



DISSERTATION

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The Treatment of Regulated Networks in European and US
Antitrust Law

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Nicole Daniel, LL.B. LL.M.

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I Foreword

Competition law has been a topic of interest to me since I researched which courses I want to take as part of my LL.B. in Law and German Law. After thoroughly enjoying the Competition Law course as part of my LL.B. I chose to take a LL.M. in Competition Law where I took a course on Regulated Networks and Competition Law and discovered my interest in the former too.

Accordingly only the intersection between sector-specific regulation and competition law came into question when I decided on the topic for my PhD thesis as these were the topics that most enthralled me during my time as a law student.

It makes me glad to say that these issues did not lose in appeal to me during my PhD studies where I spent hundreds of hours researching and writing this thesis.

This thesis is co-sponsored by the Stanford-Vienna Transatlantic Technology Law Forum (Stanford Law School/University of Vienna School of Law). This co-sponsorship is part of the Transatlantic Technology Law Forum Fellowship I hold.

I conducted research for this thesis at the library of the Law School at the University of Vienna, the library of the Institute of Advanced Legal Studies in London and the Stanford Law School library (as part of the Transatlantic Technology Law Forum Fellowship).

Last but not least I would like to thank Univ.-Prof. Dr. Florian Schuhmacher, LL.M. for his constructive criticism, his encouragement, his patience and for always lending an ear and being open to my ideas and suggestions.

II Introduction

This thesis will analyse and compare the legal situation in the European Union (EU) and the United States (US) regarding the relationship between regulated networks and competition law.

The different approaches regarding the hierarchy in the application of sector-specific regulation and competition law in the EU and the US are best evidenced by the EU decisions in the *Deutsche Telekom*¹ price squeeze case and the US Supreme Court decision in *Trinko*². These differing approaches will be central to the thesis.

The thesis starts with a general chapter on regulated industries or network industries setting out what they are and why they need to be regulated having regard to both economic and policy theories.

Then a chapter on how regulated networks in the EU are treated follows which highlights the EU policy of complimentary use of sector-specific regulation and competition law. Furthermore the leading cases exemplifying this EU policy are explained and analysed in detail.

A similar kind of chapter follows for the US policy on sector-specific regulation and antitrust law. As with the chapter on the EU the two leading cases exemplifying the US policy today are explained and analysed. Furthermore a recent Supreme Court decision on patents is included which might indicate of change of the ever evolving US policy.

Two chapters on the liberalisation efforts in the EU and the US follow to offer a full picture of the changed role of regulated networks as well as the different starting positions for liberalisation in the EU and the US.

This is followed by a chapter on the energy sector. I chose to dedicate a whole chapter to the energy sector since the EU and the US position are well exemplified in this sector,

¹ CoJ 14 October 2010, C-280/08 P *Deutsche Telekom AG v European Commission, Vodafone D2 GmbH, formerly Vodafone AG & Co. KG, formerly Arcor AG & Co. KG and others*.

² *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

where especially in the EU significant steps into the right direction for a competitive internal energy market were made in recent years.

In the final chapter the differences between the two approaches are traced back to their roots. This is followed by a direct comparison having regard to a number of criteria that in my opinion are necessary for a successful legal policy.

The aim of this doctoral thesis is to stimulate the discussion as to whether one approach is preferable to the other and/or whether the EU and the US should aim to develop a global approach on the issue of the antitrust treatment of regulated network industries, taking account of their different legal systems.

III Regulated Networks or Network Industries

A. What are Network Industries or Regulated Networks?

In network industries consumers attach themselves to a single or more networks. Networks connect users or producers through a single or more systems of physical infrastructure.³

Industries of the utility sector, e.g. energy, transport, communications, water and transport, are often described as network industries because of their dependence on some kind of physical distribution network. Electricity and telecommunication rely on wires, whereas gas and water rely on pipes.⁴ These are the most evident examples of network industries.

What they also have in common is that they involve elements of a national monopoly as the provision of their services presumes using a fixed network infrastructure with large sunk costs.⁵ Accordingly these industries are characterised by significant economies of scale and network effects.

The organization of such industries has undergone significant changes over the past three decades. These industries used to be organized mostly as vertically integrated monopolies. Accordingly the same institution managed the network as well as the provision of services.

Furthermore it was also the case that natural monopolies in networks supported monopolies engaged in the provision of services, e.g. by statutory regulation or market foreclosure. In Europe most of these vertically integrated monopolies were in state

³ **Invalid source specified.** *Fatur*, The Economics of the ICT Network Industries in *Fatur*, EU Competition Law and the Information and Communication Technology Network Industries (2012) 53.

⁴ *Baldwin*, Understand Regulation - Theory, Strategy and Practice² (2012) 443.

⁵ *Hellwig*, Competition Policy and Sector-Specific Regulation for Network Industries in *Vives*, Competition Policy in the EU - Fifty years on from the Treaty of Rome (2009) 203.

ownership whereas in the US most of them were held in private ownership and subject to sector-specific regulation.⁶

These industries have been reorganized by now; however, in a distinct way from industry to industry and country to country. Nevertheless common elements are the privatization of formally state-owned undertakings, the liberalization of the provision of services and vertical disintegration between network operation and service provision.⁷

These developments were mainly driven by the fact that it was recognized that natural-monopoly elements of the respective industry extend far less than previously thought. While networks may be natural monopolies, this is not always the case for the downstream activities based on the networks.⁸

There are two distinct sets of legal rules dealing with such monopolies: sector-specific regulation and competition law.⁹

Sector-specific regulation addresses market failures *ex ante*. According to the Court in *Oscar Bronner*¹⁰ allowing access to networks is better left to regulation. Independent regulatory bodies which enforce these rules may run the risk of infringing competition law.

The advantage of sector-specific regulation is the certainty it gives to market actors. However, it is the design of regulation that is important. It should be minimal so that ultimately competition law principles regulate the market and not impose unnecessary costs on the market players.¹¹

Accordingly such network industries are also called regulated industries since they are usually subject to sector-specific regulation, i.e. regulation designed for the specific

⁶ Hellwig, Competition Policy 2.

⁷ Hellwig, Competition Policy 2.

⁸ Hellwig, Competition Policy 3.

⁹ *Cole/Grossman*, Antitrust and Regulated Industries in *Cole/Grossman*, Principles of Law and Economics (2011) 361.

¹⁰ CoJ 26 November 1998, 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*.

¹¹ Szyssczak, The Regulation of the State in Competitive Markets in the EU (2007) 142-143.

industry in question.¹² The reason they are subject to specific rules is that market power, in this case rather monopoly power, is inefficient.¹³

In contrast to sector-specific regulation law competition rules apply *ex post* and are general rules. However, there are certain elements of sector-specific regulation that are part of competition law, for example merger and state aid notification schemes. Recently there is “a tendency towards creating sector-specific rules alongside encouraging the regulation of undertakings through private enforcement and remedies”¹⁴.

In *Deutsche Telekom*¹⁵ the Court of Justice (CoJ) *inter alia* held that competition rules continue to apply even if *ex ante* regulation is in place, unless that sector-specific regulation confers no margin of freedom to the undertaking “in which to pursue an independent pricing policy”¹⁶.

In contrast the US Supreme Court held in the *Trinko* case that where a regulatory structure exists that is designed to deter and remedy anticompetitive harm; behaviour falling under that regulatory structure will be immune from antitrust scrutiny.¹⁷

This thesis will essentially centre on the question whether the EU approach of using both sector-specific rules and competition law to deal with anticompetitive behaviour of a regulated network covered by sector-specific rules or the US approach of using only sector-specific regulation where the alleged anticompetitive behaviour falls under the scrutiny of such rules is more advantageous.

1. Monopolies and Natural Monopolies

Regulated Networks usually have their origins in a natural monopoly. A monopoly is natural when a single seller is the most efficient structure in the relevant industry.¹⁸ In a

¹² *Larouche*, Contrasting legal solutions and the comparability of EU and US experiences, in Leveque/Shelanski, *Antitrust and Regulation in the EU and US - legal and Economic Perspectives* (2009) 77.

¹³ See below chapter IIIA.1.a The economic Theory Behind (Natural) Monopolies and IIIA.2 Other Motives for Regulating.

¹⁴ *Szyszczak*, *The Regulation of the State* 143.

¹⁵ CoJ 14 October 2010, C-280/08 P.

¹⁶ *Alexiadis/Cave*, *Regulation and Competition Law in Telecommunications and Other Network Industries: Baldwin/Cave/Lodge*, *The Oxford Handbook of Regulation*, Oxford (2010) 12.

¹⁷ *Verizon v. Trinko*, 540 U.S. 398, 412-413 (FN 5). The cases are described in detail in chapter VF.5 *Verizon Communications Inc. v. Trinko*.

monopoly one seller produces the products for an entire market or industry. If the following three factors are present, monopoly pricing and output are likely to occur:

- The entire market is occupied by one seller.
- The product on sale is unique, i.e. there is no sufficiently close substitute consumers would turn to in the market.
- Substantial barriers to entry and exit exist.

A monopoly will strive to maximise profits, restrict output and price above marginal cost. The economic theory behind this is in short that if the monopoly charges a price for the product it will only achieve additional sales if it lowers the price on the whole output. Therefore it is more advantageous for the monopoly to sell fewer products and compensate for the fewer sales by simply charging an increased price for the product. Consequently, a monopoly results in reduced output and higher prices as well as a transfer of income to producers from consumers.¹⁹

The existence of natural monopoly technology was the central reason for establishing regulated industries; thereby introducing entry barriers, obligations to serve and price controls.²⁰ By asserting that there is a natural monopoly in an industry one at the same time assumes that there is a single best technology.²¹

According to commentators the history of natural monopoly justification can be traced back to John Stuart Mill, who in 1848 “*emphasized the problem of wasteful duplication of transmission facilities that can occur in utility services*”²². He also recognized that there are competitive problems when there are only a few competitors in a market: “*Where competitors are so few, they always end up agreeing not to compete.*”²³ The connection between natural monopolies and regulation was developed by Leon Walras for the

¹⁸ Kwoka, Networks and natural monopoly in Moss, Network Access, Regulation and Antitrust (2009) 17.

¹⁹ Baldwin, Understand Regulation 443- 444.

²⁰ Sidak/Spulber, Deregulatory Takings and the Regulatory Contract - The Competitive Transformation of Network Industries in the United States (1997) 20.

²¹ Sidak/Spulber, Deregulatory Takings 21.

²² Sidak/Spulber, Deregulatory Takings 21 citing Mill, Principles of Political Economy, 132-54 (1961).

²³ Stigler, The Economists and the Problem of Monopoly, in Occasional Papers from The Law School The University of Chicago, no.19 (1982), 1 (4).

construction and operation of railroads.²⁴ In the early part of the twentieth century the public interest view of regulating utilities was characterized by the assertion that on the one hand regulation was used to capture large-scale productions' efficiencies and on the other hand market power was controlled.²⁵

Deregulation was justified by the end of natural monopoly technology. If one firm is able to supply at a lower cost, the market than two or more firms, a production technology exhibits the property of a natural monopoly.²⁶ However, due to technological developments there exists much less natural monopoly technology nowadays.

a. *The economic Theory Behind (Natural) Monopolies*

One of the economic definitions of a (natural) monopoly is the following: "*A natural monopoly occurs when economies of scale available in the production process are so large that the relevant market can be served at the least cost by a single firm.*"²⁷

In a monopoly there is potential to abuse consumers as well as potential competitors since the monopolist has the power to set the prices and determine the output.²⁸ Furthermore, it is likely that a monopoly is inefficient since there is no competition in the market forcing the monopolist to work more efficiently or come up with better standards.

The comparison of a competitive market and a monopoly market will outline why competition is preferable to a monopolistic market:

²⁴ *Sidak/Spulber*, Deregulatory Takings 21 citing *Walras*, Études d'Économie Sociale: Théorie de la Repartition de la Richesse Sociale (1896).

²⁵ *Sidak/Spulber*, Deregulatory Takings 21.

²⁶ *Sidak/Spulber*, Deregulatory Takings 20.

²⁷ *Baldwin*, Understand Regulation 16.

²⁸ *Cole/Grossman*, Antitrust and Regulated Industries 362.

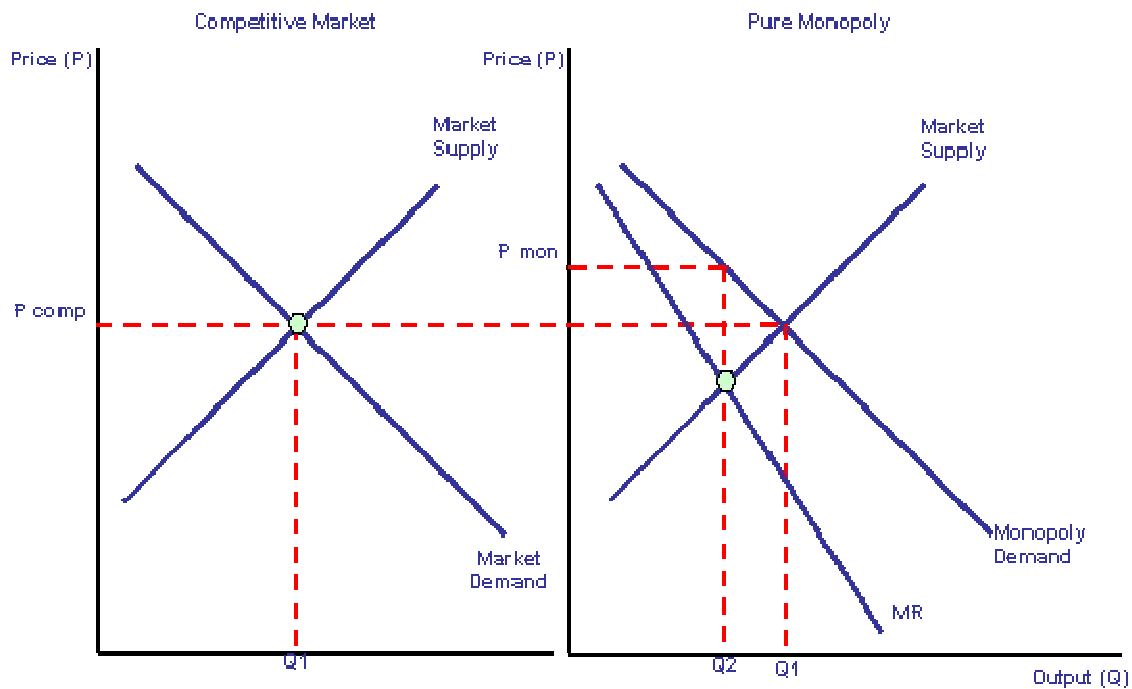


Figure 1 - Comparison Competitive Market vs Monopolistic Market

<http://www.intertic.org/Media%20Briefings/riley.html> (accessed on 29 May 2014)

Figure 1 shows a competitive market on the left and a monopolistic market on the right side.

The vertical line on the left side is the price (P) for a product or service in the market and the horizontal line below is the output, i.e. the quantity (Q), supplied on the market. In both markets an identical market supply curve (SC) is drawn from the lower left side to the upper right side in a diagonal line. SC represents the firm's cost. The costs of the firm tend to rise when output increases as it is most costly to produce an additional unit of a product or service.

In the competitive market the market demand curve (DC) represents the demand in the market. It is drawn from the upper left side to the lower right side in a diagonal line. The point (green dot in the left figure) where they meet is the equilibrium point, which represents the efficient allocation of resources, since the producers in the market supply the product or service in question at the equilibrium price (P_{comp}) to all consumers. The

equilibrium price is the price in a perfectly competitive market. Then there is no unsatisfied demand and no surplus supply in the market.²⁹ Q_1 is the ideal quantity in the market. Furthermore at this point the price is equal to the marginal cost (MC).

In the monopoly market we can see a shift where price and quantity meet, i.e. at the intersection of the monopoly price for the product or service (P_{mon}) and the output (Q_2). The price is now higher and there is less output. This can be explained as follows: Since the monopolist is the single supplier he does not supply the product or service based on cost relative to price. The monopolist has the power to choose the output level based on its costs relative to its revenues. After choosing the output level the monopolist sets the market price. This means the monopolist has the power to choose how much he wants to produce. Accordingly he will choose such a level of output that will maximise its profits.³⁰ That profit-maximising point (MC) is now the marginal revenue (MR).

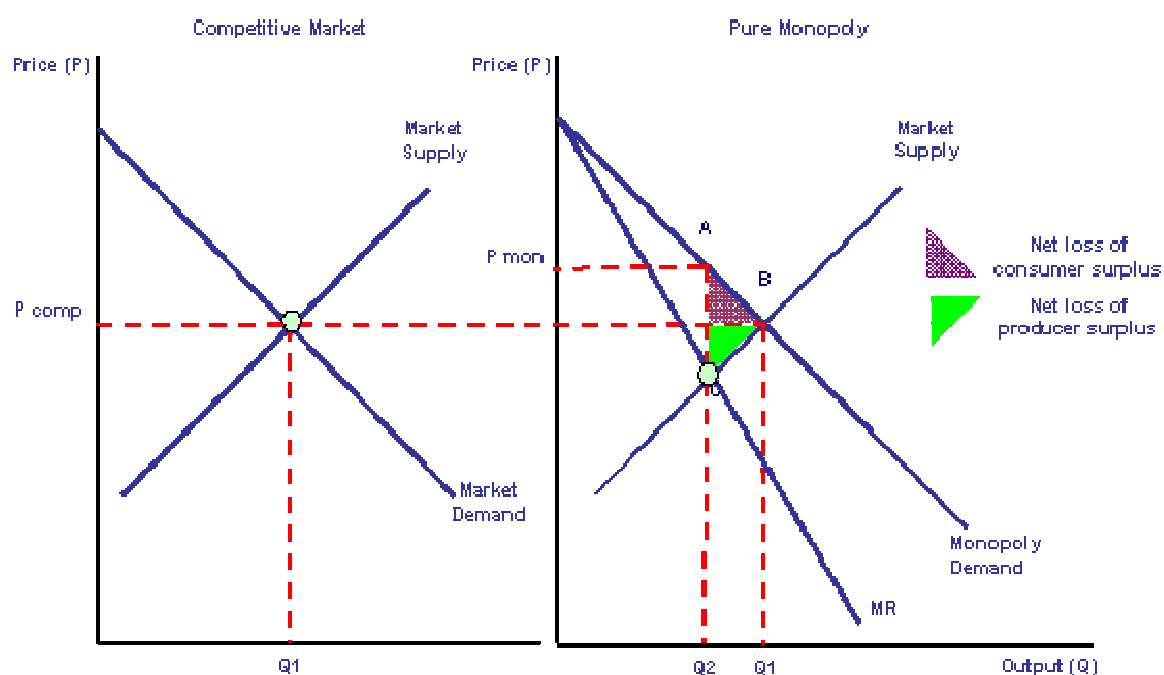


Figure 2 – Comparison II

<http://www.intertic.org/Media%20Briefings/riley.html> (accessed on 29 May 2014)

²⁹ *Cole/Grossman*, Antitrust and Regulated Industries 362.

