato B alla Delibera n. 208/07/CONS, "Consultazione pubblica sugli aspetti regolamentari relativi all'assetto della rete d'accesso ed alle prospettive delle reti di nuova generazione a larga banda

59 Proposal for a 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

60 OFCOM, Strategic Review of Telecommunications, Final Statement

removed, while the one on wholesale line rental was reduced; the authority also mitigated the regulatory requirements towards BT's retail offers for business clients - BT was allowed to offer discounted offers for bundles of services, provided that the bundle can be replicated by other providers. Other potential areas for lessening of regulation related to leased lines, wholesale international services, wholesale broadband access and wholesale fixed narrowband services.

Parallel to the assessment of the then current regulatory practice by OFCOM under the Strategic Review of telecoms, BT adopted a plan for investment of 15-18 billion euro in the construction of NGN by 2012.[61] The expectations of the company were to reduce its costs with £1 billion per annum by 2008/9.[62]

The Italian Approach

Similarly to OFCOM, in 2007 the Italian sectoral regulator AGCOM launched a public consultation for the purpose of reviewing the state of competition in the provision of network access and evaluating the prospects for the evolution of broadband NGN.[63] In its decision for the opening up of the proceedings, the NRA expressed concerns that the Italian electronic communications markets displayed structural deficiencies stemming from the dominance of the incumbent Telecom Italia (TI) over the access infrastructure for telecoms services provision. In the course of the consultation, alternative telecoms providers, consumer associations and other stakeholders unanimously voiced their concern that the remedies that AGCOM had imposed on TI, including those aimed at securing internal-external parity of treatment, had actual and prospective limited success. The regulatory failure to promote effective competition was also attributed to a multitude of dilatory practices performed by the incumbent to the detriment of its competitors or prospective entrants. The call of the interveners was for more effective regulation of the incumbent including through the introduction of atypical corrective measures to its behavior, such as forms of functional separation of TI's access network.[64] Thus following the public consultation, considering that TI was notified as SMP operator in the provision of access to the fixed network and the then ongoing infringement procedures against the company for different forms of violation of the parity of treatment principle, AGCOM also undertook a review of the functioning of the imposed regulatory remedies. Where their outcome diverged from the *ex ante* prognosis, AGCOM declared determination to strengthen the regulatory obligations on TI through remedies having an "organizational nature, including measures aimed at securing the functional separation of the activities related to the provision of network access". In conformity with this statement, at the start of its periodic review of retail (markets 1 and 2) and wholesale (markets 11 and 12) access markets, AGCOM invited TI to suggest measures that it deemed appropriate to alleviate the Authority's and its competitors' anticompetitive concerns.

On June 19, 2008 TI offered a set of behavioral and organizational commitments aiming to correct the consequences from anticompetitive behavior and to eliminate the pre-requisites for such in the future. The preliminary set of commitments was subjected by AGCOM to market test and following

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[61] AGCOM, Allegato B alla Delibera n. 208/07/CONS, "Consultazione pubblica sugli aspetti regolamentari relativi all'assetto della rete d'accesso ed alle prospettive delle reti di nuova generazione a larga banda

[62] K Foster, "BT's perspectives for NGN and standards", ITU-T / ATIS Workshop, "Next Generation Technology and Standardization", Las Vegas, 19-20 March 2006

[63] Delibera n. 208/07/CONS, "Consultazione pubblica sugli aspetti regolamentari relativi all'assetto della rete d'accesso ed alle prospettive delle reti di nuova generazione a larga banda

[64] Delibera 626/07/CONS, Avvio del procedimento relativo alla revisione ed eventuale integrazione delle misure regolamentari atte a promuovere condizioni di effettiva concorrenza nei mercati di accesso alla rete fissa.

the results from it, the Authority asked for amendments that lead to a reinforced commitment of TI to eliminate structural weaknesses in the market due to its SMP. The major commitments are:[65]

First, TI agreed to conduct functional separation between its network operating and provisioning division and its services supply departments. TI undertook to establish a new division, called Open Access, which main functions were to manage, plan and develop the access network. Initially, those main functions of Open Access were not within the scope of the commitments. Only the wholesale provision of SMP services was their subject. With respect to the latter TI suggested a new services delivery based on the "one-stop-shop" principle. The wording of the Final commitments clarifies that the new delivery process proposed by Telecom Italia provides that activation activities, termination, change and migration of all SPM services covered by the Commitments will be managed without distinguishing work orders between Telecom Italia Retail and other wholesale customers. In addition, it was specified that the undertaking extends not only to the services which will be prospectively activated but also to those already active.

Second, in the Final proposal, TI suggested a system of "customer relationship management wholesale" for technical and commercial management of the relations between alternative operators and TI Wholesale on the occasion of SMP services provision and co-location. The measures from this group strengthen TI's obligation for non-discriminatory management of co-location arrangements with its competitors.

Another set of commitments envisaged that an incentive system had to motivate the staff of Open Access and Telecom Italia Wholesale to fully comply and further ensure parity of treatment of TI's retail services department and its competitors buying wholesale access from TI. The incumbent proposed also mechanisms for performance monitoring and transparency guarantees regarding the activity of Open Access.

TI also suggested a performance monitoring system for the SMP services, which will measure the qualitative parameters of the input of TI Network and TI Information Technology, necessary for the provision of SMP services. This monitoring would be applied to the extent to which the activities of TI Network and TI Information Technology contribute to the performance of Open Access.

A transparency commitment aimed at appeasing several apprehensions of competitors and AGCOM: firstly, TI envisaged procedures for surveillance of the effective functioning of the above-mentioned undertaking; secondly, competitors in the retail provision of access products would be informed about the technical plans for the quality and the development of the fixed access network in advance of their realization; in order to guarantee full compliance with the parity of treatment principle, TI undertook to implement an accounting separation mechanism, which was going to make evident the economic conditions for sale of the intermediary services provided by Open Access to TI's retail arm and TI's competitors in retail provision. TI undertook to make evident the transfer charge for access by means of an economic model designed by the incumbent and approved by the regulator within two months from the approval of the commitments.

A surveillance authority was to be instigated under special constituency procedure aimed at securing its unbiased functioning and independence from TI.