³⁰ *Cole/Grossman*, Antitrust and Regulated Industries 362.

Figure 2 shows in the purple triangle that the price rise from P_{comp} to P_{mon} reduces consumer surplus. The green triangle shows that the reduction of output from Q_1 to Q_2 reduces producer surplus. Some of the reduction in consumer welfare due to the higher price is a transfer of profits to the producer; however some of the loss is not reassigned to a further economic agent. This phenomenon is called deadweight welfare loss (triangle ABC).³¹ This represents the loss to social welfare of the output which was not produced but could have been produced profitably.³²

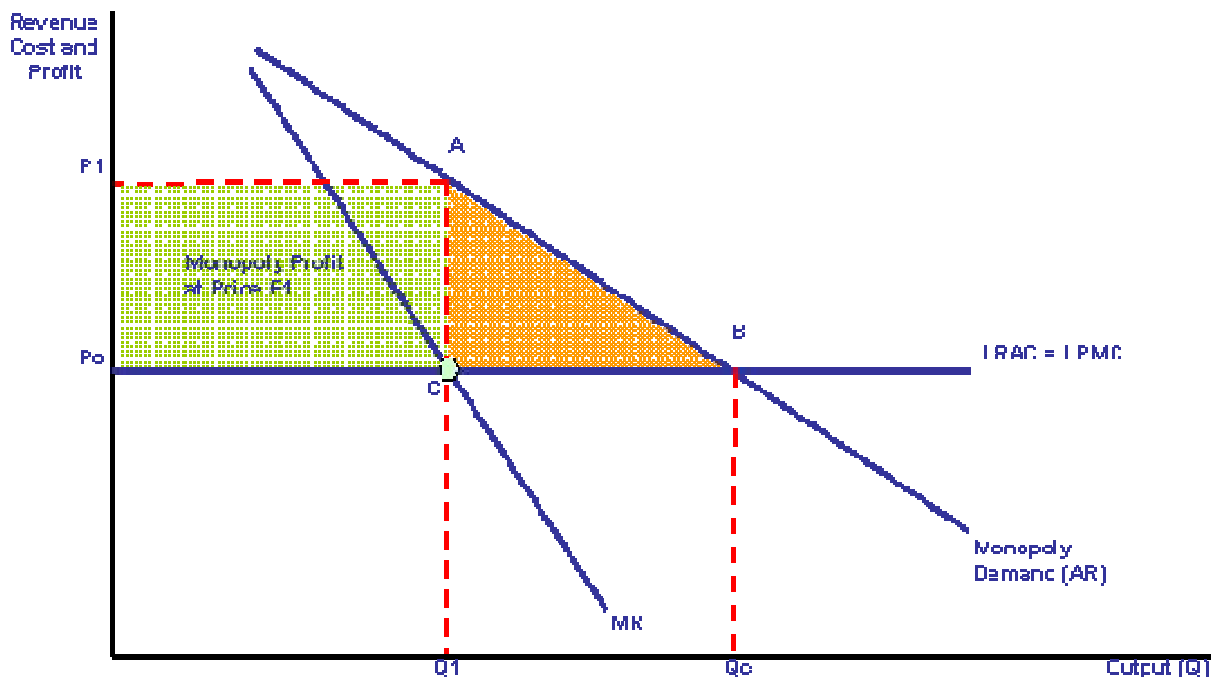


Figure 3 – Deadweight loss in ABC

<http://www.intertec.org/Media%20Briefings/riley.html> (accessed on 29 May 2014)

Figure 3 is a clearer description of the deadweight loss (triangle ABC). It also compares a competitive and a monopolistic market. In a competitive market the price is at P_c and the output at Q_c . In the monopolistic market the price is at P_1 and the output at Q_1 . The green box is the monopoly profit at price P_1 and output Q_1 . The orange triangle ABC is the deadweight loss. The long-run average cost curve (LRAC) is equal to the long-run

³¹ <http://www.intertec.org/Media%20Briefings/riley.html> (accessed on 29 May 2014).

³² *Cole/Grossman*, Antitrust and Regulated Industries 364.

marginal cost (LRMC). The marginal revenue curve (MR) and the LRMC demonstrate the costs and revenue of an additional unit of output. In a monopoly MR lies below the demand curve at all times. The amount of output where the additional revenue gain is matched by the production costs is when LRAC and LRMC are equal. When the monopolist produces up to this point he captures the maximal amount of profits.³³

This is also the basic rule for each monopoly: Choose price and output where **MR = MC**.³⁴

Result: In a competitive market the price is going down to MC, i.e. $P_c = LRMC$ (see Figure 3). This is so because the profitable market is open for competition and new entries. New suppliers will increase supply relative to demand which results in prices being driven down to the marginal costs of production. In a monopolistic market the output will be reduced to maximise the profits of the monopolist. This results in a loss to social welfare, i.e. the deadweight loss. Accordingly a monopoly has the potential to generate a market failure, since the monopolistic market does not efficiently allocate the resources to achieve the proper level of production. This means that the monopolist produces too little which he then sells at a too high price.³⁵

Economies of scale are also extremely relevant in this regard. They are present

*“if the marginal costs of production are less than the average costs of production over the relevant range of output. Stated differently, economies of scale are said to exist over the relevant range of output when unit costs decline with the volume of production. Economies of scale are a sufficient condition for natural monopoly for a single-product firm.”*³⁶

However, they are no precondition for a natural monopoly. It may still be less costly for a single firm to serve the market even though average costs are increasing.³⁷

A number of technological factors may cause economies of scale; in network industries **fixed costs** are of particular relevance in this regard.³⁸

³³ Cole/Grossman, Antitrust and Regulated Industries 363.

³⁴ Cole/Grossman, Antitrust and Regulated Industries 363.

³⁵ Cole/Grossman, Antitrust and Regulated Industries 364.

³⁶ Sidak/Spulber, Deregulatory Takings 21.

³⁷ Sidak/Spulber, Deregulatory Takings 21.

*“Fixed costs are costs that do not vary with fluctuations in output, unlike operating or ‘variable costs’. The fixed costs of establishing a network system are the costs of facilities such as transmission lines, which are not sensitive to the level of transmission on the lines.”*³⁹

Sunk costs also play an important role. They are “substantial nonrecoverable, market-specific investments”. Such costs are a precondition for establishing a network and therefore networks may be regarded as representing the “quintessential sunk costs”.⁴⁰ An incumbent firm with large sunk costs is one of most common **barriers to entry** into the market.⁴¹

What if the profitable monopoly market attracts a new supplier? When the market is entered by a second firm there are essentially two possibilities:

- The second firm would have a higher cost per unit and be forced out of the market.
- The second firm manages to achieve the same low cost as the current natural monopoly. The market would be oversupplied and one of the firms would be forced to exit the market.

It follows that in both cases only a single firm would survive.⁴² Accordingly, in case of a monopoly there is market failure since there is no competition.

The substantial market power of a monopolist may also be exercised by an industry with more than one market player, i.e. it is possible that a multiform industry acts like a monopolist. The obvious example is a cartel, i.e. the horizontal control of the industry. Another example is vertical integration.⁴³

To combat such market failure, competition laws serve to create an environment encouraging competition. However, often competition laws may be undesirable since it is less costly to society if only a single firm serves the market. An example would be

³⁸ *Sidak/Spulber*, Deregulatory Takings 22.

³⁹ *Sidak/Spulber*, Deregulatory Takings 22.

⁴⁰ *Sidak/Spulber*, Deregulatory Takings 25.

⁴¹ *Berg/Tschirhart*, Natural monopoly regulation - Principles and practices (1988) 28.

⁴² *Kwoka*, Networks 17.

⁴³ *Cole/Grossman*, Antitrust and Regulated Industries 365.

electricity: Rather than having a number of electricity companies lay cables where one company could do it, simply giving one firm a monopoly subject to regulation may be more efficient. However, the same problems as with other monopolies may follow, i.e. reduced output and higher prices as well as a transfer of income to producers from consumers. Introducing competition is no option since it will be more costly to society. This is where regulation comes in since the regulator will aim to set price near incremental cost (i.e. cost of producing an additional unit) to encourage the monopolist to increase output to the level it would be if there were competitive conditions in the market.⁴⁴

Importantly not all parts of the supply process may be subject to a natural monopoly. Accordingly it is the task of government and regulators to identify which parts may be naturally monopolistic and which parts may be open to competition.⁴⁵

Furthermore it has to be noted that not all apparent natural monopolies are served by a single firm only. For example some rail freight routes are served by two firms. In markets with sufficient demand density it is possible to exhaust all economies and permit a second producer who is cost-competitive.⁴⁶

Another noteworthy point is that it is also possible for an apparent natural monopoly market to transition into a non-monopoly market. This may happen if technological changes reduce the necessary scale in the market or if demand growth overtakes economies of scale. Examples are offered by the telecom and the newspaper sectors.⁴⁷

To establish welfare improvements that are lasting the introduction of competition is necessary. However, one should not forget that a market with effective competition requires firms to fail. This requires private ownership since public undertakings may more easily be bailed out than private ones. Accordingly private ownership is advantageous to achieve efficiency gains.⁴⁸

⁴⁴ *Baldwin*, *Understand Regulation* 16.

⁴⁵ *Baldwin*, *Understand Regulation* 17.

⁴⁶ *Kwoka*, *Networks* 18.

⁴⁷ *Kwoka*, *Networks* 18.

⁴⁸ *Klein*, *Network Industries in Helm/Jenkinson*, *Competition in Regulated Industries* (1998) 40.

Accordingly the economic theories behind monopolies evidence that it is necessary to regulate monopolies to a certain extent to combat market failure. Ideally a market with a well regulated monopoly serves to create competitor and consumer welfare. However, when reading the economic theories about monopolies and thinking them through one is induced into believing that extensive regulation is necessary to “control” monopoly power. But in my opinion one should not underestimate the power of the market to regulate itself and other legal instruments, e.g. competition rules. Therefore regulation has to be designed in a way to take account of that selfregulatory power of the market and other instruments available that quasi-regulate behaviour in the market. I am also of the opinion that one has to be sceptical about whether monopolies are nowadays still necessary. Due to technological developments monopolies rooted in the structure of the product or service in question, e.g. owning a distribution network, will vanish over time. Where a monopoly is a consequence of success in the market (e.g. Microsoft) one has to question whether the motives for regulating still apply to the same extent. Also the selfregulatory power of the market in such a situation will gain even more significance.

2. Other Motives for Regulating

Next to economic theories of regulation there are also other theories and motives of why regulation of networks is necessary. Next to public and private interest theories and theories related to them there are also the Contractual Theory and a theory arguing that regulation is not necessary.

a. *The Public Interest Theory*

As we have seen above the economic objective for regulation is the control of market power; but there is also a social objective, i.e. to ensure that all households receive a basic level of service which is considered as essential to existence.⁴⁹ Also countries will want to ensure that access to essential goods for a reasonable price is guaranteed as well as the protection of their markets, e.g. water in Austria.

This theory appears to be quite vague, because of the different approaches and meanings attached to public interest. An example is that sometimes monopoly regulation is seen as a

⁴⁹ *Alexiadis/Cave*, Regulation and Competition Law 1743.

possibility to eliminate monopoly rents. *"Rent is a return to a resource owner over its opportunity cost."*⁵⁰ For the monopolist all profits are rents or payments in excess of what is necessary to employ the resources in use. Such rents can have different meanings to regulators and consumers. Examples are that rents may be regarded as unearned enrichment; accordingly they need to be eliminated for equity or income distribution reasons. An efficiency criterion might be raised by others. Yet others could argue that monopolists try to replicate the competitive market.⁵¹

*"Rate-of-return regulation, in attempting to provide utilities with a 'fair' rate of return on capital, computes the allowed rate of return based upon the notion of the rate of return earned by investments of equivalent risk. The problem, however, with this approach is that application of the methodology allows considerable scope for discretion, and all sorts of self-seeking are seen to masquerade behind the veil of public interest rhetoric."*⁵²

Nonetheless of its relative and vague concept this theory is in my opinion one of the most relevant motives for regulating monopolies next to the economic theories described above. This is so because both in the EU and in the US the public interest and consumer welfare are of (at least theoretical) importance when designing market rules, even if, as argued by Crew *"all sorts of self-seeking"* could be masqueraded behind the public interest.

b. The Capture Theory

The Capture Theory sees regulation as a means by which undertakings establish or enhance their already existing monopoly power. Through regulation the market is provided with barriers to entry, a cartel office and monopolist price discrimination which is obviously advantageous for the monopolist. Expenditures on manipulating, maintaining or even forming the regulatory process are seen as a cost-effective investment.⁵³ This theory may also be described as a private-interest theory as opposed to the Public Interest Theory above.⁵⁴

⁵⁰ Crew, Deregulation and Diversification of Utilities (2012) 6.

⁵¹ Crew, Deregulation 6.

⁵² Crew, Deregulation 6.

⁵³ Crew, Deregulation 6-7.

⁵⁴ Vietor, Contrived Competition - Regulation and Deregulation in America (1994) 311.

This theory is closely tied with lobbying which is an ever growing industry with lots of power both in the EU and in the US. Where a regulatory agency or another institution created to act in the public interest is "captured", i.e. the concerns of specific interest groups are advanced, then this can result in negative consequences for the public or the other market players. From the perspective of a monopoly it may well be better to influence the rules that effectively influence the market than to rely on an either unregulated market or a market with disadvantageous rules. This is so since - as explained above - a new market entry may still be able to compete with the monopolist, especially if the technical development of production or provision of service changed so as to essentially lower the barriers to entry (e.g. wireless internet), and thereby lower the market share of the then former monopolist or even drive it out of the market. Accordingly the Capture Theory is not to be underestimated in its importance.

c. *The Organizational Theory*

This theory is essentially the overlap of the public interest and the Capture or Private Interest Theory. It is a dynamic model based on detailed empirical evidence and/or first-hand experience.⁵⁵

“This tradition, which tends toward qualified models and does not purport to generalize as readily as the others, attributes motive, process, and outcome primarily to individuals and organizational factors within regulatory bureaucracies. To a significant extent, the evolution of regulatory policy can be understood, industry by industry and agency by agency, only through the intellectual traditions, entrepreneurial skills, and political ambitions of key individuals in the regulatory bureaucracy. Related aspects of bureaucratic process, such as information dependency, informal procedures, organizational culture, judicial review, and budgetary constraint, add to the explanatory validity of this perspective.”⁵⁶

As this theory is essentially an overlap of two theories which are both undisputedly relevant as motives for regulation its relevance for regulation is given.

⁵⁵ Vietor, Contrived Competition 312-313.

⁵⁶ Vietor, Contrived Competition 312-313.

d. *The Contractual Theory*

This theory stresses the importance of efficiency and fairness towards utilities that took high risks, e.g. investments that become sunk costs, to provide services and goods.⁵⁷

*“It supports the view that regulation is relatively efficient, given the transactions cost of alternative governance structures and the failure of classical contracting to provide for efficient outcomes in environments characterized by asset specificity, long-term relationships, and opportunities for strategic behaviour.”*⁵⁸

Accordingly the Contractual Theory views regulation as a form of governance structure which is especially relevant for markets which are characterized by natural monopolies. Utilities are required to make investments that then turn out to be sunk costs, e.g. building a plant. Such a plant may have no or only limited value except for its current use. This generates an *ex post* risk that consumers will take away the quasi rents. Regulation deals with this problem effectively by providing an exclusive franchise in the respective service territory. Thereby regulation provides the undertaking in question with an *ex ante* incentive to invest and provide services while at the same time protecting consumers from exploitation by the monopolist.⁵⁹

This theory can also be related to the Capture Theory since it is the monopolist that wants to make sure that its investments do not turn out to be valueless. Therefore the monopolist will strive for legal rules that protect its investments. This relates to the theory of legitimate expectations. Furthermore this theory has also political and economic aspects. Politicians will not want to cause undertakings to loose their investments as this can result in financial problems which usually lead to a reduction of costs, i.e. discharging employees (i.e. voters) and other unfortunate consequences, e.g. the loss of tax income. Especially in the US the stop of campaign and party donations is also a topic of importance to politicians. Furthermore financial problems of a monopolist may well have negative effects on the market too.

⁵⁷ Crew, Deregulation 9-10.

⁵⁸ Crew, Deregulation 9.

⁵⁹ Crew, Deregulation 9.

e. *The Public Choice Theory*

“This by-product theory explains the existence and success of organizations representing agriculture, labour, and the professions. Consumer groups typically fail the selective benefits pre-requisite.”⁶⁰

If a potential interest group's common good has characteristics of publicness then group formation will be hindered by the free-rider problem which leads to weakening group pressures. So to be effective large pressure groups need to be organized for other reasons providing selective benefits for their members. Importantly such large pressure groups have to be able to pressure the common interest as a sort of by-product of the actual benefits they want to obtain.⁶¹ The interest groups can be regarded as rent seekers.⁶²

“In the public choice approach, politicians are modelled as providing a brokering function in the political market for wealth transfers. Voters and special interest groups capable of effective economic organization ‘demand’ such transfers. Other voters, and more general groups, incapable of such effective economic organization, ‘supply’ such transfers, albeit at a political price. The politicians effect market equilibrium, balancing benefits against costs at the margin, thus maximising their own utility functions, weighted variously in terms of expected wealth, expected votes, and ideology.”⁶³

In this public choice concept demand is the willingness to pay in money and/or in votes. Supply is the inability or unwillingness of those (in our case regulated networks) from whom transfers of their wealth are sought to protect themselves using money or votes.⁶⁴

“Where political market discretion exists, rent-seeking interest groups predictably will emerge with the principal objective of transferring rights (more narrowly wealth) to their respective memberships. Such interest groups are a major source of rent dissipation both in the democracies and autocracies. The emergence of countervailing rent protection further serves to dissipate potential wealth in such an environment.”⁶⁵

This theory ties in with my analysis on the Contractual Theory. Without voters there is no power for a political party. Power is essential for a political party to achieve its goals. Since votes (in a democratic environment) are vital for the achievement of power the

⁶⁰ Crew, Deregulation 11.

⁶¹ Crew, Deregulation 11.

⁶² Crew, Deregulation 12.

⁶³ Crew, Deregulation 13.

⁶⁴ Crew, Deregulation 13-14.

⁶⁵ Crew, Deregulation 14.

wishes of the voters are an important aspect to be taken account of when deciding whether to design rules and how such rules should look like.

f. *The Nihilistic Theory of Regulation by Posner*

In 1969 Posner⁶⁶ attacked natural monopoly regulation out of his personal experience as a lawyer engaged in regulatory matters⁶⁷.

*“[...] even in markets where efficiency dictates monopoly we might do better to allow natural economic forces to determine business conduct and performance subject only to the constraints of antitrust policy.”*⁶⁸

Posner argued that the regulation of monopolies was ineffective and failed to prevent monopoly profits by instead distributing profits as cross-subsidies. Furthermore dynamic inefficiencies resulted from protecting the monopolist from entry into the market of competitors. In his opinion large welfare losses are unlikely to result from monopoly profits.⁶⁹

In 1975 Posner⁷⁰ tried to quantify the effects of unregulated monopolies compared to regulated monopolies. He also included the effects of transactions costs and concluded the following:

*“[...] the costs of monopoly are quite probably much greater in the regulated sector than in the unregulated despite the greater size of the latter sector.”*⁷¹

This is a truly interesting theory, however there is no prove (“quite probably” cannot be qualified as prove) that in a regulated sector the costs of the monopoly are higher than in an unregulated sector. Also the economic theories behind monopolies and the other theories highlighting needs and motives for regulation as explained above evidence the need for natural monopoly regulation. In my opinion the question whether such regulation is necessary is not as important as the question of how to design regulation that does not go

⁶⁶ Posner, Natural Monopoly and Its Regulation, in Stanford Law Review 21 February 1969.

⁶⁷ Crew, Deregulation 10.

⁶⁸ Crew, Deregulation 10 citing Posner, Natural Monopoly and Its Regulation, in Stanford Law Review 21 February 1969, 548.

⁶⁹ Crew, Deregulation 10.

⁷⁰ Posner, The Social Costs of Monopoly Regulation, in Journal of Political Economy 83/4 (1975), 807.

⁷¹ Crew, Deregulation 10-11 citing Posner, The Social Costs of Monopoly Regulation, in Journal of Political Economy 83/4 (1975), 807 (821).

too far, ties in with other legal instruments and in the end serves consumer and competitor welfare.

3. Network Architecture

Networks have a number of different configurations; depending on those configurations the magnitude and types of issues around networks may differ. Accordingly, it is helpful to first analyse the respective network structure in question.

Links connected by nodes make up a network. In a network a number of components are necessary to provide the service in question. The network components are complementary. For a network to operate, nodes and links need to be compatible.

In this regard it is important to note that there are two-way networks and one-way networks. In two-way networks the transactions can originate at any node and terminate at any node, as long as the nodes are not central. In a one-way network some of the non-central nodes are to be distinguished from others, and sensible transactions flow in one direction only. The various network industries may be categorized into two-way and one-way classes. Telephone, roads and highways, rail, bus and truck transport, airlines, inland water transport, ocean shipping, package delivery, postal service, bank checks and payment clearance systems as well as e-mail and chats belong to the two-way networks. On the other hand one-way networks are for example broadcasting and cable television, electricity, oil and gas pipelines, water pipelines, Bank ATM systems and the World Wide Web.⁷²

As seen from the examples above networks can be real or virtual. In the latter the links that connect the nodes are not physical as the real networks, but there are no less vital for competitive strategy and market dynamics.⁷³

Furthermore transactions between nodes belonging to the same category make no sense (see Figure 7 for an example).⁷⁴

⁷² *White*, U.S. Public Policy toward Network Industries (1999) 5-8.

⁷³ *Fatur*, The Economics of the ITC Network Industries 56.

⁷⁴ *White*, U.S. Public Policy 7.

“Network architecture” is the term referred to when one speaks of network configurations, of which there are a number of types.⁷⁵ Below are some of the most common types of networks.

a. Star Network

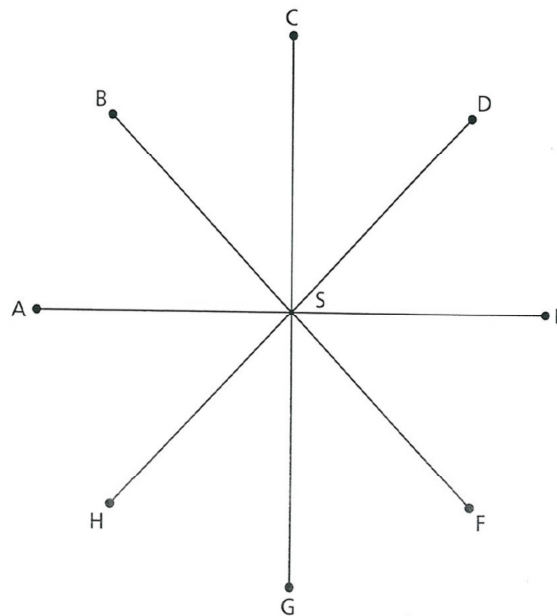


Figure 4 - Star Network

White, U.S. Public Policy 4

Such a simple star network may represent a local telephone system. Calls between, e.g. A and B are routed through S, the central node or switch.⁷⁶ It could also represent a local electricity distribution system.⁷⁷

“Such a structure economizes on the number and length of links necessary to provide all possible node-to-node transactions, but it requires that the central nodes have the capacity and the capability to handle all transactions among the nodes.”⁷⁸

⁷⁵ *Fatur*, The Economics of the ITC Network Industries 54.

⁷⁶ *White*, U.S. Public Policy 3.

⁷⁷ *Fatur*, The Economics of the ITC Network Industries 54.

⁷⁸ *White*, U.S. Public Policy 3.

Especially in such a simple star network the central node (hub) is very important. It must have an appropriate size to accommodate the demand in the market. Such a central node could be a bottleneck or even an essential facility.⁷⁹

b. Circular or Ring Structure

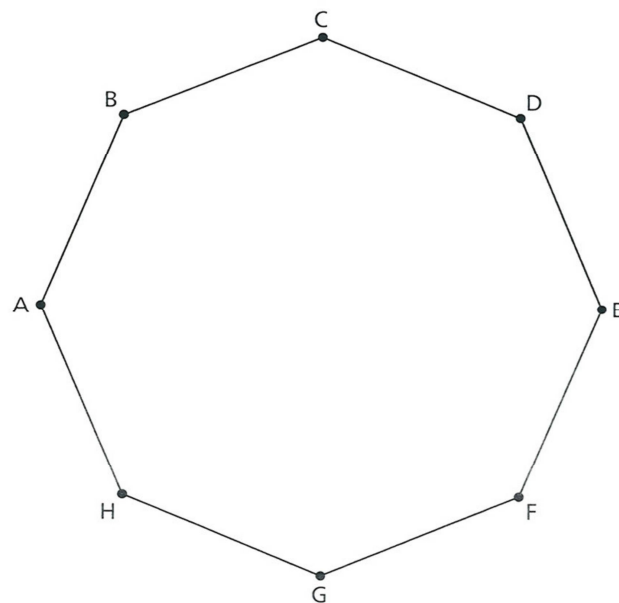


Figure 5 - Ring Network

White, U.S. Public Policy 5

In such a structure the central node is not necessary; however, as with star network the structure at hand economizes on the number of links. Some transactions have to travel short distances, e.g. A to B, other transaction have to travel longer distances, e.g. A to E. Furthermore, greater capacity of the links is necessary since they will have to provide third-party transport too.⁸⁰ Such a configuration could also represent a local network.⁸¹

⁷⁹ *Fatur*, The Economics of the ITC Network Industries FN 7 at 54.

⁸⁰ *White*, U.S. Public Policy 3.

⁸¹ *Fatur*, The Economics of the ITC Network Industries 55 (FN 9).

c. *Structure Whereby All Points are Directly Connected*

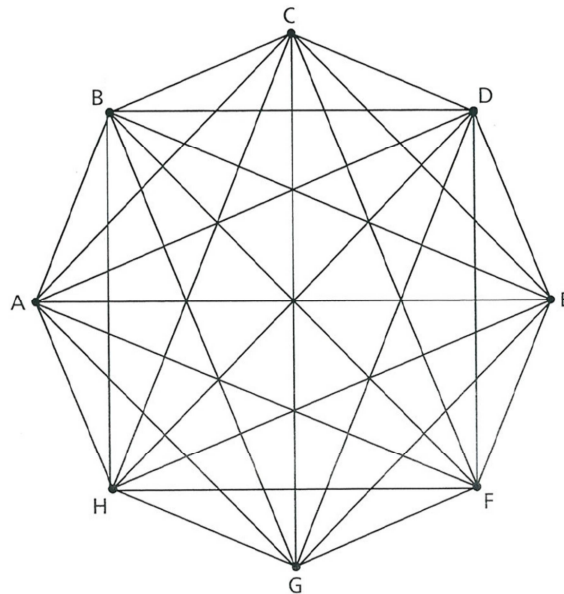


Figure 6 - Network with All Points Directly Connected

White, U.S. Public Policy 6

A structure where all points are directly connected minimizes the distances between the points to complete a transaction but requires the maximum number of links between the nodes. Alternative routes are an option which makes backup capabilities possible albeit through indirect transactions. This structure also eliminates the need for a central node. However each node requires at least some capability for choosing among the different links when a transaction is wanted.⁸²

⁸² *White*, U.S. Public Policy 4.

d. *Two Star Networks and a Trunk or Interface Link*

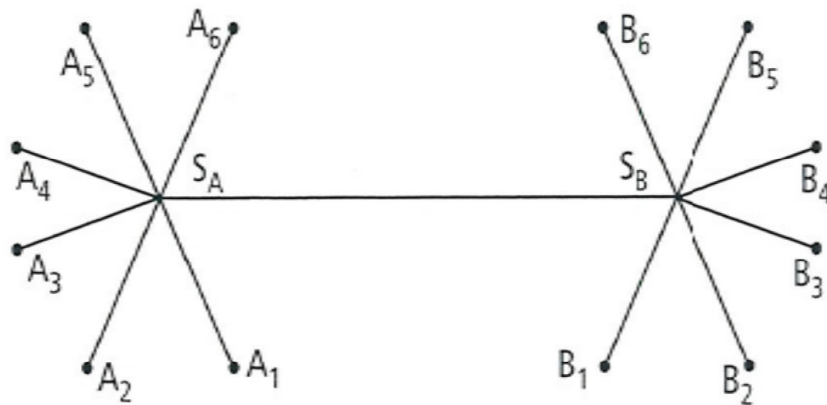


Figure 7 - Two Star Networks Connected by a Trunk Link

White, U.S. Public Policy 7

Another possible network structure is where two star networks are connected via a trunk or interface link which directly connect the two central nodes S_A and S_B . This structure may represent two local telephone systems which connect through a long-distance link. In this type of configuration S_A and S_B , as local central nodes, provide for local routing and switching as well as gateways and gathering points for long-distance transport. This structure also shows that larger entities than a network itself are created if local or stand-alone networks connect with each other.⁸³

This structure also shows why transactions between nodes of the same category make no sense. Imagine this configuration represents an electricity grid. The A nodes would be the electricity generation facilities, the link between S_A and S_B would represent high-voltage bulk transmission wires, S_B would be the local step-down and distribution station and the individual electricity users would be the B nodes. In this example the flow of the service occurs in one direction, i.e. from the A nodes to the B nodes and service flows between the A nodes or between the B nodes would, as stated above, not make sense.⁸⁴

⁸³ *White, U.S. Public Policy 4-5.*

⁸⁴ *White, U.S. Public Policy 7.*

4. Network Models

As with network architecture there are also different network models. Different competition concerns may arise with each model which have to be answered having regard to the specific network model in question.

a. *Vertically-integrated Industry with a Central Bottleneck and Competitive Complementary Markets up- or/and Downstream*

Sometimes the vertically integrated industry is an essential facility. Almost always such networks have the potential to cause substantial consumer harm since they pose access problems. It is necessary for market players to gain access to the bottleneck; accordingly these networks are typically regulated to provide for equal access.⁸⁵

b. *Multiple Competing End-to-end Networks*

Such industries may for example be ATM networks. Even though rivalry in these networks encourages innovation they also have strong network effects which could provide for strategic behaviour. Often industries which belong to this model are subject to socially desirable outcomes as opposed to price, profit and entry regulation.⁸⁶

c. *Mixed Model*

Instead of a monopolised network or a competing end-to-end network most modern networks are based on a mixture of these models and are therefore comprised of attributes of both. Accordingly the mixed model is a more realistic representation of how networks are structured today. Gas networks are a good example of the mixed model. In this model antitrust and regulation must co-exist to serve the objectives of network access.⁸⁷

Kahn⁸⁸ commented on this concept as follows:

“The decision to regulate never represents a clean break with competition. No regulatory statute to the author’s knowledge completely abandons reliance on

⁸⁵ Moss, Network Access, Regulation and Antitrust (2012) 2.

⁸⁶ Moss, Network Access 3.

⁸⁷ Moss, Network Access 3.

⁸⁸ Alfred E. Kahn (1917 – 2010) Expert in regulation and deregulation. He had important influence in deregulating the airline and energy sector and chaired the Civil Aeronautics Board during deregulation.

competition as one guarantor of good performance. The determination of the proper mixture of competitive rivalry and government orders in the formula for social control is or ought to be the central, continuing responsibility of legislatures and regulatory commissions.”⁸⁹

These mixed model network industries were often deregulated in the last decades. However, not all deregulation efforts were successful and therefore some industries were (and are still) subject to ongoing regulatory reform to accomplish the objectives of competition.⁹⁰

5. Network Features Giving Rise to Competition or Regulatory Problems

Above I have already explained the economic theory behind monopolies and why regulation in such an industry may be necessary. However there are some further features of network industries which may give rise to competition or regulatory problems.

a. *The Need to Connect*

In network industries competitors need to connect their networks with those of others so that their customers are in a position to communicate with their competitors’ customers. If the terms of the necessary interconnection agreements are not imposed by law, competitors are forced to contract with each other and inevitably there will always be a weaker party in a worse bargaining position. The latter will complain about being unfairly or even unlawfully disadvantaged.⁹¹

Another issue may be that the dominant network operator refuses to interconnect unless there is a legal duty to do so. Delaying interconnection is also a problem in this regard or providing interconnection on discriminatory terms which are commercially and/or technically disadvantageous conditions.⁹²

In cases where the parties to the contractual cooperation arrangements have about the same or a little more or less bargaining power there is danger that these agreements restrict

⁸⁹ Kahn, *The Economics of Regulation: Principles and Institution – Volume 11* (1971).

⁹⁰ Moss, *Network Access* 3.

⁹¹ Lang, *European Competition Policy and Regulation: Differences, Overlaps and Constraints in Lévêque/Shelanski, Antitrust And Regulation In The EU And US - Legal and Economic Perspectives* (2009) 28.

⁹² Lang, *European Competition Policy* 28.

competition between them and/or discriminate against third parties or create disadvantageous conditions for third parties.⁹³

b. *Leverage*

A dominant network operator may make use of its leverage of owning the principal network. This gives that undertaking advantages in the principal market it is engaged in and in related markets. However there are also leverages like economies of scale or scope. An example of making unlawful use of leverage is tying.⁹⁴

c. *Vertical integration*

Often dominant network operators are vertically integrated. This causes opportunity for price squeezes, as will be discussed in detail below.⁹⁵

⁹³ *Lang*, European Competition Policy 28.

⁹⁴ *Lang*, European Competition Policy 28.

⁹⁵ *Lang*, European Competition Policy 29.

IV The Treatment of Regulated Networks in the EU

A. Sector-Specific EU Regulation

Due to the special character of the EU there was never just one set of sector-specific rules in the whole of the EU. Accordingly not only liberalisation was at issue but also harmonization across the EU level.

Especially the electronic communications and energy sectors have been of great importance in this regard. For both sectors the usual institutional scheme used to apply, namely the Member States (ideally) implementing and applying EU law as well as certain mechanisms to report to the Commission. Accordingly the Member States and EU institutions had distinct and separate functions with not a lot of interaction. Furthermore the Member States operated in isolation from each other. This resulted in two kinds of separation: Member States and EU institutions and Member States and fellow Member States.⁹⁶

Importantly National Regulatory Authorities (NRA) carried out European regulatory services and only recently enforce competition law under Regulation 1/2003. The Commission enforces competition law. The idea of European regulators has consistently been opposed by the Member States.⁹⁷

Lang described six different kinds of objectives of regulation specific to the EU. The first one is the creation and promotion of competition where competition is still inadequate. Also competitors from each Member State shall be able to compete throughout the EU. The second objective is that it is necessary to ensure access for companies to all inputs, infrastructure or distribution systems which are essential to their activities. The third objective regards economic purposes. Exploitation of monopoly power by monopolies and ex-monopolies shall be prevented. The fourth objective described technical purposes such as setting standards or allocation of scarce radio spectrum, in a way which ensures equal

⁹⁶ *Hancher/Larouche*, The Coming of Age of EU Regulation of Network Industries and Services of General Economic Interest in *Craig/De Burca*, The Evolution of EU Law (2011) 767.

⁹⁷ *Lang*, European Competition Policy 22.

access for competitors. Furthermore scarce resources may include electricity lines and gas and oil pipelines, as well e.g. railway lines. The fifth objective is that sometimes the structural separation of ex-monopolies operations and infrastructure is required. Lastly, Lang explains that sometimes, less legitimately, national regulation under the guise of consumer protection may result in the protection of companies from competition.⁹⁸ Even though in my opinion most of these objectives are of a general nature as opposed to being specific to the situation in the EU, i.e. 28 different Member States, all of them are important objectives of regulation in the EU. Due to the fact that the EU consists of 28 Member States some objectives may be more difficult to achieve throughout the EU as opposed to a market consisting of a single country. Maybe this is why Lang viewed these objectives as specific for the EU. In my opinion the promotion of competition, access and unbundling are the most important objectives as they can have the greatest and most immediate impact on the establishment of a competitive internal market.

This means that market failures are dealt with by regulation which also controls market power, market access and market behaviour. Regulation also deals with technical issues and may change the situation on the market. This is a stark contrast to competition law which maintains competition but cannot create competition or cure market failures.⁹⁹

1. Separation between Member States and EU Institutions

In the case of electronic communication it became clear from early on that nearly all Member States would find themselves in a conflict of interest due to mostly significant if not controlling interests in the incumbent monopolist and the obligation to implement EU legislation aimed at introducing competition into the market.¹⁰⁰

Accordingly the first set of Directives for the liberalisation of the electronic communications sector, enacted in 1990, provided for the establishment of a “body

⁹⁸ Lang, European Competition Policy 29-30.

⁹⁹ Lang, European Competition Policy 30.

¹⁰⁰ Hancher/Larouche, The Coming of Age of EU Regulation 767.

independent of the telecommunications organizations”¹⁰¹. This body was essentially created to administer telecommunications regulation.¹⁰²

In 1998, at that time the telecommunications sector became fully liberalised, the NRAs were introduced in such a way as to break away the existing separation between the national institutions and the EU. The Member States were ordered by EU legislation to give the NRAs powers for the gathering of information as well as providing a right to appeal against the decisions of the NRAs.¹⁰³ Importantly EU legislation ordered the NRAs to be separated from government administration if Member States still had control or ownership of a market player.¹⁰⁴

Within the 2002 framework the design and operation of the Member States’ institutions was even more penetrated. Articles 3 to 6 of Directive 2002/21 introduced new and expanded older provisions on the relationship of the NRAs with the National Competition Authorities, appeal mechanisms against decisions made by the NRAs, transparency, confidentiality, information gathering, management and consultations. Article 8 of that Directive even set out the objectives to be pursued by the NRAs. Importantly, a supervision system was put into place to make sure that the NRAs exert the powers given to them in the interest of the EU.¹⁰⁵

In the energy sector NRAs were introduced in the second package of Directives.¹⁰⁶

Over time the NRAs started to play a role in the development of EU policy. The NRAs were brought together into regulatory networks, for example the European Regulators Group for Electronic Communications Networks and Services (ERG)¹⁰⁷ for telecommunications and the European Regulators Group for Electricity and Gas

¹⁰¹ Commission Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services, Art 7.