Considering ongoing sanctioning procedures, TI undertook to eliminate those practices questioned by AGCOM: it undertook an obligation to notify final consumers for the activation of unrequested services; obligation to communicate the deactivation of the carrier pre-selection services; prohibition on the technical personnel of wholesale access producing and operating units to approach final customers for sale of retail access products.

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[65] Delibera N 718/08/CONS, "Approvazione della proposta di impegni presentata dalla società Telecom Italia S.P.A ai sensi della legge 248/06 di cui al procedimento avviato con Delibera n. 351/08/CONS

AGCOM required TI to commit itself not to stifle innovation and competition in next generation network services. In order to guarantee the open nature of the NGN that TI plans to construct, TI proposed another set of commitments. It undertook an obligation to make an offer, coming from Open Access, for access and sharing of the so called “passive infrastructures”, the conditions of which have to be approved by AGCOM. It was made explicit that the commitments extend to all intermediary SMP network services provided through TI’s NGN. In the opinion of AGCOM, the proposed commitments had to anticipate the issuance of the Guidelines of AGCOM on the migration of alternative operators to NGN, particularly by suggesting workable solutions for co-location on TI’s premises. The incumbent undertook to prepare such Guidelines.

The Italian approach to functional separation differs from the one of the UK’s OFCOM. While functional separation in the UK was not provided by sector-specific regulation and could not be imposed by the NRA, the Italian national legislation admits such remedy under Law n. 248/06 on "Urgent measures for the development of growth, the promotion of competition and competitiveness, consumer protection and the liberalisation of productive sectors" and its Article 14-bis and empowers AGCOM to accept commitments.[66] Law n. 248/06 provides necessary and urgent measures directed towards, among others, ensuring full respect for the EC antitrust provisions and aims at securing compliance with the acts of the Italian NCA, the European Commission and the sectoral regulators favoring and promoting consumers’ choice and even more pro-competitive markets (Article 1). Notwithstanding EC sector-specific regulation, Article 14-bis allows AGCOM to accept commitments of any nature, arguably also structural ones, as complementary to sector-specific remedies. Thus differently from OFCOM, AGCOM could itself negotiate with the incumbent remedies with structural nature, while in the UK this is within the competences of the Competition Commission under the Enterprise Act.

Discussion

The above described UK and Italian co-regulatory measures are allegedly successful means to prompt the SMP providers to renounce from incentives for abusive use of their market power. Several are their advantages. On the one hand, functional separation is less costly for incumbents than structural separation in terms of forgone coordination benefits and economies of scope.[67] It provides SMP companies with an opportunity to propose the least restrictive to their business freedom reorganization of their activities to the satisfaction of the regulator. Settling regulatory concerns by commitments provides greater stimulus to prompt and full compliance, which does not generate more costs than the expected benefit from avoided lengthy and complex litigation or infringement proceedings with uncertain end. Competitors of the incumbent benefit from non-discriminatory conditions for access and facilities sharing with the incumbent at regulated terms, provided that the non-discrimination obligation can be successfully enforced.[68]

The efficiency of functional separation is also likely to have positive effect on the regulatory costs for design and surveillance the compliance with the regulatory remedies. As it is a remedy proposed by the incumbent, some of the regulator’s resources can be directed towards other fields that need

[66] Legge 4 agosto 2006, n. 248, "Conversione in legge, con modificazioni, del decreto-legge 4 luglio 2006, n. 223, recante disposizioni urgenti per il rilancio economico e sociale, per il contenimento e la razionalizzazione della spesa pubblica, nonche' interventi in materia di entrate e di contrasto all'evasione fiscale", pubblicata nella *Gazzetta Ufficiale* n. 186 dell'11 agosto 2006 - Supplemento Ordinario n. 183

[67] Crandall, R.W. and J.G. Sidak (2002), “Is Structural Separation of Incumbent Exchange Carriers Necessary for Competition?”, *Yale Journal on Regulation* Vol. 19, p. 335-411.

[68] An example for the difficulties in enforcing the non-discrimination obligation is the US case *US v. AT&T*, 552 F.Supp. 131 (DDC 1982)

attention. Functional separation also mitigates the regulatory weakness stemming from the imperfect information of regulators about incumbents' cost structures.[69]

The contribution of functional separation for securing non-discriminatory access to NGN is important. As it is imposed outside the Regulatory framework, NRAs avoid conflict of competence issues and legislative lacunas. An example for the latter difficulties is Germany, where the inclusion of access to NGN among the SMP services was much debated and conflictual issue, which had also a strong political bias.[70]

Despite of the above mentioned positives of introducing functional separation, the measure creates legal uncertainty in two respects. Firstly, being complementary to existing regulatory remedies, it is "aimed at facilitating the enforcement of obligations to provide access on a transparent and non-discriminatory basis – at least part of them can *prima facie* be considered as directly related and ancillary to these access obligations".[71] As such functional separation is a remedy and shall be notified to the European Commission under Article 7 (3) of the Framework Directive consultation mechanism. Otherwise, regulatory inconsistency among Member States might arise, threatening the right of undertakings to legal certainty. Secondly, functional separation can be used by SMP incumbents as a means for regulatory evasion, where the NRAs are prone to regulatory capture or deficiencies in the performance of their functions. The Italian case suggests that such fears are not overstated - functional separation was negotiated also in exchange of the termination of the infringement proceedings against the company for behavior that the commitments undertake to eliminate. And considering that the prospective effects of functional separation will be taken into account by regulators in the periodic review of the access markets, incumbents might be even more better off for relaxation of the regulatory burden on them. Such outcome would contradict the intention of the European Commission to introduce functional separation as a remedy under the EC Regulatory Framework but as "a new remedy of last resort", designed to deal with persistent competition problems and bottlenecks, where other remedies are not effective at achieving non-discrimination.[72]

In the light of the above discussion of the advantages and disadvantages of functional separation, it is submitted that forms of co-regulation are likely to strengthen the success of regulatory policies and shall be encouraged. However, functional separation as such seems to be linked to the stage of market development and to the state of effective competition. Thus, in the UK case, the European Commission did not raise concerns with regard to it but claimed it in contravention of the current Regulatory Framework in the Italian case. A possible reason for this "double standard" can be attributed to the bigger maturity of UK telecoms markets and to the more advanced state of competition. The Italian market presents very little market constraints to the SMP of the incumbent and the latter is constrained primarily by regulation. If functional separation is implemented in such setting, regulation might result in the two extremes of inappropriate regulation – over- or under-regulation of the incumbent TI.