¹⁰² *Hancher/Larouche*, The Coming of Age of EU Regulation 767.

¹⁰³ Council Directive 90/387/EEC of 28 June 1990 on the establishment of the internal market for telecommunications services through the implementation of open network provision, Art 5a.

¹⁰⁴ Commission Directive 90/387/EEC, Art 5a.

¹⁰⁵ Commission Directive 90/387/EEC, Art 7.

¹⁰⁶ *Hancher/Larouche*, The Coming of Age of EU Regulation 768. See chapter VIIC EU Approach in the Energy Sector below for details.

¹⁰⁷ Commission Decision, 2002/627/EEC of 29. July 2002, establishing the European Regulators Group for Electronic Communications Networks and Services, 38.

(ERGEG)¹⁰⁸ for energy. ERG and ERGEG advise the Commission on the one hand, but on the other hand bring the NRAs together, forcing them to take a European perspective on their activities and therefore look beyond the respective borders.¹⁰⁹

2. Separation between the Member States themselves

Even though some sectors other than network industries were harmonized at EU level, e.g. banking, insurance or broadcasting, it became clear that the Member States were not willing to harmonize network industries.¹¹⁰

In the electronic communications sector the EU therefore chose the following strategy: Making regulation as light as possible to limit regulatory burdens in the respective Member States.¹¹¹ For example the 2002 framework replaced the individual licence requirements with a general authorization procedure.¹¹²

In the energy sector cross-border structure and shared regulatory responsibilities were addressed with the Third Energy Package in 2009 which featured two Directives and three Regulations¹¹³

Market players and industry observers criticized the EU for the failure of establishing an internal market in network industries. Since the Member States together with their respective NRAs follow diverging attitudes in the implementation and application of EU law, undertakings faced (and still face) different rules across the EU. However the aforementioned Directives contained provisions serving to ensure coordination and convergence amongst NRAs; however ERG and ERGEG need to push the level of convergence. In this regard it is important to note that the Commission has the powers to override and sideline the NRAs and to force them to follow its line. The Commission can

¹⁰⁸ Commission Decision 2003/796/EC of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas (ERGEG), 34.

¹⁰⁹ *Hancher/Larouche*, The Coming of Age of EU Regulation 768.

¹¹⁰ *Hancher/Larouche*, The Coming of Age of EU Regulation 769.

¹¹¹ *Hancher/Larouche*, The Coming of Age of EU Regulation 69.

¹¹² Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services, Art 5.

¹¹³ *Hancher/Larouche*, The Coming of Age of EU Regulation 769.

also issue guidelines describing how the NRAs should conduct assessments and review and veto draft decisions.¹¹⁴

Accordingly more harmonization in network industries, e.g. energy is to be expected in the years to come.

3. Separation between National Regulatory Authorities and the National Legislative and Executive Power

As described above the NRAs were established as separate authorities enjoying certain autonomy from the government. In the following the NRAs strived for more autonomy; however, expanding their autonomy beyond what was needed to avoid a conflict of interest caused problems. For example it runs against separation of powers if an autonomous body receives norm-making powers since norms would usually be set by the legislative. Another problem is that there is no political accountability of the executive if the NRAs establish the norms.¹¹⁵

However *ex ante* NRAs are given certain objectives and directions by national law, directly applicable EU law and possibly also from the EU-wide regulatory networks they belong to. Their tasks and powers are set out too. *Ex post* a number of mechanisms are in place, e.g. they are subject to good governance principles and usually need to file reports to the legislature. Furthermore decisions of NRAs are subject to judicial review.¹¹⁶

4. National Regulatory Authorities and the Commission

As described above the NRAs must be independent from both national governments and the industry. There must not be political interference. Two institutions were created to strengthen the independency of the NRAs in the electronic communications and energy sector: The Agency for the Co-ordination of Energy Regulators (ACER) and the Body of European Regulators for Electronic Communications (BEREC). They are network agencies.¹¹⁷

¹¹⁴ Hancher/Larouche, The Coming of Age of EU Regulation 770.

¹¹⁵ Hancher/Larouche, The Coming of Age of EU Regulation 773.

¹¹⁶ Hancher/Larouche, The Coming of Age of EU Regulation 774-775.

¹¹⁷ Hancher/Larouche, The Coming of Age of EU Regulation 775.

ACER is “to assist the regulatory authorities [...] in exercising at community level, the regulatory tasks performed in the Member States and where necessary, to coordinate their action”¹¹⁸. ACER may be described as an advisory body providing the NRAs and the Commission with opinions on energy policy issues. ACER also provides a framework for the implementation of the new energy policy of Third Energy Package.¹¹⁹ BEREK is less of an agency than ACER and actually a reinforced ERG.¹²⁰

B. Competition Law Powers

The Commission can not only intervene in matters of the NRAs by sector-specific regulation but also using its competition law powers. Especially in the electronic communications and the energy sector the Commission managed to turn issues relating to regulation to competition law issues under Article 102 Treaty for the Functioning of the European Union (TFEU).¹²¹

This development started in the 1990s in the electronic communications sector. The Commission used its powers under competition law to “convince” the Member States to further and support the liberalisation of telecommunications. Regarding the interference with actions of the NRA, the Commission intervened in pricing issues by taking account of Art 102 TFEU and fining the local incumbents for prize squeeze or predatory pricing (e.g. *Deutsche Telekom*).¹²²

Especially in the energy sector this Commission practice was used to a wide extent which will be set out in detail in the chapter on EU energy law and the relevant case law¹²³.

¹¹⁸ Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, 1.

¹¹⁹ *Hancher/Salerno*, Energy Policy after Lisbon in *Biondi/Eeckhout/Riply*, EU Law After Lisbon (2012) 378-379.

¹²⁰ *Hancher/Larouche*, The Coming of Age of EU Regulation 775.

¹²¹ *Hancher/Larouche*, The Coming of Age of EU Regulation 770.

¹²² *Hancher/Larouche*, The Coming of Age of EU Regulation 771.

¹²³ See chapter VIII C EU Approach in the Energy Sector below for details.

C. Sector-Specific Regulation and Competition Law

1. Differences

To understand the relationship between sector-specific regulation and competition law it is necessary to take a look at the fundamental differences.

For the purposes for which regulation is adopted it creates and imposes new legal duties. Accordingly regulation usually has wider objectives than competition law. Regulators can impose additional or new duties to achieve the objectives specified; therefore they can also impose very precise obligations. In contrast a competition authority has usually no power to impose or create new duties. When it does order conditions of e.g. resolving a dispute it has to rely on non-discriminatory examination to create precise conditions. This is problematic when there is no basis for a comparison, e.g. if a question arises for the first time. A basis for comparison is not necessary for a regulator wanting to impose precise obligations.¹²⁴

Regulators have the power to do things normally not authorized by competition rules since they can impose obligations for purposes apart from competition. Examples are breaking up monopolies or setting price caps, profit margins or even prices.¹²⁵

Regulators usually act *ex ante* by imposing duties; in contrast competition authorities usually act *ex post*, i.e. after the anticompetitive behaviour has begun (except where prior approval is required, e.g. mergers).¹²⁶

Due to these differences procedural consequences follow: In a regulatory case the authority considers actions necessary and/or appropriate to improve the respective situation. The undertaking involved is faced with a larger range of possibilities it has to deal with and defend itself for as in competition cases. In the latter the authority has to describe the unlawful, anticompetitive conduct and in turn the undertaking involved argues that the conduct was not unlawful or that it should not be punished.¹²⁷

¹²⁴ Lang, European Competition Policy 30-31.

¹²⁵ Lang, European Competition Policy 31.

¹²⁶ Lang, European Competition Policy 31.

¹²⁷ Lang, European Competition Policy 31.

There are also differences when it comes to claiming damages. In a regulatory case one can claim compensation for loss caused by a breach after the regulatory decision was adopted but not for the time before that decision since then the conduct was still legal. In contrast in a competition case one gets to sue for damages for the period before the competition decision is adopted.¹²⁸

There are also differences in practice between regulators and competition authorities. Regulators tend to act more often than the competition authorities thereby preferring to regulate behaviour. They have a more specialized knowledge of the respective industry they regulate; this, however, comes with the risk that regulators may come too much under the influence of that industry. Also they usually adopt more detailed regulation than competition authorities do. In general regulators are more willing to supervise or monitor on a continuing basis than competition authorities. Since measures by a regulator are more likely to be based on policy consideration for the respective industry than on competition considerations, it is likely that these measures are subject to less stringent judicial review. Therefore greater safeguards are necessary for procedures taken by regulators. Nevertheless NRAs are under the duty to not approve any practice contrary to EU competition law.¹²⁹

Competition authorities in contrast act after the behaviour or while it takes place, except for merger cases, whereas regulators usually make their rules in advance. Since competition rules are applied after the event occurred it is often the case that the competition authority is better informed than the NRA which is usually trying to foresee the future. Structural remedies are preferred by competition authorities. Also the competition authorities have to apply and enforce Articles 101 and 102 TFEU. Among other things, this means that national rules need to be disregarded when they restrict competition. Furthermore the competition rules are comprehensive and apply to all sectors; therefore the scope of competition rules and their applicability are not affected by

¹²⁸ *Lang*, European Competition Policy 32.

¹²⁹ *Lang*, European Competition Policy 35-36.

convergence. Since competition law involves less discretion than regulation it is more easily foreseen by the undertakings subject to it.¹³⁰

Two developments make the distinction between regulation and competition law less clear. One is the practice of the Commission to negotiate structural or behavioural remedies under settlement negotiations and the other is accepting and making binding commitments under Article 9 of Regulation 1/2003.¹³¹ Both will be described in the chapter on EU energy policy since especially in that sector these new practices were used extensively by the Commission.¹³²

Nevertheless it is important to keep the distinctive features in mind since unfortunate consequences may result from not doing so. Examples are that competition authorities may try to achieve regulatory objectives using competition law or regulatory authorities may try to achieve competition objectives using regulation. Another unfortunate consequence would be to use one kind of law and if the desired objective is not achieved simply use the other set of laws thereby engaging in multiple procedures. It goes without saying that this would lead to legal uncertainty and unnecessary expenses.¹³³

2. Complementary Use

The complementary use of sector-specific regulation and competition law as liberalisation tools is a significant feature of the liberalisation process in the European Union.

Furthermore, it was early on recognised that competition law alone cannot suffice to establish a competitive market, especially in network industries. This created legislation which uses principles of both regimes in the same piece of legislation.¹³⁴

Accordingly, in each case it has to be determined which regime provides the appropriate legal redress or both can apply. To do this it is necessary to examine whether sector-

¹³⁰ *Lang*, European Competition Policy 36.

¹³¹ *Lang*, European Competition Policy 38.

¹³² See chapter VIII C EU Approach in the Energy Sector below for details.

¹³³ *Lang*, European Competition Policy 49.

¹³⁴ *Szysczak*, The Regulation of the State 141-142.

specific regulation or competition rules are more appropriate “*in terms of speed, breadth of remedy, nature of market failures addressed*”¹³⁵.

Nevertheless in a liberalised industry there should be less need for regulation as competition develops, otherwise the term “liberalised” and the effort to get there becomes meaningless. Only as long as market imperfections last should there be a need for regulation; except for e.g. technical issues. In this regard it is also relevant to note that the more regulation there is, the greater becomes the risk that some rules will become unnecessary, out-of-date or inappropriate, especially in industries rapidly changing due to developing technologies, e.g. telecommunications.¹³⁶

D. Case Law

EU case law evidences the complementary use of sector-specific regulation and competition law in the EU. Since this thesis compares the relationship of sector-specific regulation and competition law in the EU and the US, I chose the two cases which highlight the EU position best and provide for the best basis to distinguish the EU from the US position. These cases also evidence the contrasting position in the EU and the US regarding margin squeezes.

1. The *Deutsche Telekom* Case

a. Introduction

In this regard the famous *Deutsche Telekom*¹³⁷ price squeeze case is of specific relevance. The wholesale and retail tariffs of Deutsche Telekom had been approved by the German NRA. Deutsche Telekom relied on that regulatory approval to argue against the application of competition law. The Commission however was of the opinion that compliance with regulation does not exclude an undertaking from liability under competition law. This stance was confirmed by the General Court (then the Court of First

¹³⁵ *Alexiadis/Cave*, Regulation and Competition Law 11.

¹³⁶ *Lang*, European Competition Policy 33.

¹³⁷ European Court of First Instance 10 April 2008, T 271/03, *Deutsche Telekom AG v Commission of European Communities*.

Instance)¹³⁸ and the Court of Justice. As will be explained in detail below this approach is quite the opposite of the US approach.

b. Case Details

In Germany Deutsche Telekom AG (Deutsche Telekom) is the incumbent telecommunications operator. At the time of the General Court judgment the German State held about 31 % of the shares directly and about 12 % of the shares indirectly. Institutional and private investors held the remaining shares.¹³⁹ Before liberalisation took place on 1 August 1996 Deutsche Telekom enjoyed the legal monopoly for the retail provision of fixed-line telecommunications services. Accordingly Deutsche Telekom operated the German fixed telephone network.¹⁴⁰

To other telecommunications operators and subscribers Deutsche Telekom offered access to its local networks, i.e. wholesale and retail access.¹⁴¹ Wholesale access charges had to be approved by the Regulierungsbehörde für Telekommunikation und Post (German regulatory authority for telecommunications and post; RegTP) and the rates had to be based on the costs of efficient service provision.¹⁴² The charges for retail access were regulated by a price cap system.¹⁴³

In 1999 the Commission received complaints from 15 undertakings (competitors) challenging the pricing of Deutsche Telekom.¹⁴⁴ In 1999, 2000 and 2001 the Commission sent to Deutsche Telekom requests for information.¹⁴⁵ In May 2002 and February 2003 statements of objections pursuant to Article 19 (1) of Regulation No 17 were sent from the Commission to Deutsche Telekom.¹⁴⁶

¹³⁸ *Hancher/Larouche*, The Coming of Age of EU Regulation 771.

¹³⁹ CFI 10 April 2008, T-271/03, para 1.

¹⁴⁰ CFI 10 April 2008, T-271/03, para 2.

¹⁴¹ CFI 10 April 2008, T-271/03, para 4.

¹⁴² CFI 10 April 2008, T-271/03, paras 7-8.

¹⁴³ CFI 10 April 2008, T-271/03, para 11.

¹⁴⁴ CFI 10 April 2008, T-271/03, para 25.

¹⁴⁵ CFI 10 April 2008, T-271/03, paras 26-28.

¹⁴⁶ CFI 10 April 2008, T-271/03, paras 29 and 32.

c. *Commission Decision*

The Commission adopted its Decision 2003/707/EC¹⁴⁷ on 21 May 2003 holding that Deutsche Telekom had infringed Article 82(a) EC by charging its competitors unfair prices for wholesale access and retail services in the local network thereby engaging in a margin squeeze.¹⁴⁸

The Commission held that there is an abusive margin squeeze if the difference between retail prices charged by the respective dominant undertaking and the wholesale prices charged to competitors is either negative or insufficient to cover the dominant undertaking's product-specific costs of providing its own retail services on the downstream market.¹⁴⁹

In the period from 1998 to 2001 there was a negative spread between the wholesale and retail prices of Deutsche Telekom¹⁵⁰. In 2002 that spread was positive¹⁵¹; however this positive spread was insufficient to cover the product-specific costs of Deutsche Telekom linked to the provision of retail services.¹⁵² At the time the Commission adopted its decision the margin squeeze still existed.¹⁵³

In this regard it is important to note that since economics regarding predation may not always be entirely conclusive the particular facts of the case may even be more important in this area than in other inquiries being already very fact-intensive. Importantly the method of thinking of the Commission in predation cases seems to be mostly consistent with economic findings and due to the emphasis on the importance of facts and consumer welfare coming to the right conclusion seems to be rather possible.¹⁵⁴ In this case the economic analysis of the Commission came to the right conclusion, i.e. there was a margin squeeze. Since the anticompetitive behaviour has been evidenced well by the Commission the rest of the analysis can concentrate itself on the policy question this case poses.

¹⁴⁷ Commission Decision of 21 May 2003, 2003/707/EC (COMP/C-1/37.451, 37.578, 37.579 - Deutsche Telekom AG).

¹⁴⁸ Commission Decision 21 May 2003, 2003/707/EC, para 199.

¹⁴⁹ Commission Decision 21 May 2003, 2003/707/EC, para 107.

¹⁵⁰ Commission Decision 21 May 2003, 2003/707/EC, para 153.

¹⁵¹ Commission Decision 21 May 2003, 2003/707/EC, para 154.

¹⁵² Commission Decision 21 May 2003, 2003/707/EC, para 160.

¹⁵³ Commission Decision 21 May 2003, 2003/707/EC, para 161.

¹⁵⁴ *Fatur*, Unilateral Esclusionary Conduct and ICT Network Industries in *Fatur*, EU Competition Law and the Information and Communication Technology Network Industries (2012) 158.

Importantly the Commission discussed the application of competition law where sector-specific regulation was in place:

“Contrary to DT’s view, however, the Court of Justice of the European Communities and the Court of First Instance of the European Communities have consistently held that the competition rules may apply where the sector-specific legislation does not preclude the undertakings it governs from engaging in autonomous conduct that prevents, restricts or distorts competition [...] This is particularly so in the case of complaints submitted to the Commission regarding possible violations of the EU competition rules. In such cases the Commission has a duty to investigate, and if necessary to order appropriate remedies.”¹⁵⁵

In this regard the Commission cited a number of cases and taking the oldest one of these as an example one can see that already in 1997 it was held by the ECJ that the competition may apply *“if it is found that the national legislation does not preclude undertakings from engaging in autonomous conduct which prevents, restricts or distorts competition.”¹⁵⁶*

Furthermore there is an ECJ decision from 1980¹⁵⁷ where the court analysed in detail whether sector-specific regulation (tobacco sector in this case) left leeway for the competitors (important members of a trade association containing almost all Belgian and Luxembourg tobacco manufacturers) to engage in competitive behavior:

“It is therefore necessary to consider in the first place whether [...] the Belgian rules and their application [...] have as their effect either to exclude [...] the opportunity for manufacturers and importers to compete significantly in relation to the margins to be allowed to the trade or to cast serious doubt on the existence of such an opportunity.”¹⁵⁸

¹⁵⁵ Commission Decision 21 May 2003, 2003/707/EC, para 54 thereby citing the following cases: ECJ 11 November 1997, Joined cases C-359/95 P and C-379/95 P, *Commission of the European Communities and French Republic v Ladbroke Racing Ltd*, para 34, with further references; CFI 7 October 1999, T-228/97, *Irish Sugar v Commission of the European Communities*, para 130; CFI 30 March 2000, T 513/93, *Consiglio Nazionale degli Spedizionieri Doganali v Commission of the European Communities*, , paras 59 et seq.