2. Commitment decisions under Competition law

A form of co-regulation similar to the commitment decisions under sector-specific regulation are commitment decisions under competition law. Co-regulatory remedies can be agreed between the

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69 P.W.J. de Bijl, "Structural Separation and Access in Telecommunications Markets", CESifo WP n. 1554, September 2005

70 See for discussion on Deutsche Telekom's "regulatory holiday" see M Stoyanova, "Competition Problems in Liberalised Telecommunications: Regulatory Solutions to Promote Effective Competition", Kluwer Law International, 2008

71 European Commission's comments pursuant to Article 7(3) of Directive 2002/21/EC concerning cases IT/2009/0890, IT/2009/0891, IT/2009/0892, 14.4.2009

72 Commission's Staff Working document "Impact Assessment", accompanying the Commission's reform package of the 2002 Common Regulatory Framework, SEC(2007) 1473

undertakings and the European Commission and (some) NCAs either under an ongoing investigation for an infringement of Articles 81 and 82 of the Treaty or under merger control. In the first case, according to Article 9 of Regulation 1/2003

> "Where the Commission intends to adopt a decision requiring that an infringement be brought to an end and the undertakings concerned offer commitments to meet the concerns expressed to them by the Commission in its preliminary assessment, the Commission may by decision make those commitments binding on the undertakings".[73]

Commitment decisions under Regulation 1/2003, however, are not a means for the undertakings to escape liability under the competition rules. Commitments might be accepted where the Commission does not intend to impose a fine for an infringement.[74] A special feature of commitment decisions is that they do not state or disprove the existence of a violation of the competition rules. With view to that, ending up a case with a commitment decision might create difficulty for a follow-up private enforcement of the competition rules. In the system of parallel application of the EC competition rules, this undesirable effect can be mitigated as "Commitment decisions adopted by the Commission do not affect the power of the courts and the competition authorities of the Member States to apply Articles 81 and 82 of the Treaty".[75] Thus they leave the way to private enforcement open.

By requiring commitments from telecoms providers in exchange of positive regulatory assessment of their business practices, on a number of occasions the European Commission aimed at creating a new regulatory environment despite of or in the absence of sector-specific regulation. At the start of the liberalization process, commitments under competition law were a means for the European Commission to put pressure on governments to advance opening up of telecoms markets even before the legislatively provided start of liberalization initiatives. Such use of the antitrust rules for furthering regulatory objectives is exemplified by the Commission's approval of the Atlas joint venture.[76] Geradin argues that 'Clearance of JVs and mergers has often been used by the Commission to further regulatory objectives. For instance, in Atlas, a JV between France Telecom and Deutsche Telekom, the Commission granted a five-year exemption that provided inter alia that France and Germany liberalize alternative infrastructures, a requirement that was not yet imposed by EC telecommunications legislation'.[77] The decision on this individual case gives a roadmap and aims to put pressure for full telecoms liberalization in France and Germany by allowing for review of imposed restrictions on the parties to the joint venture (JV) 'once the new French and German telecoms liberalization laws are fully implemented and operative'.[78] The agreements between DT and FT on this occasion were found to contain a number of restrictive clauses but nevertheless the transactions were allowed to go through conditional on the commitment by the German and French governments to early infrastructure liberalization in 1996. The Commission's attempt to bind also public authorities of a Member State to oversee the behavior of their dominant companies was driven by the concern to allow

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73 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, published in OJ L 1, 4.1.2003, p. 1 (Regulation 1/2003 hereafter).

74 Regulation 1/2003, recital 13

75 Regulation 1/2003, recital 22

76 Commission Decision of 17 July 1996 in Case IV/35.377 – *Atlas*, OJ L 239, 19 September 1996,p. 0023 – 0056

77 D. Geradin and J. G. Sidak, 'European and American Approaches to Antitrust Remedies and the Institutional Design of Regulation in Telecommunications,' Handbook of Telecommunications Economics, volume 2 2005, pp. 517–53. M. Styliadou, 'Applying EC Competition Law to Alliances in the Telecommunications Sector', Telecommunications Policy, Vol. 21, No. 1,pp. 47–58, 1997

78 'Atlas-GlobalOne: Commission Gives Go-ahead to Global Telecommunications Alliance Conditional on Liberalised Regulatory Framework', IP/96/651 from 17 July 1996.

new entrants unobstructed access to the infrastructure indispensable for the competitive provision of telecoms networks and services.[79]

Later on, other Commission decisions reflect then-current priorities from the telecoms policy agenda. The approval of the Commission of British Interactive Broadcasting/Open (BiB hereafter) JV was particularly targeted at securing the best conditions for the realization of the EC policy priority for the emergence of network competition in the provision of pay-TV services.[80] BiB was a JV between a subsidiary of British Telecoms (BT) – the dominant telecoms supplier in the UK, BSkyB – the dominant provider of pay-TV through satellites for direct-to-home and cable reception, Midland Bank, providing a range of banking and financial services, and Matsushita Electric Europe – the electric appliances manufacturer. The primary activity of the JV was the development of the infrastructure necessary for the provision of digital interactive television services and the provision of digital interactive television services via satellite. The analysis of the Commission demonstrated that the envisaged cooperation had the potential to restrict competition between the parties to the agreement and between them and third parties. BSkyB was a major wholesale supplier of premium content – films and sports channels – to the other pay-TV competitors. The regulatory obligations imposed on BSkyB for supply of conditional access and access control services for use of its electronic program guide were decisive for the Commission's favourable opinion. Interestingly, however, the Commission did not consider them sufficient to appease its apprehensions and in addition to them required BSkyB to ensure interoperability of its set-top boxes with all other transmission systems that might be employed by competitors. This obligation imposed by the Commission sought to ensure intrabrand competition for provision of pay-TV services.