¹⁵⁶ ECJ 11 November 1997, Joined cases C-359/95 P and C-379/95 P, para 34 thereby citing the following cases: ECJ 29 October 1980, Joined cases 209 to 215 and 218/78, *Heintz van Landewyck SARL and others v Commission of the European Communities*.; Joined Cases 240/82 to 242/82, 261/82, 262/82, 268/82 and 269/82 *Stichting Sigarettenindustrie and Others v Commission*; and Case C-219/95 P *Ferriere Nord v Commission*.

¹⁵⁷ ECJ 29 October 1980, Joined cases 209 to 215 and 218/78.

¹⁵⁸ ECJ 29 October 1980, Joined cases 209 to 215 and 218/78, para 126.

The Court found that there was enough leeway and therefore the competition rules applied to the anticompetitive activities in question.¹⁵⁹

In this regard the *British Telecommunications* judgment in 1984¹⁶⁰ is also noteworthy (for details see below) as the the Court held that competition law was applicable to the telecommunications sector.¹⁶¹

The reasoning in these cases is followed by the Commission and the courts consistently.¹⁶² Accordingly the Commission was right in stating - as cited above - that competition rules apply where sector-specific regulation gives leeway to act in a way as to prevent a distortion of competition.

The Commission also mentioned that it stated in the notice on the application of the competition rules to access agreements in the telecommunications sector: framework, relevant markets and principles (access notice), that cases might be subject to both national or European sector-specific measures as well as competition rules. This was so important to the Commission that it even cited the relevant paragraph in its decision as follows:¹⁶³

*“In the telecommunications sector, the ONP Directives aim at establishing a regulatory regime for access agreements. Given the detailed nature of ONP rules and the fact that they may go beyond the requirements of Article 86 (now Article 82), undertakings operating in the telecommunications sector should be aware that compliance with the Community competition rules does not absolve them of their duty to abide by obligations imposed in the ONP context, and vice versa.”*¹⁶⁴

*“The notice goes on: ‘Articles 85 and 86 of the Treaty (now Articles 81 and 82) apply in the normal manner to agreements or practices which have been approved or authorised by a national authority, or where the national authority has required the inclusion of terms in an agreement at the request of one or more of the parties involved.’”*¹⁶⁵

¹⁵⁹ ECJ 29 October 1980, Joined cases 209 to 215 and 218/78, para 164.

¹⁶⁰ ECJ 16 June 1987, 118/85, *Commission of the European Communities v Italian Republic*.

¹⁶¹ *Fatur*, Unilateral Esclusionary Conduct 156.

¹⁶² CFI 7 October 1999, T-228/97, *Irish Sugar v Commission of the European Communities*, para 130; CFI 30 March 2000, T 513/93, *Consiglio Nazionale degli Spedizionieri Doganali v Commission of the European Communities*, paras 59 et seq.

¹⁶³ Commission Decision 21 May 2003, 2003/707/EC, para 55.

¹⁶⁴ Commission Decision 21 May 2003, 2003/707/EC, para 55 citing Notice on the application of the competition rules to access agreements in the telecommunications sector - framework, relevant markets and principles, OJ C 265, 22.8.1998, para 22.

¹⁶⁵ Commission Decision 21 May 2003, 2003/707/EC, para 56 citing OJ C 265, 22.8.1998, para 60.

This reference to the access notice further shows that indeed both sets of rules apply complementary. By emphasizing that there has always been extensive case law in this regard and referring to the access notice the Commission shows that the complementary use of both sets of rules is an integral part of EU legal practice which ought not to be changed. The question remains why this issue attracted so much interest if the EU position on this point was always clear? In my opinion the answer can be traced to the US cases which will be dealt with later in this thesis. In these cases the Supreme Court clearly tried to establish case law on an issue which was not entirely clear before. Another possible answer is that liberalisation created sectors which are less regulated than before and where effective competition became possible.

Accordingly, Deutsche Telekom's wholesale and retail charges were subject to sector-specific regulation. Nevertheless Deutsche Telekom had enough commercial discretion to restructure its charges to reduce or put an end to the margin squeeze. The margin squeeze therefore was an imposition of unfair selling prices within the meaning of Article 82(a) of the Treaty.¹⁶⁶

The Commission further ordered Deutsche Telekom to immediately end the infringement, to refrain from repeating the infringement found by the Commission and further imposed a fine of EUR 12.6 million.¹⁶⁷

Deutsche Telekom brought an action to the General Court on 30 July 2003¹⁶⁸ asking it to annul the contested decision or reduce the fine imposed.¹⁶⁹ For the former the applicant raised three pleas in law¹⁷⁰ and for the latter six pleas in law¹⁷¹.

d. *General Court Judgment*

On 10 April 2008 the General Court (then CFI) handed down its decision. For the purpose of this thesis the relevant part of the judgment is where the General Court

¹⁶⁶ Commission Decision 21 May 2003, 2003/707/EC, para 57.

¹⁶⁷ Commission Decision 21 May 2003, 2003/707/EC, Articles 2 and 3.

¹⁶⁸ CFI 10 April 2008, T-271/03, para 47.

¹⁶⁹ CFI 10 April 2008, T-271/03, para 64.

¹⁷⁰ CFI 10 April 2008, T-271/03, para 68.

¹⁷¹ CFI 10 April 2008, T-271/03, para 273.

discusses the applicability of competition law rules on behaviour covered by sector specific regulation.

The first plea in law by the applicant alleged the absence of an abuse since the applicant did not have sufficient scope to avoid the margin squeeze in question.¹⁷² In this regard the General Court made some preliminary observations regarding the application of then Articles 81 EC and 82 EC in instances where the alleged abuse is due to national legislation:

“It follows from the case-law that Articles 81 EC and 82 EC apply only to anti-competitive conduct engaged in by undertakings on their own initiative. If anti-competitive conduct is required of undertakings by national legislation or if the latter creates a legal framework which itself eliminates any possibility of competitive activity on their part, Articles 81 EC and 82 EC do not apply. In such a situation, the restriction of competition is not attributable, as those provisions implicitly require, to the autonomous conduct of the undertakings (see Joined Cases C 359/95 P and C 379/95 P Commission and France v Ladbroke Racing [1997] ECR I 6265, paragraph 33, and the case-law cited).”¹⁷³

However the General Court observed that it has been only partially accepted by the Court of Justice that particular anti-competitive conduct is excluded from the scope of then Articles 81 and 82 EC because such conduct by undertakings has been required by existing national legislation or because national legislation eliminated the possibility of undertakings to engage in a competitive conduct.¹⁷⁴ Accordingly for national legislation to make then Articles 81 and 82 EC inapplicable to anti-competitive activities of companies, the restrictive effects must stem solely from national law.¹⁷⁵ If national legislation leaves the possibility of competition open for undertakings such conduct falls within the scrutiny of the competition rules.¹⁷⁶

¹⁷² CFI 10 April 2008, T-271/03, para 69.

¹⁷³ CFI 10 April 2008, T-271/03, para 85.

¹⁷⁴ CFI 10 April 2008, T-271/03, para 86 citing ECJ 29 October 1980, Joined cases 209 to 215 and 218/78, para 130-134; ECJ 20 March 1985, 41/83, *Italian Republic v Commission of the European Communities*, para 19; ECJ 10 December 1985, Joined cases 240, 241, 242, 261, 262, 268 and 269/82, *Stichting Sigarettenindustrie and others v Commission of the European Communities*, paras 27-29; and ECJ 9 September 2003, C-198/01, *Consorzio Industrie Fiammiferi (CIF) v Autorità Garante della Concorrenza e del Mercato*, para 67.

¹⁷⁵ CFI 10 April 2008, T-271/03, para 87 citing CFI 30 March 2000, T 513/93, para 61.

¹⁷⁶ CFI 10 April 2008, T-271/03, para 88 citing ECJ 29 October 1980, Joined cases 209 to 215 and 218/78, paras 126 and 130 to 134; ECJ 10 December 1985, Joined cases 240, 241, 242, 261, 262, 268 and 269/82,

As explained above this stems from the extensive case law of the Commission and the courts.

Accordingly the General Court went on to assess whether the German legal framework gave the applicant leeway to fix its prices to a level ending or reducing the margin squeeze the Commission identified in the contested decision. When describing the contested decision in this regard the General Court noted that it confined its analysis to whether Deutsche Telekom had scope to increase its retail prices; thereby the Commission distinguished two periods.¹⁷⁷ This meant that also the General Court focused on the retail prices in its assessment of the German legal framework and the scope the applicant had to increase its retail prices.

Regarding the first period from 1 January 1998 to 31 December 2001 the General Court held that the Commission was correct in finding that the applicant had scope to increase its prices while at the same time respecting the price-cap.¹⁷⁸ The General Court then went to assess whether notwithstanding the discretion to increase prices, the applicant was subject to Article 82 EC.

It stated that the fact the charges of Deutsche Telekom had to be approved by the RegTP did not absolve this undertaking from the responsibility it had under Article 82 EC. As admitted in its reply the applicant influenced its retail charges through applications to the RegTP for authorisation. Accordingly the anti-competitive effects associated with the margin squeeze did not originate solely in the national legal framework.¹⁷⁹

The General Court continued describing the policy objectives of RegTP. Even though RegTP was obliged to respect the provisions of the EC Treaty, it was at the time in question the German body responsible for regulating the telecoms sector and not the

paras 12-37; ECJ 17 July 1997, C-219/95 P, *Ferriere Nord SpA v Commission of the European Communities*, paras 23-25; and ECJ 11 November 1997, Joined cases C-359/95 P and C-379/95 P, para 34.

¹⁷⁷ CFI 10 April 2008, T-271/03, para 93.

¹⁷⁸ CFI 10 April 2008, T-271/03, para 107 citing CFI 30 March 2000, T-513/93, para 61.

¹⁷⁹ CFI 10 April 2008, T-271/03, para 107.

competition authority in Germany. RegTP operated under national law, which may have objectives in the telecoms sector which may differ from those of EC competition policy.¹⁸⁰

The General Court then went on to analyse the decisions of the RegTP which the applicant referred to, to support its arguments. These decisions did not include any reference to then Article 82 EC.¹⁸¹ Nevertheless the RegTP found a negative spread between Deutsch Telekom's wholesale and retail prices but was of the opinion that the other operators should be able to offer to their retail consumers competitive prices by resorting to cross-subsidisation of charges for access services and calls.¹⁸² It was so important to the General Court to show that the RegTP took no regard of Article 82 EC or applied it incorrectly that it even citing one of the decisions as follows:

“Thus, RegTP finds in its decision of 29 April 2003 that: ‘[C]ompetitors are not so prejudiced with regard to their competitive opportunities in the local network by the slight difference between retail and wholesale prices as to make it economically impossible for them to enter the market successfully or even to remain in the market. [...] [That difference] was not so significant as to deprive competitors of any opportunity themselves to cross-subsidise their retail prices in order to be able to offer their end-users connections at a price as attractive as that offered by the applicant, or even at a lower price. That applies particularly to the higher-value and costlier ISDN and ADSL connections, which have increased markedly in number on account of the significant expansion of internet penetration, as well as of the marketing of faster and better access to the internet.’”¹⁸³

The General Courts noted that in other decisions in this regard the RegTP followed the reasoning above.¹⁸⁴ This reasoning showed that compatibility of the charges with Article 82 EC was not considered by the RegTP or that Article 82 EC was applied incorrectly.¹⁸⁵ Importantly the General Court further held that in any event, even if RegTP was obliged to consider whether the retail charges Deutsche Telekom proposed were compatible with

¹⁸⁰ CFI 10 April 2008, T-271/03, para 113 thereby noting “see the Commission’s Notice of 22 August 1998 on the application of the competition rules to access agreements in the telecommunications sector — framework, relevant markets and principles (OJ 1998 C 265, p. 2), paragraph 13”.

¹⁸¹ CFI 10 April 2008, T-271/03, para 114.

¹⁸² CFI 10 April 2008, T-271/03, para 116.

¹⁸³ CFI 10 April 2008, T-271/03, para 117.

¹⁸⁴ CFI 10 April 2008, T-271/03, para 118.

¹⁸⁵ CFI 10 April 2008, T-271/03, para 119.

Article 82 EC, the Commission would not thereby be precluded from finding Deutsche Telekom responsible for an infringement of Article 82 EC.¹⁸⁶

”The Commission cannot be bound by a decision taken by a national body pursuant to Article 82 EC.”¹⁸⁷

The General Court then turned to the judgment of the German Supreme Court (Bundesgerichtshof, BGH) of 10 February 2004. The BGH confirmed Deutsche Telekom’s responsibility to submit applications for the adjustment of its charges. Importantly it stated that according to German law RegTP was not precluded from authorising charges which were contrary to Article 82 EC. Here again the General Court cited the decision due to its importance for the case:

“The Bundesgerichtshof held, in fact, that, ‘[u]nlike those cases in which the conduct of the undertaking in a dominant position is directly determined by national legal provisions, the authorisation of charges that is prescribed by telecommunications law is nevertheless based on the application for authorisation made by the provider’, and that, ‘[e]ven if the administrative examination procedure is intended not to authorise tariffs which prove to constitute an abuse of a dominant position [...], that does not preclude the possibility in practice of an undertaking submitting a charge by which it abuses its dominant position and obtains authorisation for it because the abuse is not revealed during the examination procedure’.”¹⁸⁸

This is obviously a problematic point in business practice and also as regards legal certainty. When reading the judgment one wonders whether it is too much to ask for of an undertaking to abide by the sector-specific rules, thereby questioning the decisions of the NRA in regard to competition rules. Should not the NRA be responsible for taking wrong decisions, i.e. decisions not abiding EU competition law? However, the policy objectives of an NRA are not necessarily those of the respective national competition authority or the Commission. The NRA is no competition authority, so how and why should it take regard of competition law in each and every decision? Furthermore it is vital to note that the addressees of this decision are dominant undertakings which according to case law have a special responsibility. Due to their market power, knowledge of the market and resources they are in the position to not only abide by these two sets of rules but also recognise when

¹⁸⁶ CFI 10 April 2008, T-271/03, para 120.

¹⁸⁷ CFI 10 April 2008, T-271/03, para 120 citing ECJ 14 December 2000, C-344/98, *Masterfoods Ltd v HB Ice Cream Ltd*, para 48.

¹⁸⁸ CFI 10 April 2008, T-271/03, para 123.

behaviour, which according to the NRA is fine with sector-specific regulation, is in breach with competition rules. One must not forget that usually these dominant undertakings derive their dominance straight from national sector-specific rules, i.e. the respective Member State. Since these companies were mostly protected by the respective Member State from competition it is the least that they are now under a special responsibility to contribute to a competitive market.

Nevertheless it would certainly be advisable that national administrative courts deal with regulators applying regulatory rules wrongly in order to emphasize that the NRAs are responsible for their actions or rather omissions.¹⁸⁹

The General Court found that in regard to the first relevant period from 1 January 1998 to December 2001 the applicant had sufficient scope to end the margin squeeze.¹⁹⁰

The General Court then turned to the second relevant period from 1 January 2002 onwards and also held that the applicant had sufficient scope to end the margin squeeze.¹⁹¹

The General Court also held that it was not necessary for the Commission to demonstrate that the retail prices of the applicant were abusive.¹⁹²

Importantly the General Court also discussed equality of opportunity between competitors in the context of the lawfulness of the (calculation) method of the Commission. Nevertheless it can be seen from the decision that the dominant undertaking also holds responsibility for equality of opportunity between itself and competitors. Deutsche Telekom had such a responsibility also under German national law.¹⁹³

"Equality of opportunity as between the incumbent operator and owner of the fixed network, such as the applicant, on the one hand, and its competitors, on the other, therefore means that prices for access services must be set at a level which places competitors on an equal footing with the incumbent operator as regards the provision of call services. Equality of opportunity is secured only if the incumbent operator sets its retail prices at a level which enables competitors – presumed to be just as efficient as the incumbent operator – to reflect all the wholesale costs in their retail prices.

¹⁸⁹ Lang, European Competition Policy 55.

¹⁹⁰ CFI 10 April 2008, T-271/03, para 140.

¹⁹¹ CFI 10 April 2008, T-271/03, para 151.

¹⁹² CFI 10 April 2008, T-271/03, para 167.

¹⁹³ CFI 10 April 2008, T-271/03, para 198.

However, if the incumbent operator does not adhere to that principle, new entrants can only offer access services to their end-users at a loss. They would then be obliged to offset losses incurred in relation to local network access by higher call charges, which would also distort competition in telecommunications markets."¹⁹⁴

This statement is certainly in line with the EU position of protecting both consumer and competitor welfare. In EU antitrust case law the special responsibility of a dominant undertaking is emphasised.¹⁹⁵ In contrast in the US under §2 of the Sherman Act there is no duty to aid competitors. The roots of this difference are discussed later on this thesis.¹⁹⁶

Importantly a court should seek evidence to establish whether the distortion of competition really reduced equality of opportunity in the relevant case as such a reduction depends on the facts of the case and the market structure at hand. One may argue that only if such a reduction of equality of opportunity had negative effects on consumer welfare then this concept should be relevant. However, in my opinion, it is enough to establish the reduction since it automatically has a detrimental effect on competitors and in the EU competitor welfare is a main goal to be achieved by the internal market.

In the *Deutsche Telekom* case the Commission's economic analysis clearly established such a reduction of equality of opportunity.

Another relevant part of the judgment was where the General Court decided on the applicant's plea in law alleging the misuse of powers and infringement of the principles of proportionality, legal certainty and protection of legitimate expectations by the Commission.

Regarding proportionality and legal certainty the General Court held that the legal framework the applicant relied upon did not affect the power the Commission derived directly from Article 3(1) of Regulation No 17 and, since 1 May 2004, from Article 7(1) of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles [81 EC] and [82 EC] (OJ 2003 L 1, 1) to find an

¹⁹⁴ CFI 10 April 2008, T-271/03, para 199.

¹⁹⁵ Commission Decision 4 July 2007, COMP/38.784, para 278. In the corresponding footnote 238 the Commission referred to the judgment of the ECJ 9 November 1983, Case 322/81, para 57.

¹⁹⁶ See chapter V D Origins of Antitrust Law: The Sherman Act and Monopolistic Markets.

infringement of Article 81 and 82 EC.¹⁹⁷ The General Court further stated that even though it was not inconceivable that EC law was infringed by the German authorities, especially the provisions of Directive 90/388, as amended by Directive 96/19, by deciding to gradually rebalance connection and call charges, such a failure to act did not remove Deutsche Telekom's scope to reduce the margin squeeze.¹⁹⁸

In this regard it should be emphasised again that it is established case law that undertakings have to abide by both sector-specific rules and competition law. Nevertheless it remains clearly problematic in cases where the NRAs do not consider competition law when making decisions; however, it can be expected of (dominant) undertakings to behave in a way to obey the competition rules and not to take advantage of national sector-specific rules or decisions by NRA which may not be compatible with EU competition rules.

Regarding the protection of legitimate expectations the General Court found that the RegTP in its decisions considered whether a margin squeeze resulted from Deutsche Telekom's charges. However, even though it found a negative spread between the applicant's wholesale and retail prices it was of the opinion that through cross-subsidisation the other operators were able to price competitively.¹⁹⁹ Citing parts of the decision of 29 April 2003 again the General Court stated it followed implicitly that the applicant's pricing practices had an anti-competitive effect since its rivals had to resort to cross-subsidisation to stay competitive.²⁰⁰ It follows that the decisions of the RegTP could not have created legitimate expectations for the applicant that its pricing practices were compatible with Article 82 EC.²⁰¹

Part of the reasoning of the RegTP in its decision of 29 April 2003 is cited above. This paragraph indicated that the EC competition were either not considered at all or applied incorrectly.

¹⁹⁷ CFI 10 April 2008, T-271/03, para 263.

¹⁹⁸ CFI 10 April 2008, T-271/03, para 265.

¹⁹⁹ CFI 10 April 2008, T-271/03, para 267.

²⁰⁰ CFI 10 April 2008, T-271/03, para 268.

²⁰¹ CFI 10 April 2008, T-271/03, para 269.

This reasoning showed that compatibility of the charges with Article 82 EC was not considered by the RegTP or that Article 82 EC was applied incorrectly.²⁰² Instead of holding that the former incumbent ought to behave in a way as not to distort competition (as is required by law) the RegTP turns to the competitors stating that they have to deal with this situation by themselves. This is certainly a reasoning that is in stark contrast with competition rules.

Regarding the alleged misuse of powers the General Court held that the Commission referred to Deutsche Telekom's pricing practices only and not to the decisions made by the German authorities. The lawfulness of the contested decision was not affected even if a Community rule was infringed by RegTP and even if the Commission could have started proceedings against Germany for failing to fulfill obligations. The Commission's decision merely found an infringement of Article 82 EC, a provision addressing economic operators and not Member States. It did not misuse its powers by making that decision based on Article 82 EC.²⁰³

Even though it was arguably not a misuse of powers to decide to start proceedings against Deutsche Telekom instead of or in addition to proceedings against Germany for failing to fulfill obligations there still remains a stale taste. Certainly the Member States should take responsibility for failing to fulfill obligations and for the NRAs.

Importantly the General Court also mentioned that the Commission reduced the initial fine by 10% to take account of the fact that the wholesale and retail charges of the applicant were subject to sector-specific regulation on the national level.²⁰⁴

Deutsche Telekom then appealed the case to the Court of Justice and put forward three pleas in law alleging (1) errors of law regarding the manner in which the RegTP's regulation of its activities was dealt with, (2) errors of law in the application of then Article 82 EC and (3) errors of law regarding the calculation of fines.²⁰⁵

²⁰² CFI 10 April 2008, T-271/03, para 119.

²⁰³ CFI 10 April 2008, T-271/03, para 271.

²⁰⁴ CFI 10 April 2008, T-271/03, para 6.

²⁰⁵ CFI 10 April 2008, T-271/03, para 28.

e. *Court of Justice Judgment*²⁰⁶

The CoJ handed down its judgment on 14 October 2010. For the purpose of this thesis mainly the Court's decision on the first plea in law, namely errors of law regarding the manner in which the RegTP's regulation of its activities was dealt with, is relevant. In sum the CoJ confirmed the Commission and the General Court decisions.

The appellant claimed that the General Court erred in law by adopting a legally incorrect test regarding the attributability of the infringement of Article 82 EC. Furthermore the appellant claimed that the margin squeeze was considered to be attributable to it solely because the appellant had scope to adjust its retail prices for access-services to the end-user.²⁰⁷

The CoJ held in this regard that these premises were incorrect.²⁰⁸ It confirmed that Articles 81 and 82 EC do not apply if the alleged anti-competitive conduct of a company was ordered by national legislation, or if national legislation created a legal framework eliminating the possibility of competitive activity. Accordingly the restriction of competition is not attributable to the respective undertaking in such a situation since these provisions implicitly require autonomous conduct of the companies in question. However, if national legislation leaves open the possibility of competition in the market which may then be prevented, restricted or distorted by autonomous conduct of companies, Articles 81 and 82 EC apply.²⁰⁹ Furthermore only to a limited extent has the CoJ accepted that anti-competitive conduct is excluded from the scope of Articles 81 and 82 EC on the grounds as explained above.²¹⁰ The Court has held that in cases where the national law merely encouraged or made it easier to engage in anti-competitive behavior autonomously then these undertakings remained subject to Articles 81 and 82 EC.²¹¹

²⁰⁶ CoJ 14 October 2010, C-280/08 P.

²⁰⁷ CoJ 14 October 2010, C-280/08 P, paras 77-78.

²⁰⁸ CoJ 14 October 2010, C-280/08 P, para 79.

²⁰⁹ CoJ 14 October 2010, C-280/08 P, para 80 thereby citing Commission 11 November 1997, Joined cases C-359/95 P and C-379/95 P, paras 33 and 34.

²¹⁰ CoJ 14 October 2010, C-280/08 P, para 81 thereby citing ECJ 20 March 1985, 41/83, para 19; ECJ 10 December 1980, Joined cases 240, 241, 242, 261, 262, 268 and 269/82, paras 27-29; and ECJ 9 September 2003, C-198/01, para 67.

²¹¹ CoJ 14 October 2010, C-280/08 P, para 82 thereby citing ECJ 16 December 1975, Joined cases 40 to 48, 50, 54 to 56, 111, 113 and 114-73, *Coöperatieve Vereniging "Suiker Unie" UA and others v Commission of the European Communities*, paras 36-73, and ECJ 9 September 2003, C-198/01, para 56.

The CoJ in this regard also emphasised the special responsibility dominant undertakings have to not allow their behavior to impair genuine undistorted competition on the EC common market.²¹²

From the above it follows that the mere fact that the appellant was encouraged by the intervention of RegTP to maintain the pricing practice which led to the margin squeeze of rivals, who are at least as efficient as the appellant, cannot absolve Deutsche Telekom from its responsibility under then Article 82 EC.²¹³ Notwithstanding such interventions by the RegTP the appellant had scope to adjust its retail prices; therefore the General Court was indeed entitled to hold that, on that ground alone, the margin squeeze was attributable to Deutsche Telekom.²¹⁴

Importantly the CoJ also held that the argument by the appellant that RegTP considered and approved the margin squeeze in light of national and EC telecommunications law and Article 82 EC and also that the BGH held in the judgment of 10 February 2004 that Deutsche Telekom cannot take the place of the regulatory authority RegTP in assessing whether a pricing practice is contrary to Article 82 EC cannot alter that the pricing practice is attributable to Deutsche Telekom which had scope to adjust its retail charges.²¹⁵ Also the existence of fault cannot alter the fact that the appellant had scope to adjust its retail prices.²¹⁶

Moreover the CoJ confirmed that the Commission cannot be bound by a decision a national body took pursuant to Article 82 EC.²¹⁷ Even if the national regulatory authorities had themselves infringed Article 82 EC, such an infringement by the NRA would have not affected the scope Deutsche Telekom had to adjust its retail charges.²¹⁸ The same applies to

²¹² CoJ 14 October 2010, C-280/08 P, para 83 thereby citing ECJ 9 November 1983, 322/81, *NV Nederlandsche Banden Industrie Michelin v Commission of the European Communities*, para 57.

²¹³ CoJ 14 October 2010, C-280/08 P, para 84 thereby citing ECJ 30 January 1985, 123/83, *Bureau national interprofessionnel du cognac v Guy Clair*, paras 21-23.

²¹⁴ CoJ 14 October 2010, C-280/08 P, para 85.

²¹⁵ CoJ 14 October 2010, C-280/08 P, paras 87-88.

²¹⁶ CoJ 14 October 2010, C-280/08 P, para 89.

²¹⁷ CoJ 14 October 2010, C-280/08 P, para 90 thereby citing ECJ 14 December 2000, C-344/98, para 48.

²¹⁸ CoJ 14 October 2010, C-280/08 P, para 91.

the appellant's argument that opening the relevant markets up to competition was the purpose of RegTP's regulation.²¹⁹

The CoJ also made some statements regarding equality of opportunity stating that it consistently held that undistorted competition can only be guaranteed if between the various economic operators equality of opportunity is guaranteed.²²⁰ The General Court did not err in law when holding that equality of opportunity means that Deutsche Telekom and its equally efficient rivals are placed on equal footing in the retail market for access for end-users and that this is not the case when the wholesale prices charged by the appellant for local loop access services cannot be reflected in their retail prices for consumer access other than by providing such services at a loss.²²¹

Regarding the reduction of the fine by 10% in view of RegTP's intervention the CoJ held that having regard to the Commission's discretion in determining the amount of the fine, the Commission had duly taken into account the applicant's limited role on view of RegTP's intervention.²²²

The CoJ dismissed the appeal by Deutsche Telekom.²²³

f. Analysis

This landmark case which addressed two important issues, namely margin squeeze and the relationship between sector-specific regulation and competition law, sparked extensive academic discussion.

Regarding margin squeeze the General Court (as well as the CoJ) made it clear that this constitutes a distinct category of abuse and that this finding does not limit itself to scenarios with excessive upstream pricing or predatory downstream pricing. The

²¹⁹ CoJ 14 October 2010, C-280/08 P, para 92.

²²⁰ CoJ 14 October 2010, C-280/08 P, para 230 thereby citing ECJ 13 December 1991, C-18/88, *Régie des télégraphes et des téléphones v GB-Inno-BM SA.*, para 25; ECJ 22 May 2003, C-462/99, *Connect Austria Gesellschaft für Telekommunikation GmbH v Telekom-Control-Kommission*, and *Mobikom Austria AG*, para 83; ECJ 20 October 2005, Joined cases C-327/03 and C-328/03, *Bundesrepublik Deutschland v ISIS Multimedia Net GmbH und Co. KG*, represented by *ISIS Multimedia Net Verwaltungs GmbH*, and *Firma O2 (Germany) GmbH und Co. OHG*, para 39; and CoJ 1 July 2008, C-49/07, *Motosykletistiki Omospondia Ellados NPID (MOTOE) v Elliniko Dimosio*, para 51.

²²¹ CoJ 14 October 2010, C-280/08 P, para 233.

²²² CoJ 14 October 2010, C-280/08 P, para 279.

²²³ CoJ 14 October 2010, C-280/08 P, para 301.

Commission may analyse such a scenario as either a margin squeeze or a predatory pricing case.²²⁴

Commentators in general seemed to be satisfied with the approach the CoJ, the General Court and the Commission took for margin squeeze. The academic discussion centred itself more on the relationship between sector-specific regulation and competition law.

This case addressed criticism of *ex ante* and *ex post* rules amounting to double regulation by emphasising that competition rules apply always apart from very limited circumstances. Also there is no *carte blanche* under competition law for dominant undertakings merely because they are subject to sector-specific regulation.

In this regard one commentator even wrote that antitrust enforcement is arguably more necessary in cases where a vertically integrated monopolist is partially regulated than entirely unregulated.²²⁵ Does that explain why competition rules apply even if the behaviour in question is actually covered by sector-specific regulation? In industries where still some sector-specific regulation exists the vertically integrated monopolist arguably may be more protected from competition than in unregulated industries. It follows that in a market where the vertically integrated monopolist is only partially regulated there is less competition in the market and therefore antitrust enforcement is more necessary. This is definitely the situation in the *Deutsche Telekom* case where antitrust enforcement was clearly necessary to end the anticompetitive behaviour of Deutsche Telekom since the NRA did not stop the margin squeeze even though it found that there was one.

One commentator takes regard to this case while writing about the energy sector inquiry. She explained that prior to the sector enquiry in 2007 a tendency towards a *lex specialis* approach was not uncommon in the energy sector; however, it was not absolute, but depended on the commercial discretion of the company. She refers to the applicability of *ex ante* and *ex post* rules as double regulation. In her opinion a limitation of the *lex*

²²⁴ *Fatur*, Unilateral Esclusionary Conduct 157.

²²⁵ *Brunell*, In Regulators We Trust: The Supreme Court's New Approach To Implied Antitrust Immunity, in *Antitrust Law Journal* (2012) 279 (280).

specialis approach by commercial discretion is not problematic since Article 102 is applied under its competition law cover.²²⁶

For Jones this case shows that a company having done everything required of it by the relevant sector-specific regulator can be caught by competition law. This is a contrast to US law where *Trinko* shows that the Supreme Court did not want to impose on undertakings intervention from two different sources.²²⁷ This analysis essentially catches the problem of the way the Commission applies competition rules to behaviour which should actually be dealt with by the NRA if that behaviour falls under sector-specific regulation. As will be explained below in detail the issue of importance in this regard is whether the NRAs should be responsible for not taking account of competition rules when making decisions. In sum I believe that dominant undertakings (especially former incumbents) should take all measures necessary to obey all kinds of rules that are applicable to them even if some seem contradictory on the surface.

Naturally the Commission welcomed the decision of the CoJ. According to the Commission the CoJ decision confirmed the Commission's action against dominant undertakings pursuing margin squeezes. The decision also underlined that decisions taken by national regulators do not absolve dominant undertakings from competition rules. Also the special responsibility of dominant undertakings under Article 82 EC was confirmed as well as that decisions taken by national authorities under EU telecommunications law do not affect the power of the Commission to find infringements of EU competition law.²²⁸

Almunia even stated the following on the CoJ judgment:

“Today’s judgment confirmed the Commission’s well established policy of fighting the temptation by dominant firms in network industries to set wholesale and retail prices at levels that do not allow their competitors, which have to rely on the dominant firms’ infrastructure, to cover their costs. Such strategies prevent competition and breach EU competition rules. The judgement is good news for consumers and for the economy in general as effective competition in the crucial network industries such as telecoms

²²⁶ Van Den Bergh, The Relationship between Sector Specific Regulation and Competition Law in the Energy Sector in *Delvaux/Hunt/Talus*, EU Energy Law and Policy Issues (2012) 190.

²²⁷ Jones/Sufrin, EU Competition Law - Text, Cases and Materials (2010) 56.

²²⁸ European Commission - MEMO/10/493, 14 October 2010, Antitrust: Commission welcomes Court judgement in Deutsche Telekom “margin squeeze” case.

*or energy translates not only in more choice and ultimately lower prices but also more growth and jobs.*²²⁹

In sum the judgment underlined the powers of the Commission, the reach of competition law and the special responsibility dominant undertakings carry.

2. The *Telefónica* Case²³⁰

a. Introduction

This case relies heavily on the *Deutsche Telekom* case and confirms the reasoning in *Deutsche Telekom* on the relationship between sector-specific regulation and competition law, as well as on the method of assessing whether a margin squeeze took place.

Telefónica S.A. (Telefónica) was the only Spanish telecommunications operator who had a nation-wide fixed telephone network.²³¹ Its competitors had to contract with Telefónica to gain access to the fixed telephone network; otherwise they would not have been able to provide broadband internet access to end-users. Building their own alternative local access network would have required lots of time and immense investments; accordingly that option was economically not viable.²³²

A complaint against Telefónica was lodged on 11 July 2003 by Wanadoo España S.L. (at the time of the Commission decision already France Telecom España S.L., Wanadoo) alleging that the margin between wholesale prices charged to competitors and retail prices charged to end-users was not sufficient in that it did not enable competitors to compete with the former incumbent in the broadband retail market.²³³

The Commission found that from September 2001 to December 2006 Telefónica abused its dominant positions on the three identified relevant markets in form of margin squeezes.²³⁴ Importantly, existing regulation did not prevent Telefónica from pricing in a

²²⁹ European Commission - MEMO/10/493, 14 October 2010.

²³⁰ Commission Decision 04 July 2007, COMP/38.784, *Wanadoo España v Telefónica*.

²³¹ Commission Decision 04 July 2007, COMP/38.784, para 1.

²³² Commission Decision 04 July 2007, COMP/38.784, para 3.

²³³ Commission Decision 04 July 2007, COMP/38.784, para 5.

²³⁴ Commission Decision 04 July 2007, COMP/38.784, para 9.

way as to put an end to the margin squeeze.²³⁵ The Commission decision was upheld by the General Court in 2012.²³⁶ The Court of Justice in turn upheld the decision of the General Court on 10 July 2014.²³⁷

b. Addressees and complainant

As in Deutsche Telekom an abuse of a dominant position through margin squeeze by an incumbent telecommunications undertaking subject to sector-specific regulation was at issue in this case.

The addressees in this case were Telefónica, its 100% owned subsidiary Telefónica de España, S.A.U (TESAU) and Telefónica's subsidiaries Telefónica Data de España, S.A.U (TDATA) and Terra Networks España S.A. (TERRA), which both merged with TESAU on 30 June 2006 and 7 July 2006 respectively.²³⁸ These undertakings have formed a single economic entity during the investigation²³⁹ and will therefore be referred to as "Telefónica".

Until full liberalisation in 1998 Telefónica was owned by the Spanish state and had a legal monopoly for the retail provision of fixed-line telecommunications services. The Telefónica group enjoyed the telecommunications monopoly in Spain.²⁴⁰

The complainant France Telecom was 100% owned by the French incumbent for telecommunication services, France Telecom.²⁴¹ The latter acquired Eresmas Interactive S.A. (eresMas), an ISP and portal provider in Spain, in 2002. In the last quarter of 2002 eresMas and the initial complainant Wanadoo were merged.²⁴²

²³⁵ Commission Decision 04 July 2007, COMP/38.784, para 8.

²³⁶ General Court 29 March 2012, T-398/07, *Kingdom of Spain vs. European Commission*, 13.

²³⁷ CoJ 10 July 2014, C-295/12 P, *Telefónica SA Telefónica de España SAU v. European Commission, France Telecom España, SA, Asociación de Usuarios de Servicios Bancarios (Ausbanc Consumo), European Competitive Telecommunications Association*.

²³⁸ Commission Decision 04 July 2007, COMP/38.784, para 11.

²³⁹ Commission Decision 04 July 2007, COMP/38.784, para 12.

²⁴⁰ Commission Decision 04 July 2007, COMP/38.784, para 13.

²⁴¹ Commission Decision 04 July 2007, COMP/38.784, para 24.

²⁴² Commission Decision 04 July 2007, COMP/38.784, para 25.

c. Commission Decision

After investigating the complaint by Wanadoo the Commission in its decision from 4 July 2007 held that Telefónica had indeed abused its dominant position by engaging in a margin squeeze. The relevant parts of the decision are those where the relationship between sector specific regulation and competition law are discussed and where reference is made to the *Deutsche Telekom* case.