The Commission also raised concern regarding competition between networks, namely the provision of pay-TV services through the fixed network, operated by BT (interbrand competition). Because of its UK wide coverage, BT's upgraded infrastructure was the only conceivable medium term alternative for potential competition, capable of constraining the market power of the JV. Despite of the behavioral commitments, the Commission equally intervened to eliminate the incentives for BT to leverage its market power into this emerging market by requiring divestiture of some of its cable franchises and preventing it from acquiring new ones.

Commitment decisions under merger control bear resemblance to those under sector-specific regulation as they aim at ensuring in *ex ante* fashion a relief to a competition problem arising from market restructuring. In order to render a concentration compatible with the Common market undertakings might approach the Commission and to agree on commitments, which are "proportionate to the competition problem and entirely eliminate it".[81] Thus in its decision on the *Vodafone Airtouch/Mannesmann* merger the Commission considered that the integrated infrastructure of the merging parties could be described as an essential facility as access of competitors to it was a prerequisite for the emergence of competitive service provision in the period "prior to the building of alternative infrastructure and in particular of UMTS infrastructure".[82] The indispensability of this asset for competitors resulted from its "exceedingly difficult, if not highly unlikely" replication even through contractual cooperative joint effort (in the form of JV or strategic alliances) due to particular network configuration, the centralised management solutions and the ensuing mechanisms for efficient

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79 M Stoyanova, "Competition Problems in Liberalised Telecommunications: Regulatory Solutions to Promote Effective Competition", Kluwer Law International, 2008

80 Case IV/36.539 – *British Interactive Broadcasting/Open*, OJ L312, 1999

81 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (The EC Merger Regulation), OJ L24/1, 29.1.2004, recital 30

82 Ibid, 59; Veljanovski formulates the competition concern of the Commission in the following way: "The EC Commission argues that Vodafone would secure a first mover advantage which other operators could not replicate, and that it would thereby become the dominant (maybe even the only) seamless pan-European mobile platform", see C. Veljanovski, "EC Merger Policy after GE/Honeywell and Airtours," *Antitrust Bulletin* 2003.

cost and benefit allocation.[83] Non-merger related (objective) factors that rendered, in addition, the seamless integrated network non-replicable included segmentation of the existing networks and the difficulties in interconnecting them into a seamless integrated network; the need for regulatory approval either for cooperative agreements or mergers would have caused delays in companies becoming operational and would most likely require complex divestments due to horizontal overlaps in activity; agreements or mergers undertaken with the purpose of providing advanced pan-European services would require a large number of agreements in order to achieve a spread and coverage similar to the one that the parties to the *Vodafone Airtouch/Mannesmann* merger have; fixed and mobile telephony did not represent a competitive constraint on the merged entity because of the specific customers demand for wireless pan-European offer that the traditional fixed and mobile telephony services could not satisfy.[84]

With view to securing access to this essential asset, the Commission did not contend only with the structural remedy of divesting all shareholding held by Mannesmann in Orange but approved the merger under a set of detailed behavioural commitments seeking to compel the merged entity to share its competitive advantage stemming from developing the integrated seamless network with competitors. The merged entity assumed a non-discrimination obligation with regard to access to its integrated network, pricing and the quality of services provided through that network. According to the Commission's analysis these undertakings would allow competitors to gather foothold in the relevant market by providing services through the Vodafone Airtouch/Mannesmann infrastructure up to the point when they would have constructed a network of their own. The behavioural remedies were considered to produce also a structural effect on the market "in that they will make it possible to preserve a competitive structure of supply" and will prevent the emergence of a dominant position of the merged entity in the developing market for advanced seamless pan-European services.[85] Veljanovski criticises the Commission's reasoning on several grounds[86] and defines the inconsistence in it in the following way: "the merged entity did not create or enhance a dominant position in any existing geographical market, nor did it have a dominant position in any established relevant product market. Rather, what troubled the EC Commission was the merged entity's possible first mover advantage and possible introduction of an innovative product over a European geographical footprint".[87]

Similarly to commitment decisions of regulatory authorities, where the Commission accepts the proposed undertakings, its decision renders them obligatory for the parties to the concentration and their compliance in a timely and effective manner might be secured by conditions and obligations (Article 6, p. 2 ECMR). Thus commitment decisions negotiated with telecoms providers are an important tool either to pre-empt intervention of the sector-specific regulator or to cover cases that escape the application of the sector-specific regulatory framework.[88] Therefore they can be viewed as a safeguard of regulatory driven telecoms reform.

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83 Case COMP/M.1795 – Vodafone Airtouch/Mannesmann, 40

84 Ibid, 40 et seq.

85 Ibid, 60

86 C. Veljanovski, "EC Merger Policy after GE/Honeywell and Airtours," *Antitrust Bulletin* 2003.

87 Ibid.

88 See for ex. Case No COMP/M.3916 – *T-Mobile Austria/Tele.ring*, 26/04/2006, where the concentration was allowed after the parties undertook to divest UMTS frequencies and mobile telephony sites to operators with lower market share. For comments see A Nourry, "Commission Decides in First Gap Case Since Recast Merger Regulation", ILO newsletter, December 14, 2006

The way ahead

Two recent decisions of the European Commission regarding the electricity and gas markets in Germany are instructive about the way in which the Commission would likely apply Article 9 of Regulation 1/2003 in network industries.

Despite of the sector-specific liberalization initiatives for opening up of the electricity markets to competition, following its energy sector inquiry the Commission opened an investigation into the activity of E.ON – the German electricity incumbent, for alleged abuse of dominant position by two types of anticompetitive practices:[89] Firstly, as a wholesaler, E.ON deliberately did not offer for sale the production of certain power plants that were available and that it would have been economically rational to sell, with a view to raising prices, revealing a conceived and implemented strategy to deter third parties from investing in electricity generation. Secondly, as a transmission system operator, E.ON allegedly discriminated in favor of its own production affiliate. Even when it charged higher prices the overcharge was passed on to final consumers. The case was closed with commitment decision whereby the Commission obtained "unprecedented set of remedies" of behavioral but most importantly of intrusive structural nature. To address the first concern, E.ON undertook to divest about 20 % of generation capacity thus favoring the entry and the performance of competitors and newcomers. In order to appease the second Commission preoccupation it proposed to divest its transmission system business consisting of an Extra-High-Voltage (380/220 kV) line network and system operations currently run by E.ON Netz.[90]

In a case involving the German gas incumbent – RWE, the European Commission agreed to close the case under similar intrusive commitments of structural nature. The Commission suspected that RWE abused its dominant position by restricting its competitors' access to its gas transmission network and by applying a price squeeze through pricing aiming at lowering the margins of RWE's downstream competitors in gas supply. In reaction to the Commission's concerns, RWE offered to divest its entire Western German high-pressure gas transmission network.[91]

The two above-described cases deliver noteworthy messages for the way commitment decisions might be used also in the telecoms sector. Firstly, the European Commission determinedly uses the Article 9 of Regulation 1/2003 mechanism to further regulatory objectives pursued by a separate set of sector-specific normative acts. Secondly, the above mentioned commitment decisions impress with the intrusiveness of the negotiated structural remedies. Commitment decisions taken in application of Article 82 EC thus display an alarming tendency to regulate regulated markets even beyond the regulatory scope set in sector-specific regulation. This infringes on the undertakings' legal certainty and might create tension with existing regulatory remedies and their timeliness. Thirdly, by accepting heavy regulatory remedies under competition law, a competition authority risks to appropriate the functions of sector-specific regulatory authorities. It would be undesirable if competition authorities put a check on the exercise of sector-specific regulatory authorities (regulate the regulator). Fourthly, the door for over-regulation of the telecoms sector remains widely open as intervention under Article 82 EC goes beyond protection of competition from abusive practices but instead amounts to molding even more pro-competitive structure through regulatory-type of remedies.

With view to the multitude of regulatory remedies and regulatory patterns available under sector-specific regulation and considering the Commission's proposal under the current review of the 2002 Common Regulatory Framework to empower NRAs to impose functional separation as a type of

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89 Press Release, "Antitrust: Commission opens German electricity market to competition", IP/08/1774, 26th November 2008

90 Press Release, "Antitrust: Commission opens German electricity market to competition", IP/08/1774, 26th November 2008

91 Press Release, "Antitrust: Commission opens German gas market to competition by accepting commitments from RWE to divest transmission network", IP/09/410, 18th March 2009

structural remedy, it is submitted that competition authorities should better exercise forbearance in negotiating intrusive structural remedies when a particular company is already subject to sector-specific remedies. Otherwise, the competitive balance might be tipped in favor of inefficient competitors and entrants. Considering that the latter are already sheltered from the market power of the incumbent through the "ladder of investment" concept applied in sector-specific regulation, it is not necessary that commitment decisions under competition law are used for protecting competitors rather than competition.

IV. Challenges to Private Enforcement

In 2008 the European Commission issued a White Paper on Damages actions for breach of the EC antitrust rules.[92] Its primary goal was to suggest policy options for the creation of effective redress mechanisms allowing that victims of antitrust violations are fully compensated for their harm suffered. The suggestions put forward by the Commission are guided by several principles, the most important of which being: truly European solutions grounded in the European traditions and cultures and complementarity between public and private enforcement amounting to a partnership.[93] Thus, private enforcement of the competition rules including in the telecoms sector is not going to substitute public enforcement – "it is not 'either/or' but 'both'".[94] If successful, private enforcement would likely also increase the deterrent effect of the competition rules but deterrence is not its direct objective.

An important reason for the lack of private antitrust enforcement is the inability of Member States' procedural rules to take into due account the specifics of the substantive rights conferred to the customers and consumers by the competition rules. This general consideration is further exacerbated by industry specifics of the telecoms sector. One challenge comes from the multi-sided characteristic of telecoms markets. Typical of multi-sided markets is that an array of services is provided over a single platform and the same services can be used by a variety of customer groups,[95] while there are significant externalities between these groups. Another distinguishing feature of such markets is that infrastructure suppliers are able to price discriminate between the different groups. In such setting, a possible competition problem might relate to high prices, but if positive externalities are considered "apparently very high prices about which some customers complain very loudly may be part of a reasonably optimal payments package when all groups of consumers and investment incentives are properly taken into account".[96] And in the words of Motta/de Streel "In those markets, the side that conveys the most positive externalities on the others will naturally be 'subsidised' by the other sides, who may then (wrongly) appear to pay an excessive prices".[97] For the different groups to derive utmost value from the respective platform, they need to contribute financially to support investment in this platform. Such investments, however, tend to create highly concentrated market structures and this makes them disproportionally important in antitrust cases.[98] Thus private enforcement of the

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92 White Paper on Damages actions for breach of the EC antitrust rules, COM(2008) 162 final, 2.4.2008

93 N Kroes, "Reinforcing the fight against cartels and developing private antitrust damages actions: two tools for a more competitive Europe", SPEECH/07/128, Commission/IBA Joint Conference on EC Competition Policy, Brussels, 8th March 2007

94 N Kroes, "Reinforcing the fight against cartels and developing private antitrust damages actions: two tools for a more competitive Europe", SPEECH/07/128, Commission/IBA Joint Conference on EC Competition Policy, Brussels, 8th March 2007

95 Thus for ex. Provision of calls benefits not only the party that generates the call but also the receiving one.

96 B Lyons, "The Paradox of the Exclusion of Exploitative Abuse" in *"Pros and Cons of High Prices"*, Swedish Competition Authority, Stockholm, 2007, pp. 65-88

97 M Motta, A de Streel, "Excessive Pricing in Competition Law: Never Say Never?" in *"Pros and Cons of High Prices"*, Swedish Competition Authority, Stockholm, 2007, pp. 14-47

98 B Lyons, "The Paradox of the Exclusion of Exploitative Abuse" in *"Pros and Cons of High Prices"*, Swedish Competition Authority, Stockholm, 2007, pp. 65-88

consumers' right in the telecoms sector runs the risk of over or under-compensation depending on the national rules for establishing causality and harm. In multi-sided markets, unmeritorious stand-alone claims also cannot be excluded and this might contravene the essence of the European approach to private enforcement, which would like to avoid the creation or encouragement of litigation culture.[99]