In its decision the Commission describes in the detail the applicable sector-specific regulation. Regarding retail broadband access services the Commission observed that until 1 November 2003 administrative authorisation by the Comisión Delegada del Gobierno para Asuntos Económicos (CDGAE) was necessary to obtain for Telefónica. From 1 November 2003 onwards administrative authorisation was put to end, instead any modifications in price had to be communicated ten days before their introduction into the market.²⁴³

The prices for national wholesale offers (ADSL-IP Total and ADSL-IP) were never subject to any price regulation.²⁴⁴

The situation regarding regional wholesale offers (GigADSL) was more complicated. With its decision from 25 March 1999²⁴⁵ the CDGAE mandated access to broadband and established the prices competitors had to pay to Telefónica. Until 31 December 2000 this decision was valid.²⁴⁶ As of January 2001 a regime of maximum nominal prices for GigADSL was valid. Telefónica was not precluded from lowering its prices. From that day onward the Comisión del Mercado de las Telecomunicaciones (CMT), the Spanish national regulatory authority for telecommunications, was the only authority vested with the power for price regulation.²⁴⁷ The CMT reduced the prices of GigADSL with its decision of 26

²⁴³ Commission Decision 04 July 2007, COMP/38.784, paras 105 to 107.

²⁴⁴ Commission Decision 04 July 2007, COMP/38.784, para 109.

²⁴⁵ Orden de 26 de marzo de 1999 por la que se dispone la publicación del Acuerdo de la Comisión Delegada del Gobierno para Asuntos Económicos, de 25 de marzo de 1999, por el que se determinan los precios que los operadores autorizados deberán abonar a Telefónica, Sociedad Anónima, por la provisión del acceso indirecto al bucle de abonado de la red pública telefónica fija, hasta el 31 de diciembre del año 2000 – BOE 86 pages 13513 to 13515.

²⁴⁶ Commission Decision 04 July 2007, COMP/38.784, para 111.

²⁴⁷ Commission Decision 04 July 2007, COMP/38.784, para 113.

July 2001²⁴⁸ and established that the prices would be fixed based on a retail-minus system determining that the price of each GigADSL modality should not be higher than a given percentage of Telefónica's corresponding retail fee.²⁴⁹ As from 31 March 2004 onwards Telefónica had the regulatory obligation to propose new corresponding tariffs in advance. The CMT had the power to modify those new tariffs to allow competitors to compete with Telefónica's retail offer.²⁵⁰

Spanish General Telecommunications Law 11/1998 was replaced by the Spanish General Telecommunications Law 32/2003 on 5 November 2003. The new law transposed the new EC regulatory framework for electronic communications. It further allowed for the CMT to impose appropriate regulatory obligations on undertakings with significant market power.²⁵¹

Accordingly the CMT decision of 1 June 2006²⁵² changed the above-described regulation for national and regional wholesale prices.²⁵³ Prices for GigADSL should be based on cost orientation and prices of ADSL-IP, which had been unregulated as described above, should also be based on cost orientation.²⁵⁴

Importantly, the Commission mentioned that since 2002, 55 conflicts relating to the access to the local network have been brought before the CMT. Most of these conflicts resulted in decisions against Telefónica.²⁵⁵ The Commission cites the decision of the CMT

²⁴⁸ Resolución de la CMT de 26 de julio de 2001, por la que se resuelve el recurso potestativo de reposición interpuesto por TESAÚ contra la Resolución de medidas cautelares dictadas dentro del expediente MTZ 2001/4935 sobre el establecimiento de condiciones para el acceso indirecto al bucle de abonado de la red telefónica pública fija de Telefónica de España con el objeto de articular los mecanismos que posibiliten la prestación de servicios ADSL en competencia.

²⁴⁹ Commission Decision 04 July 2007, COMP/38.784, para 114.

²⁵⁰ Commission Decision 04 July 2007, COMP/38.784, para 115.

²⁵¹ Commission Decision 04 July 2007, COMP/38.784, para 120.

²⁵² CMT, Decisión AEM 2005/1454 of 01.06.06 – Resolución por la que se aprueba la definición del mercado de acceso mayorista de banda ancha, el análisis del mismo, la designación de operadores con poder significativo de mercado y la imposición de obligaciones específicas, y se acuerda su notificación a la Comisión Europea. According to footnote 111 of the Commission Decision the CMT “*in this decision [...] analysed the wholesale broadband market, found that Telefónica had significant market power in it, detected competition problems in the wholesale and retail broadband markets (in particular refusal to supply, delaying tactics, undue use of privileged information, unfair requirements, price and quality discrimination, margin squeeze) and imposed regulatory obligations based on the nature of the problems identified*”.

²⁵³ Commission Decision 04 July 2007, COMP/38.784, para 121.

²⁵⁴ Commission Decision 04 July 2007, COMP/38.784, para 123.

²⁵⁵ Commission Decision 04 July 2007, COMP/38.784, para 139.

from 16 November 2006²⁵⁶ where Telefónica was fined EUR 20 million for infringing procedures and conditions under which this undertaking had to provide services under the unbundling regime between January 2004 and April 2005.²⁵⁷

The Commission then found that Telefónica was dominant in the regional²⁵⁸ and the national²⁵⁹ wholesale market, as well as in the retail market²⁶⁰.

In part VI of the Commission decision the abuse in question is established. In its first paragraph of part VI the Commission emphasises the special responsibility of an undertaking enjoying a dominant position. Holding a dominant position is not in itself contrary to competition law, however, such an undertaking is under a special responsibility not to engage in anti-competitive conduct.²⁶¹

As in the *Deutsche Telekom* case the special responsibility of an undertaking enjoying a dominant position was emphasised which is in line with EU policy and the EU stance on competitor and consumer welfare.

The Commission then turned to the regulatory context in which Telefónica has been supplying regional and national wholesale access. The national regulation imposing the obligation to supply wholesale access at both national and regional level on Telefónica is based on and compatible with EC law.²⁶²

Another relevant part of the establishment of the abuse in part VI of the decision is the Commission's assessment of the scope for avoiding the margin squeeze in (VI) (G). Telefónica argued that it lacked autonomy to set the relevant prices due to the Spanish

²⁵⁶ Resolución del expediente sancionador RO 2004/1811, incoado a la entidad "Telefónica de España, S.A.U." por acuerdo del Consejo de la Comisión del Mercado de las Telecomunicaciones de 9 de junio de 2005", 16.11.2006 ("*CMT decision RO 2004/1811 of 16.11.2006*").

²⁵⁷ Commission Decision 04 July 2007, COMP/38.784, para 140.

²⁵⁸ Commission Decision 04 July 2007, COMP/38.784, para 232.

²⁵⁹ Commission Decision 04 July 2007, COMP/38.784, para 242.

²⁶⁰ Commission Decision 04 July 2007, COMP/38.784, para 277.

²⁶¹ Commission Decision 04 July 2007, COMP/38.784, para 278. In the corresponding footnote 238 the Commission referred to the judgment of the ECJ 9 November 1983, 322/81, para 57.

²⁶² Commission Decision 04 July 2007, COMP/38.784, para 292.

broadband market being supervised through *ex ante* and *ex post* resolutions by the regulator in Spain.²⁶³ The Commission stated as follows:

*“In this respect, the Court of Justice and the Court of First Instance have consistently held that competition rules may apply where sector specific legislation does not preclude the undertakings it governs from engaging in autonomous conduct that prevents, restricts or distort competition.”*²⁶⁴

As discussed above this case law can be traced back decades and there is no indication that it will change in the future.

The Commission accordingly assessed whether Telefónica had the commercial discretion to avoid or end on its own initiative the margin squeeze. TESAU had been free to raise its retail prices for broadband access at any time. It had enjoyed commercial discretion to the extent that it proposed to the regulatory authority its prices until October 2003 and was entitled to request a price review. After October 2003 the retail charges were liberalised and only subject to advance communication.²⁶⁵

Regarding the national wholesale services prices the Commission held that since September 2001 Telefónica had been free to reduce the charges. Until December 2006 the wholesale prices had never been subject to any price regulation.²⁶⁶

In terms of the regional wholesale service charges TESAU could have decreased its prices any time. Even though the adjustment of these charges had to be notified to the regulatory authority, Telefónica could have taken the initiative and apply for authorisation of a price adjustment at any time. On the contrary, Telefónica, whenever it lowered its retail prices, asked the CMT to maintain its wholesale prices.²⁶⁷

For the Commission it was therefore evident that during the whole reference period for which the infringement of then Article 82 EC had been found, there was nothing that

²⁶³ Commission Decision 04 July 2007, COMP/38.784, para 665.

²⁶⁴ Commission Decision 04 July 2007, COMP/38.784, para 666. In the corresponding footnote 715 the Commission referred to the following judgments: CoJ 11 November 1997 Joined Cases C-359/95 and C-379/95 P, para 34; CFI 7 October 1999, T-228/97, para 130; CFI 30 March 2000, T-513, paras 59 et seq.

²⁶⁵ Commission Decision 04 July 2007, COMP/38.784, para 670.

²⁶⁶ Commission Decision 04 July 2007, COMP/38.784, para 671.

²⁶⁷ Commission Decision 04 July 2007, COMP/38.784, para 672.

precluded Telefónica from ending the evidenced margin squeezes by proposing lower wholesale prices or requesting a decrease of the GigADSL prices from the CMT.²⁶⁸

As above in the *Deutsche Telekom* case the Commission conducted a thorough economic and legal analysis which clearly evidenced that Telefónica had leeway regarding price setting. Accordingly also in this case the issue was whether competition rules are applicable to the behaviour in question as sector-specific regulation applied too.

The Commission then turned to the CMT's decisions regarding margin squeeze since Telefónica alleged that the Commission was not entitled to adopt a decision since, contrary to the situation in *Deutsche Telekom*, the national regulatory authority had already made several national decisions on the same subject matter thereby enforcing competition law. Furthermore Spanish courts had already recognised that the CMT had the competence to apply competition law.²⁶⁹

In this regard the Commission held as follows:

*"It is clear from the case law of the Court that the Commission is entitled to adopt at any time individual decisions under Articles 81 and 82 of the Treaty, even where an agreement or practice has already been the subject of a decision by a national Court or the decision contemplated by the Commission conflicts with that national court's decision."*²⁷⁰

Additionally the CMT is a regulatory authority within the meaning of Article 5 of the Framework Directive 2002/21/EC and no competition authority. The CMT had never intervened to enforce then Article 82 EC. Telefónica even acknowledged that according to Article 25 of the *Ley de Defensa de la Competencia* (Spanish Competition Law), modified by the Law 52/99, it is within the competence of the *Tribunal de Defensa de la Competencia* to enforce then Article 81 and 82 EC in Spain. Accordingly the enforcement of these Articles was not within the CMT's responsibilities and these competences have not been given to the CMT. The Commission further notes that not a single one of the resolutions of the CMT mentioned by Telefónica had neither then Article 82 EC nor the Spanish equivalent of Article 6 of the *Ley de Defensa de la Competencia* as their legal

²⁶⁸ Commission Decision 04 July 2007, COMP/38.784, para 675.

²⁶⁹ Commission Decision 04 July 2007, COMP/38.784, para 676.

²⁷⁰ Commission Decision 04 July 2007, COMP/38.784, para 677. In the corresponding footnote 722 the Commission referred to CoJ 14 December 2000, C-344/98, para 48.

basis.²⁷¹ Additionally CMT's competence to safeguard competition was more general than the enforcement of competition law as such is. CMT was enabled to merely impose certain behavioural obligations in the telecommunications sector in Spain.²⁷²

The Commission then stated that in fact the CMT had not adopted a single decision on the same subject matter to which the present decision refers. Particularly the existence of a margin squeeze involving Telefónica's national wholesale charges had not been analysed by the CMT so far.²⁷³

Similarly to the *Deutsche Telekom* case the NRA interpreted then Article 82 wrongly. Regarding the regulation of charges of GigADSL the CMT was of the opinion that GigADSL need not be cost orientated and therefore implemented a retail-minus system to motivate other network operators to invest into their own infrastructure. Despite this emphasis by the CMT on investments in alternative infrastructure, the CMT also thought that no situation of margin squeeze could arise due to the retail minus system. However, the CMT was not successful at avoiding a margin squeeze.²⁷⁴ This once again shows that the actual problem with the complementary use of sector-specific regulation and competition rules is the respective NRA which only focuses on its own policy goals instead of widening their horizon to competition which clearly is an important factor in any market.

The Commission concludes this issue by finding that the *ne bis in idem* principle was not at stake since the CMT assessed whether the regulatory obligations had been breached whereas the Commission assessed whether then Article 82 EC had been breached.²⁷⁵

In part IX of the Commission decision the imposition of the fine is assessed and numerous times referred to the *Deutsche Telekom* decision:

“In any event, the Deutsche Telekom decision constitutes a clear precedent for this case, clarifying in particular the conditions of application of Article 82 EC to an economic activity subject to sector-specific ex ante regulation. The fact that the

²⁷¹ Commission Decision 04 July 2007, COMP/38.784, para 678.

²⁷² Commission Decision 04 July 2007, COMP/38.784, para 680.

²⁷³ Commission Decision 04 July 2007, COMP/38.784, para 683.

²⁷⁴ Commission Decision 04 July 2007, COMP/38.784, para 684.

²⁷⁵ Commission Decision 04 July 2007, COMP/38.784, para 685.

Deutsche Telekom decision is currently under appeal does not mean that the margin squeeze methodology applied in that decision can be ignored. Nor does it mean that the abuse in question cannot be clear-cut. The analysis applied in the present decision has precedents in the case-law of the European Courts and in Commission decisions prior to Deutsche Telekom. Furthermore, the Deutsche Telekom decision which was publicly available as of October 2003, should have been sufficient to put the company on notice that the type of behaviour it has engaged into constituted, in the Commission's view, a clear-cut abuse of a dominant position under Article 82 EC."²⁷⁶

The Commission further rightly (see above in *Deutsche Telekom*) stated that there are precedents for the kind of infringement Telefónica is accused of. Especially after the *Deutsche Telekom* decision was published in October 2003 the conditions setting out the applicability of then Article 82 EC to an economic activity subject to sector-specific regulation was to a large extent clarified and also known to Telefónica.²⁷⁷

The Commission stated that it did not qualify the infringement by Deutsche Telekom as very serious since the method applied to establish a margin squeeze had not been subject to a formal Commission decision before. Furthermore, Deutsche Telekom had reduced the margin squeeze steadily since 1999 through tariff adjustment at both wholesale and retail level. From 2002 onwards the only legal means available for Deutsche Telekom to reduce the margin squeeze was the increase of T-DSL charges, a retail product. In the present case none of these reasons applied to Telefónica's conduct.²⁷⁸ In contrast Telefónica had adjusted neither its retail nor its wholesale charges to reduce or eliminate the margin squeeze. The abuse ended only after the Spanish regulator intervened in December 2006 by reducing the wholesale prices between a range of 22% to 61%.²⁷⁹

Telefónica had commercial discretion to avoid the margin squeezes by merely reducing its wholesale prices. The Commission at this point mentioned again that until December 2006 the national wholesale prices had never been regulated and the regional wholesale charges were subject to a maximum level only. In comparison with the *Deutsche Telekom* case Telefónica had a much wider discretion to avoid a margin squeeze than Deutsche Telekom. This was so since Deutsche Telekom's wholesale prices were set by the regulator

²⁷⁶ Commission Decision 04 July 2007, COMP/38.784, para 735.

²⁷⁷ Commission Decision 04 July 2007, COMP/38.784, para 740.

²⁷⁸ Commission Decision 04 July 2007, COMP/38.784, para 745.

²⁷⁹ Commission Decision 04 July 2007, COMP/38.784, para 747.

at cost oriented level and therefore could not be reduced. Most of the retail prices of Deutsche Telekom were subject to a price cap formula.²⁸⁰

*“In conclusion, taking into account the Commission’s Guidelines on fines and the relevant case law, the Commission concludes that, in the specific circumstances of the present case, the overall gravity of the infringement should be considered to be very serious. But the Commission will take also due account of all the factors explained above when setting the basic amount of the fine.”*²⁸¹

Account was taken of the fact that the gravity of Telefónica’s abuse became clearer due to the *Deutsche Telekom* decision.²⁸² However, according to the Commission the regulatory intervention regarding the regional wholesale product GigADSL may justify the existence of a mitigating circumstance.²⁸³ Accordingly a 10% reduction from the basic amount was made due to that sectoral regulation and the final fine was set to EUR 151,875,000.²⁸⁴

Even though Telefónica’s infringement was clearly more serious than that of Deutsche Telekom the difference in fine is still enormous and certainly not proportionate. Also I do not share the Commission’s opinion that Telefónica’s abuse became clearer due to the *Deutsche Telekom* decision. Yes, the abuse was more serious in the former case when compared with the latter. However, since the complementary use of sector-specific regulation and competition law is established case law Deutsche Telekom must have known, as it was requested of Telefónica, at any time that its anticompetitive actions were under the scrutiny of competition rules.

d. General Court Judgment²⁸⁵

The General Court handed down its judgment on 29 March 2012. In a rather short decision of merely 18 pages, starting with its legal analysis on page 6, the General Court not only dismissed the action of the Kingdom of Spain but also confirmed the case law established in *Deutsche Telekom*.

²⁸⁰ Commission Decision 04 July 2007, COMP/38.784, para 748.

²⁸¹ Commission Decision 04 July 2007, COMP/38.784, para 750.

²⁸² Commission Decision 04 July 2007, COMP/38.784, para 756.

²⁸³ Commission Decision 04 July 2007, COMP/38.784, para 730.

²⁸⁴ Commission Decision 04 July 2007, COMP/38.784, para 766.

²⁸⁵ General Court 29 March 2012, T-398/07.

In its action against the Commission the Kingdom of Spain relied on five pleas in law. In its first plea the applicant alleged an infringement of the duty of sincere cooperation laid down in Article 10 EC and Article 7(2) of 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).²⁸⁶ In this regard the General Court *inter alia* confirmed that competition law is applicable to regulated sectors.²⁸⁷ Furthermore competition is applicable where sectoral provisions do not preclude companies from engaging in autonomous conduct preventing, restricting or distorting competition.²⁸⁸ Telefónica had leeway to prevent the margin squeezes; accordingly its conduct was within the scope of then Article 82 EC.²⁸⁹ Furthermore it could not be maintained that Telefónica had been penalised by the Commission for an anti-competitive behaviour already analysed by the CMT.²⁹⁰

Then the General Court importantly turned to the *Trinko* judgment the Kingdom of Spain relied upon in its action and held the following:

“There is no need to rule on the relevance of the judgment of the Supreme Court of the United States of 13 January 2004 (Verizon Communications Inc. v Law Offices of Curtis V. Trinko, LLP 540 U.S. 398 (2004)), relied on by the Kingdom of Spain, to the analysis in the present case of the conditions under which the Commission can take action on the basis of Article 82 EC in the regulated market at issue, since the view must be taken that the Commission [...] did in fact examine the regulatory context in which Telefónica supplied wholesale access at the regional level and at the national level, and took into account that context, precisely because of the need [...] to assess all the circumstances, including the obligation imposed on Telefónica by the Spanish regulatory framework to supply wholesale access at regional level from 1999 and wholesale access at national level from April 2002 [...] In any event, even if the sectoral regulation referred to by the Kingdom of Spain derives from European Union secondary legislation, it must be stated that, in view of the principles governing the hierarchical relationship of legal rules, such secondary legislation could not, in the

²⁸⁶ General Court 29 March 2012, T-398/07, para 39.