Another difficulty to private enforcement stems from convergence. Convergence brings to deeper integration of products and services that traditionally belong to distinct markets. Thus, with regard to the effects of convergence, one distinguishes between the so called "functional convergence": formerly separated products and services are offered as combined services or products; "vertical convergence" taking place along the value chain and "horizontal convergence" which takes place along several dimensions: (1) between formerly separated industries such as the ICT sector and the content industry, (2) the lines between traditional ICT sectors, such as for ex. cable, fixed and mobile providers are blurring, consequently creating new competitive pressures and competitive patters of intensified competition and (3) "Entrance of new players or players from formerly different industries, into traditional ICT market segments like the VoIP software provider Skype into the telephony market or, the other way round, the ICT company Apple into the media industry".[100] Convergence requires adapting the standard competition law analysis to the specifics of telecoms as a dynamically competitive industry. It might render the economic assessment of the facts of each case a daunting task for judges who are used to applying the civil liability norms to relatively uncomplicated disputes.

Courts will run into difficulty when claims for damages are directed against cross-border companies. A conservative application of the national rules for establishing the effects of an antitrust practice might lead a court to decline jurisdiction where the effects of an anticompetitive practice are predominantly felt in a third Member state thus depriving local consumers from protection.

Innovation is a major driver of competition in the telecoms sector. Assessing its significance for the state of competition is crucial as it renders competition problems obsolete. Whether pronouncing on a follow-on action or on a stand-alone claim, judges would have difficulty to establish when a platform is no longer dominant and consequently, when a claim for harm from abusive behavior is no longer meritorious.

The above-commented difficulties can be attributed to the fact that judges limit themselves to points of law and are slow to reflect in their practices changes in market, technology and policy developments relative to a particular economic sector. Thus, for example, on a number of occasions, the Community Courts have endorsed an enhanced protection of new entrants vis-à-vis a dominant incumbent.[101] They consider smaller competitors of incumbents to be objectively in a different position that has to be taken into account by national courts when assessing the benefits of *ex ante* regulation and competition law enforcement by a public body.[102] However, as regulation allowed new entrants to progressively climb higher rungs of the ladder of investment, it is uncertain for how long such Courts decisions would be adequate response to the ultimate goal of sustainable infrastructure competition in telecoms.

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[99] N Kroes, "Reinforcing the fight against cartels and developing private antitrust damages actions: two tools for a more competitive Europe", SPEECH/07/128, Commission/IBA Joint Conference on EC Competition Policy, Brussels, 8th March 2007

[100] The proposed distinction between different types of convergence and the related examples follows the one presented in E-Business w@tch, "ICT and E-Business in the Telecommunications Industry", Sector Report N 9, 2006

[101] See for ex. Judgement of the Court in Joined cases C-544/03 and C-545/03 - *Mobistar v Comune di Fleron* from 8 September 2005; Judgement of the Court in Case C-462/99 – *Connect Austria v. Telekom-Control-Kommission*, 22 May 2003; Case T-475/04 of 7 July 2007 - *Bouygues and Bouygues Télécom v. Commission*, E.C.R. 2007, p. II-2097, para. 109

[102] A Verheyden & Y Desmedt, "Article 82 Guidelines—Missed Opportunities In the Telecoms Sector", *Global Competition Policy*, release Feb-09 (1)

V. Against what standard do we define harm?

While this question is of relevance to private enforcement in general, its answering is particularly difficulty when the tort-feasor is a telecoms provider. One way to prevent socially wasteful litigation is by not awarding damages where the market behavior meets socially efficient level of performance. The latter is specified by the sector-specific, the antitrust rules, NRAs and NCAs enforcement practice and jurisprudence. A prerequisite for establishing the standard for inflicted harm is deciding what type of efficiency the enforcer wishes to safeguard. The type of efficiency in its turn determines the pairs of provider obligations and consumer/customer rights that can be enforced before the civil courts by private action.

The pairs of provider/consumer rights and obligations are likely to vary depending on the exclusionary or exploitative nature of the illegal conduct that has inflicted the harm.

Neither the Community, nor national legal frameworks provide clarity over the set of rights that originate from the antitrust rules protecting from exclusionary behavior. A step toward their formulation is firstly, delineating the group of subjects that would be recognized standing to bring actions for damages for antitrust violations. This, however, is a difficult task as different normative acts and policy statements provide conflicting indicia. Thus the recently released Guidance on the European Commission's priorities in the application of Article 82 introduces the presumption that harm to intermediate buyers results in harm to consumers.[103] The notion of consumers is intended to encompass "all direct or indirect users of the products affected by the conduct, including intermediate producers that use the products as an input, as well as distributors and final consumers both of the immediate product and of products provided by intermediate producers",[104] which are actual or potential *competitors* of the dominant company. This statement raises a number of questions. Firstly, it leaves the impression that victims of exclusionary foreclosure might be only actual or potential competitors of an essential input provider. Secondly, if this is the case, are final consumers excluded from the ones eligible to seek compensation from the harm suffered? The definition of "consumer", however, seems to answer this question negatively. Such interpretation leaves the door open to private antitrust over-enforcement and creates tension with the stated purely compensatory nature of actions for damages. Thirdly, it remains unclear, when intermediate users are *not* competitors of the dominant input provider will the Commission assess effects on consumers?[105] Fourthly, the Commission states that "Where intermediate users are actual or potential competitors of the dominant undertaking, the assessment focuses on the effects of the conduct on users further downstream". A legitimate question that arises is how further down the vertical chain the Commission will stop to assess effect on consumers?

In search of answers to the above-mentioned questions and doubts, it might help to relate the policy statements found in the Guidelines on Article 82 to rulings of the Community Courts. Thus according to the ECJ *Manfredi* and *Courage* judgements[106] both intermediate buyers and users will be eligible to claim damages. While pursuant to the *Manfredi* decision, the group of the harmed ones is quite broad, the White paper on actions for damages attempts to restrict misuse of actions for damages for unjust

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[103] Communication from the Commission, "Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings", 3 December 2008, para. 19 in relation to ftn. 15; For critical assessment of this point see P Akman, "Consumer" v "Customer": the Devil in the Detail, CCP WP 08-34, 2008

[104] Communication from the Commission, "Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings", 3 December 2008, ftn. 15

[105] P Akman, "Consumer" v "Customer": the Devil in the Detail, CCP WP 08-34, 2008

[106] Judgement of the Court in Joined cases C-295/04 to C-298/04 – *Vincenzo Manfredi v. Lloyd Adriatico Assicurazioni SpA* and others from 13 July 2006, para. 61 and Judgement of the Court in Case C-453/99 – Courage Ltd. from 20 September 2001

enrichment by introducing the rebuttable presumption that the illegal overcharge was passed on to end users and therefore, the latter will have standing to claim damages from antitrust violation.[107]

The difficulties in defining the group of subjects eligible to bring actions for damages stem from the unequivocal stand of regulators as to the type of efficiency they wish to promote with their enforcement practice. In its Guidelines on the enforcement priorities of Article 82 of the Treaty the Commission emphasized that

> "In applying Article 82 to exclusionary conduct by dominant undertakings, the Commission will focus on those types of conduct that are most harmful to consumers. (…) The Commission, therefore, will direct its enforcement to ensuring that markets function properly and that consumers benefit from the efficiency and productivity which result from effective competition between firms".

And

> "The aim of the Commission's enforcement activity in relation to exclusionary conduct is to ensure that dominant undertakings do not impair effective competition by foreclosing their rivals in an anticompetitive way and thus having an adverse impact on consumer welfare (…)".[108]

Thus the Commission identifies consumer welfare as the predominant standard for social inefficiency of market behavior, which can equally justify awarding of damages. Despite the reiterated adherence to this theory of harm, academics are highly skeptical whether the Commission and the European Courts upheld it in their enforcement practice[109] and even if they do, their understanding of its essence is quite uncertain.[110] It is beyond the purpose of this paper to analyse in detail the pros and cons of the consumer welfare standard but for the purposes of the current analysis, the consumer welfare standard would be presumed to designate this part of the economic welfare, which "refers to the difference between what consumers would have been willing to pay for a product or service and the price that they actually pay".[111] While pricing is an important aspect for determining the trade-off between existing high level of market power and consumer gains, economic theory suggests that income distribution effects are another qualifier of welfare effects.[112] A problem would arise when the analysis of market efficiency does not regard consumer and producer interests symmetrically but shows a preference for a certain direction of the welfare flow. As stated by Williamson in his well-known article:

> "Hence if, as is probably common, the income redistribution that results when market power is increased is regarded unfavorably, an appropriate weighting of this factor will, at least occasionally, upset a net valuation which on resource allocation grounds is positive.
>
> Note in this connection that the transfer involved could be regarded unfavorably not merely because it redistributes income in an undesirable way (increases the degree of inequality in the size distribution of income), but also because it produces social discontent."

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[107] White Paper on Damages actions for breach of the EC antitrust rules, COM(2008) 162 final, 2.4.2008

[108] Article 82 Guidelines

[109] P Akman, "'Consumer Welfare' and Article 82EC: Practice and Rhetoric" forthcoming in 32 *World Competition*, 2009; KJ Cseres, "The controversies of the Consumer Welfare Standard", The Competition Law Review, Volume 3 Issue 2 pp 121-173, March 2007;

[110] P Akman, "Consumer" v "Customer": the Devil in the Detail, CCP WP 08-34, 2008

[111] This is the understanding proposed by the European Commission with regard to its Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU of 7.5.2009, C(2009) 3359 final, see the Staff WP accompanying the Recommendation, SEC(2009) 599; For suggested pricing mechanisms to prevent deadweight welfare loss see RW Pittman, "Russian Railways Reform and the Problem of Non-discriminatory Access to Infrastructure", *Annals of Public and Cooperative Economics* 75:2 2004, pp. 167–192

[112] O E. Williamson, "Economies as an Antitrust Defense: the Welfare Tradeoffs", The American Economic Review, 2001

In applying the Community competition rules, the European Commission and the European Courts are sensitive to the direction of income redistribution. One example can be taken from the case law on Article 81 of the Treaty. In the *Metropole* decision, the CFI determined the prerequisites for exempting an anti-competitive agreement under Article 81(3) and one of those cumulative conditions was the demonstration of benefits that will be passed on to consumers.[113] By requiring proof of benefits for consumers, EC competition law places strong emphasis on the importance of allocative efficiency[114] and also indicates the policy-desired direction of the resources' transfer. It is unacceptable if an agreement will allow one or both parties to it to engage in rent-seeking, while for example restricting output and/or consumer choice.[115] Proof of increase in the total social welfare is therefore not sufficient and consumer-welfare-enhancing distributive effects have also to be shown for exemption under Article 81(3) EC.

It is submitted that the consumer welfare standard is served through balancing productive and dynamic versus allocative efficiency. If allocative efficiency decreases more than productive and dynamic efficiency increase, damages will be necessary to compensate the welfare shift from consumers to producers. Where the competitive advantage is achieved through imposing costs on competitors and consequently reducing the current or potential supply of substitutes, "then the court should award damages that restore the competitor's prior level of productive efficiency".[116] The difficulty in the last case relates to the quantification of the illegal gain – it will be difficult to make a precise estimate of the benefit as a result of the competitor's diminished profitability. In those cases, there is a serious risk of under-compensation.

Admissibility of efficiency defence has the important role of filtering the cases in which damages should be awarded. Depending on the type of the efficiency defence upheld by the enforcement authorities and Courts in exclusionary type of abuse cases one can formulate the countervailing parties' rights and obligations. Differently from exploitative behaviour, where focus is on the direct effect on consumers' welfare, exclusionary tactics aim to reduce a supplier's product elasticity of demand and are therefore prejudicial to competitors.

Out of the case law on duty to deal it emerges that a dominant supplier of an indispensable input has not *a priori* duty to deal[117] but the exercise of an exclusivity right, in exceptional circumstances, clarified in the case law, might constitute an abuse.[118] On the opposite side of the relationship with a dominant supplier are two types of subjects: competitors and final consumers. In dealing with a dominant company competitors seeking an essential input have a right to equity in their commercial

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113 Judgment of the Court of First Instance in Case T-112/99 - *Métropole télévision (M6), Suez-Lyonnaise des eaux, France Télécom and Télévision française 1 SA (TF1) v Commission*, [2001] ECR II-02459, para. 74

114 Geradin observes that "EC competition law seems to primarily focus on 'consumer welfare'" and hence has as an important objective the promotion of allocative efficiency", see D Geradin, "Efficiency Claims in EC Competition Law and Sector-Specific Regulation" (2004), paper prepared for the First workshop on Comparative Competition Law, "The Evolution of European Competition Law – Whose Regulation, Which Regulation?", 12-13 November 2004, Florence

115 Guidelines on the application of Article 81(3) of the Treaty, OJ C 101/97, 27.4.2004, recital 21

116 JG Sidak, "Rethinking Antitrust Damages", *Stanford Law Review*, Vol.33, N 2, 19811981

117 Joined cases C-241/91 P and C-242/91 P, *Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v Commission*, [1995] ECR I-00743 (*Magill*), para. 49 and 50 and Case 238/87, *AB Volvo v Erik Veng (UK) Ltd.* - Reference for a preliminary ruling: High Court of Justice, Chancery Division - United Kingdom, ECR [1998] 06211 (Volvo), para. 7 and 8

118 Case C-7/97- *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG*.,[1998] ECR I-07791 (*Bronner*), Joined cases C-241/91 P and C-242/91 P, *Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v Commission*, [1995] ECR I-00743 (*Magill*)

dealings.[119] Corresponding to this right is the special responsibility of the incumbent not to discriminate between its own retail arm and competitors.

Out of the case law including *Magill*, *Bronner* and *IMS* there stems a right of expected profitability, contained implicitly in the replicability right. For the replicability obligation to arise, a series of legally relevant facts have to occur. It originates once regulators oblige the incumbents to provide access and interconnection with their infrastructure. Related to it is the right of current and prospective competitors to efficient expansion within the limits of the case law on refusal to supply.

Consumers of the product of an excluded competitor would be eligible to claim damages where the abusive practice has deprived them from the benefits of efficient competition in terms of greater choice, better quality, innovative products etc.

Considering that the substantive antitrust rules as exemplified above confer differing rights to the two groups of victims of illegal conduct, it is submitted that in the course of private enforcement of the competition rules Courts need to approach differently identification, qualification and quantification of harm suffered from an excluded competitor and from potential, past or deprived consumers.

With regard to exploitative abuses, crucial for the success of private enforcement is answering the question whether consumers have the right to competitive prices. Establishing what a competitive price is, is an always difficult question that is likely to present courts with real challenge for lack of expertise to conduct complex economic analyses involving price formation. This difficulty will increase where the defendant is a regulated multi-product operator, which production involves a large share of costs common for the production of an array of end-user services.[120] Courts, however, will be able to deal with this complexity if they approach the case verifying that competition is open and that prices are fair, i.e. that they are not formed as a result of an illegal exploitation of market power.

In order not to go beyond the compensatory nature of private enforcement courts need to be mindful of the implications of their rulings on the rate of innovation and investment in dynamically competitive industries, such as telecoms. A daunting task for them will be to ensure the best trade-off between investment incentives, innovation and affordable prices. They will have to make a choice whether to enhance consumer welfare today by admitting the claim or to promote dynamic efficiency and allow temporary monopoly pricing that will reward the innovator.

Countervailing the right of consumers to competitive prices is the right of the dominant supplier to exploit efficiently its market power. Thus if the pricing is not in abuse of a dominant position there would be no case for action for damages.

Private enforcement of consumers' rights stemming from the antitrust provisions might run into additional difficulty when it involves as a defendant a regulated telecoms incumbents. The White paper on actions for damages primarily suggests measures to create incentives for consumers to safeguard their rights stemming from the antitrust provisions before the national courts. It does not distinguish between regulated and unregulated addressees of the competition provisions and aims at crafting horizontal measures applicable to all. Over-zealous private enforcement in the telecoms sector, however, might create perverse incentives for competitors of SMP undertakings to put pressure on incumbents to offer SMP products under even more favorable conditions than the regulatory ones. A competitor might decide to abuse its right to a stand-alone claim in an effort to increase its

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[119] See for ex. The Commission's decision in Case COMP/C-3/37.792 – *Microsoft* and Judgment of the CFI in Case T-328/03 - *O2 (Germany) GmbH & Co. OHG v. the Commission*, 2 May 2006 (*Germany Network Sharing Agreement)*, para. 76-78

[120] See M Stoyanova, *"Competition Problems in Liberalised Telecommunications: Regulatory Solutions to Promote Effective Competition"*, Kluwer Law International, 2008 and the listed references; see also the reasoning of the US Supreme Court in *Trinko - Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*, certiorari to the United States Court of Appeals for the 2nd circuit, No. 02-682, decided January 13, 2004

bargaining strength vis-à-vis the incumbent. Even if a claim is not meritorious, it can be traded in exchange of better contractual conditions. In this way, private enforcement in telecoms could complement not only public enforcement of the competition rules but it might also pre-empt interventions of the NRA. Thus it might lose its intended compensatory nature and it might undesirably evolve as a self-regulatory instrument that might disproportionately seek to limit the right of dominant incumbents to compete aggressively on the merits with their smaller competitors.

The purpose of private enforcement in a regulated industry might also be compromised and costly unmeritorious litigation might ensue, if a sector-specific regulator intervenes to lower the prices that an incumbent charges for its products or services. While such intervention can be explained by a number of reasons such as change in the cost-accounting methodology, imposition or lifting of a regulatory obligation etc., in a situation of informational asymmetry consumers might decide to bring a claim for damages from excessive pricing.

Guidelines provided at Community level, which state the substantive rights and obligations of suppliers and customers, and/or consumers stemming from competition law might be a possible solution to the above-commented difficulties of courts in deciding procedural issues and in pronouncing on the merits of actions for damages resulting from exclusionary or exploitative abuse. This will contribute to overcoming divergences between Member States with regard to *locus standi*, access to evidence, establishing causality and defining and quantifying harm from antitrust violations.

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