²⁸⁷ General Court 29 March 2012, T-398/07, para 50 citing ECJ 16 December 1975, joined Cases 40/73 to 48/73, 50/73, 54/73 to 56/73, 111/73, 113/73 and 114/73, paras 65-72; CoJ 11 April 1989, 66/86, *Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v Zentrale zur Bekämpfung unlauteren Wettbewerbs e.V.*

²⁸⁸ General Court 29 March 2012, T-398/07, para 50 citing CoJ 11 November 1997, Joined cases C-359/95 P and C-379/95 P, paras 33-34.

²⁸⁹ General Court 29 March 2012, T-398/07, para 50.

²⁹⁰ General Court 29 March 2012, T-398/07, para 52.

*absence of any enabling provision in the Treaty, derogate from a provision of the Treaty, in this case Article 82 EC [...].*²⁹¹

Even though it would have certainly been interesting if the General Court had indeed spend more time on the *Trinko* judgment it was made very clear that it had no relevance in an EU court.

The General Court also turned to the relationship of *ex ante* and *ex post* rules stating that *ex ante* regulation by a NRA and *ex post* review by the Commission had distinct purposes and objectives.²⁹²

The second plea in law regarded an alleged infringement of Article 82 EC because of manifest errors of assessment.²⁹³ Here the General Court emphasised that Article 82 EC may apply if national legislation preserves the possibility for the undertaking in question to engage in autonomous conducts to prevent, restrict or distort competition.²⁹⁴ Furthermore, notwithstanding such legislation, in a case where a dominant vertically integrated undertaking has leeway to adjust its retail prices alone, then a margin squeeze may be attributable to that undertaking.²⁹⁵ The General Court emphasised the special responsibility of a dominant undertaking as follows:

*“Since Article 82 EC thus refers not only to practices which may cause damage to consumers directly, but also to those which are detrimental to them through their impact on competition, a dominant undertaking has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market (see judgment in Case C-280/08 P Deutsche Telekom v Commission, paragraph 176 and case-law cited).”*²⁹⁶

In its third plea in law the Kingdom of Spain claimed an *ultra vires* application of Article 82 EC by the Commission.²⁹⁷ In essence they meant that the Commission had acted *ultra vires* by intervening late in an adequately regulated market.²⁹⁸ The General Court

²⁹¹ General Court 29 March 2012, T-398/07, para 55.

²⁹² General Court 29 March 2012, T-398/07, para 56.

²⁹³ General Court 29 March 2012, T-398/07, para 59.

²⁹⁴ General Court 29 March 2012, T-398/07, para 71.

²⁹⁵ General Court 29 March 2012, T-398/07, para 72.

²⁹⁶ General Court 29 March 2012, T-398/07, para 92.

²⁹⁷ General Court 29 March 2012, T-398/07, para 97.

²⁹⁸ General Court 29 March 2012, T-398/07, para 101.

held that this plea was too vague to be answered and accordingly declared it inadmissible.²⁹⁹

In its fourth plea in law the Kingdom of Spain claimed a breach of the principle of legal certainty.³⁰⁰ However this plea was based on the mistaken premise that the regulatory framework was altered *ex post* by the Commission, which had not been demonstrated.³⁰¹ Nevertheless the General Court made a number of important statements in its decision in this regard:

*“[...] it is clear that the sectoral legislation to which the Kingdom of Spain refers has no effect on the competence which the Commission derives directly from Article 3(1) of Council Regulation No 17 of 6 February 1962, First Regulation implementing Articles [81 EC] and [82 EC] (OJ 1962 13, p. 204), and, since 1 May 2004, Article 7(1) of Regulation No 1/2003, to find infringements of Articles 81 EC and 82 EC (see, to that effect, Case T-271/03 Deutsche Telekom v Commission, paragraph 263).”*³⁰²

The General Court added that the competition rules supplement the legislative framework adopted by the EC for *ex ante* regulation of the telecommunications sector.³⁰³

The General Court also took regard of the claims by the Kingdom of Spain stating that the Commission ought to have brought infringement proceedings against it, if the Commission came to the conclusion that the CMT, as organ of Spain, did not comply with the regulatory framework by not ensuring the absence of a margin squeeze. The General Court stated that such possibilities had no effect on the lawfulness of the contested decision. Article 82 EC concerns only economic operators. Furthermore the Commission has discretion to decide whether to bring an action for failure to fulfil obligations and the courts of the EU do not assess the appropriateness of that decision.³⁰⁴

As explained above there remains a stale taste if no infringement proceedings are brought against a Member States. However one should not forget that the economic operators Article 82 EC applies to have the responsibility to abide by both sets of rules

²⁹⁹ General Court 29 March 2012, T-398/07, para 105.

³⁰⁰ General Court 29 March 2012, T-398/07, para 106.

³⁰¹ General Court 29 March 2012, T-398/07, para 108.

³⁰² General Court 29 March 2012, T-398/07, para 109.

³⁰³ General Court 29 March 2012, T-398/07, para 110.

³⁰⁴ General Court 29 March 2012, T-398/07, para 115.

even if a NRA makes a contradictory decision or fails to react to anticompetitive behaviour.

In its fifth plea in law the Kingdom of Spain alleged a breach of the principle of the protection of legitimate expectations since the operators on the market believed that they acted under the protection of a sectoral framework regarding wholesale access which was established by the CMT.³⁰⁵ This was answered by the General Court by referring to its former findings that sectoral legislation had no effect on the competence of the Commission to find an infringement of the competition rules and that Telefónica's conduct was within the scope of then Article 82 EC. Accordingly the Commission's action cannot be regarded as unforeseen.³⁰⁶ Furthermore CMT's analyses were never based on EC competition law.³⁰⁷ Therefore the decisions or the regulatory framework of the CMT could not be the basis of legitimate expectations for Telefónica or others that conduct complying with those decisions or rules was compatible with then Article 82 EC.³⁰⁸

The General Court accordingly dismissed the action in its entirety.³⁰⁹

e. *Court of Justice Judgment*³¹⁰

Telefónica SA and Telefónica de España SAU appealed the General Court decision on 13 June 2012 and the CoJ handed down its decision on 10 July 2014.

The applicants relied on ten grounds of appeal (divided into different parts) which were all held to be inadmissible. For the purposes of this thesis only a few of these parts of the grounds of appeal are relevant.

According to the first part of the sixth ground of appeal the General Court erred in law in its examination of the breach by the Commission of the prohibition on exceeding its powers.³¹¹ In this regard the CoJ held *inter alia* as follows:

³⁰⁵ General Court 29 March 2012, T-398/07, para 117.

³⁰⁶ General Court 29 March 2012, T-398/07, para 120.

³⁰⁷ General Court 29 March 2012, T-398/07, para 121.

³⁰⁸ General Court 29 March 2012, T-398/07, para 122.

³⁰⁹ General Court 29 March 2012, T-398/07, para 123.

³¹⁰ CoJ 10 July 2014, C-295/12 P.

³¹¹ CoJ 10 July 2014, C-295/12 P, para 127.

*“It should be recalled in that regard that Article 102 TFEU is of general application and cannot be restricted [...] by the existence of a regulatory framework adopted by the EU legislature for ex ante regulation of the telecommunications markets.”*³¹²

The seventh ground of appeal alleges errors in law in the application of Article 15(2) of Regulation No 17 and Article 23(2) of Regulation No 1/2003. In this regard the CoJ held that Decision 88/518 (*Napier Brown*) and the *Deutsche Telekom* decision were indeed foreseeable precedents.³¹³ Action taken by the Commission was not subject to prior consideration of an intervention by the NRA and is therefore independent of such an intervention. The appellants can therefore not rely on a claim that the Commission’s action was unforeseeable because of the steps taken by the NRA.³¹⁴

The CoJ accordingly rejected the appeal in its entirety.³¹⁵ In my opinion the decision is a natural consequence of the precedents and could not have been a surprise to anyone involved.

f. Analysis

Essentially this case confirmed the *Deutsche Telekom* case in its entirety. Nevertheless the situation in these two leading margin squeeze cases was different. In *Deutsche Telekom* the Commission found that the retail prices were too low. In *Telefónica* the situation was different. Its retail broadband prices were among the highest in Europe; accordingly its retail prices were too high.³¹⁶

The harm in the present case resulted in actual harm to consumers since they would have benefitted from more competition in the market, i.e. in that case lower prices and increased innovation and choice. Accordingly the detrimental effect of Telefónica’s conduct could be measured. Not only were the Spanish retail prices among the highest in

³¹² CoJ 10 July 2014, C-295/12 P, para 128.

³¹³ CoJ 10 July 2014, C-295/12 P, para 149.

³¹⁴ CoJ 10 July 2014, C-295/12 P, para 161.

³¹⁵ CoJ 10 July 2014, C-295/12 P, para 233.

³¹⁶ *Bishop/Walker*, The Economics of EC Competition Law: Concepts, Application and Measurement (2010) recital 6-138 (339).

the EU, but ADSL penetration was below EU average without factors like demand or supply explaining this low penetration.³¹⁷

However, Damien Geradin criticised the *Telefónica* Commission decision with regard to the refusal to supply and margin squeeze elements. He cited the *Deutsche Telekom* judgment where the CFI held that the objectives of competition law and regulation are different. Regulators have a broader set of objectives. Importantly the Commission may not use Article 102 TFEU to enforce regulatory obligations.³¹⁸

This critique may be met by arguing that Article 102 TFEU was first and foremost used to tackle the respective anticompetitive behaviour. It is true that Telefónica did not abide by the sector-specific rules in Spain, but the Commission and the appeal courts concentrated on the margin squeeze, which is considered an anticompetitive behavior. Even though the NRA could have taken actions regarding the margin squeeze it did not do so; accordingly antitrust intervention was necessary.

A stale taste remains since the NRA was not prosecuted for its behaviour by the EU or Spain itself even though it should not have allowed the anticompetitive behaviour in question.

g. Implication

In the aftermath of this decision the Spanish antitrust and regulatory authorities were merged. The new *Comisión Nacional de los Mercados y la Competencia* (National Commission for Markets and Competition, CNMC) took up its enforcement activity on 7 October 2013.³¹⁹

³¹⁷ *Cavaleri Rudaz*, Did *Trinko* Really Kill Antitrust Price Squeeze Claims? A Critical Approach to the *Linkline* Decision Through a Comparison of E.U. and U.S. Case Law, in *Vanderbilt Journal of Transnational Law*, Vol. 43 No. 4 (2010), 1077 (1087).

³¹⁸ *Geradin*, Refusal to supply and margin squeeze: A discussion of why the 'Telefonica exceptions' are wrong (January 28, 2011) via <http://dx.doi.org/10.2139/ssrn.1750226> (accessed 10.11.2014).

³¹⁹ *Brokelmann*, Die Fusion der spanischen Wettbewerbs- und Regulierungsbehörden in Wirtschaft und Wettbewerb 02/2014 (2014), 131

The antitrust authority was merged with the NRAs of seven network industries, e.g. telecommunications, energy and railroads.³²⁰ The CNMC has two decision-making chambers; the first one is in charge of antitrust issues, whereas the second chamber is in charge of regulatory issues. Each chamber has five members which have to rotate between these two chambers. Diverging decisions of the two chambers will be treated in a plenum. Due to the different sectors, the complexity of the regulated industries and the rotation of members between the two chambers it suggests itself that the members of these chambers won't be specialised to the same degree as within separate competition authorities and NRAs.³²¹ Another issue of importance in this regard is that the concentration of power in the new CNMC is substantial and might lead to a politicisation of the CNMC and therefore to less independency from the government. Also due to the number and complexity of expected cases the chamber members will merely review the recommendation of the distinct directorates instead of getting information firsthand on all sectors and cases.³²² Especially NRAs need to have specialised knowledge of the respective sectors and having merely five people responsible for deciding on cases regarding seven different sectors is certainly not desirable. This is even more so if those five people rotate with the chamber on antitrust issues.

Brokelmann argues that there is a danger of “contamination” if a single authority applies both sets of rules and gives two examples. Even before the merger the antitrust authority made decisions which crossed the border to regulation, e.g. the three largest telecommunications operators in Spain – Telefónica, Vodafone and Orange - were fined EUR 120 million in December 2012 for abusing their dominant positions as regards SMS since they allegedly charged too high prices. The antitrust authority found there was an abuse even though there was no price squeeze involved. In the energy sector the Spanish antitrust authority prosecuted alleged anticompetitive behaviour of energy undertakings where they breached sector-specific rules only. In these energy cases substantial fines were

³²⁰ Brokelmann, Die Fusion der spanischen Wettbewerbs- und Regulierungsbehörden in Wirtschaft und Wettbewerb 02/2014 (2014), 133

³²¹ Brokelmann, Die Fusion der spanischen Wettbewerbs- und Regulierungsbehörden in Wirtschaft und Wettbewerb 02/2014 (2014), 135

³²² Brokelmann, Wirtschaft und Wettbewerb 02/2014 (2014), 140-141.

ordered.³²³ However, these examples stem from a time before the merger; accordingly, the actual problem was that the antitrust authority exceeded its authority.

One could argue that the merger of the aforementioned authorities raises concerns about the parallel application of sector-specific rules and competition laws since the latter serve as a safety net in regulated industries. A NRA might come to a decision which allows for anticompetitive behaviour of an undertaking for different reasons, e.g. regulatory capture. In such a situation it is the responsibility of an antitrust authority to prosecute the anticompetitive behaviour in question. Anticompetitive behaviour which has been cleared by the NRA has to fall under the competition laws and the application of both sets of rules might be more difficult if only a single authority is responsible.³²⁴ Where the CNMC finds that a specific price structure is lawful according to sector-specific regulation the CNMC will find it hard to prosecute this specific price structure under the competition rules.³²⁵

There are further reasons apart from regulatory capture which are responsible for diverging decisions between NRAs and antitrust authorities, e.g. different goals or the wrong interpretation of competition rules. Nevertheless regulatory capture is exactly what should not get any influence at all on the applicability of competition rules.

Importantly it is a good sign that Spain tried to learn its lesson from the *Telefónica* judgment and make sure that there are no more diverging decisions between the antitrust authority and the respective NRA. However, I do believe that merging the respective authorities is not ideal, especially due to the fact that detailed knowledge on the antitrust issues and regulatory sectors is missing in the chambers. Also there is the danger of politicisation, and independence from government is vital for the achievement of the respective goals. It would be better if the respective authorities merely cooperate with each other or take account of each other's goals and rules instead of forming a single authority with rather general knowledge.

³²³ Brokelmann, *Wirtschaft und Wettbewerb* 02/2014 (2014), 134-135.

³²⁴ Brokelmann, *Wirtschaft und Wettbewerb* 02/2014 (2014), 136.

³²⁵ Brokelmann, *Wirtschaft und Wettbewerb* 02/2014 (2014), 141.

V The Treatment of Regulated Networks in the US

A. The US Approach - Introduction

Whereas the EU approach is characterised by a symbiotic relationship between sector-specific regulation and competition law the US takes a different approach.

In the US regulatory and antitrust rules developed along more or less independent paths. The policy goals to be achieved were not coordinated under these disciplines. Accordingly, a US court of law determines an antitrust action without resorting to the policy goals of another government institution, whose interventions will likely be perceived as distorting the market.³²⁶

This means that even though there are antitrust rules dealing with anticompetitive behaviour, some of these rules may not apply in certain regulated industries.

As will be further explained below (during deregulation) the US moved from a traditional approach, where antitrust rules were essentially inapplicable in a regulated market, to an approach of implied immunity.

B. Origins of Sector-Specific Regulation

At least since the seventeenth century legal scholars have determined that there are certain industries which are affected with a public interest and therefore require government, i.e. public, oversight. Accordingly bridges, seaports and other public facilities were singled out and put under specific government regulation.³²⁷

The number of industries and facilities singled out to be put under specific government regulation was expanded to public services and utilities by the nineteenth century.³²⁸

³²⁶ *Alexiadis/Cave*, Regulation and Competition Law 13.

³²⁷ *Cole/Grossman*, Antitrust and Regulated Industries 378.

³²⁸ *Cole/Grossman*, Antitrust and Regulated Industries 378.

In many other countries these industries were owned by government agencies to manage them in the public interest. However, in the US there was strong debate regarding the allocation of ownership, i.e. public or private, and the structure of these vital industries.³²⁹

One of the main differences to the European countries is that from the start there used to be privately owned public utilities as opposed to the EU where they usually were owned and operated by the states themselves.

Commentators argued that such services were monopolies and for natural monopolies competition would be inefficient. Accordingly it would be inefficient to break them up according to antitrust rules.³³⁰

The US government therefore maintained the natural monopolies as monopolies and aimed at either owning them or regulating the privately owned monopolies. For example electric utilities have been privately and publicly owned since the early twentieth century; however, they have been regulated by the government.³³¹

In *Munn v. Illinois*³³² in 1876 the Supreme Court decided that it was entirely legal for the government to regulate businesses in the public interest. A decade later the first regulatory agency was created by Congress. The Interstate Commerce Commission oversaw the railroads. Since then the industries today known as regulated industries were regulated and supervised by the government. However, in recent decades most of these industries have become less regulated.³³³

C. Sector-Specific Regulation

As we saw earlier on the monopolist would find the intersection between the marginal revenue curve and the marginal cost curve for the product or service in the market and produce the quantity at the point of intersection.³³⁴ At this point the monopolist would

³²⁹ *Cole/Grossman*, Antitrust and Regulated Industries 378-379.

³³⁰ *Cole/Grossman*, Antitrust and Regulated Industries 379.

³³¹ *Cole/Grossman*, Antitrust and Regulated Industries 379.

³³² *Munn v Illinois*, 94 U.S. 113 (1876).

³³³ *Cole/Grossman*, Antitrust and Regulated Industries 379.

³³⁴ See chapter III A 1 a The economic Theory Behind (Natural) Monopolies.

make the maximal profit. However this would result in a waste of social resources or deadweight loss. Furthermore too little would be produced at a too high price.³³⁵

Accordingly it has to be goal of the regulator to ensure that this for consumers harmful behaviour does not occur. This means that it is necessary for the government to control the prices thereby inducing the monopolist to produce the socially optimal quantity for the market. However, the government may not restrict the prices to a point where no profits are earned otherwise the monopolist is forced out of business. The objective therefore has to be to make sure that the monopolist does not earn more or less than a reasonable profit. The determination of “reasonable” is difficult and requires that the regulator has a lot of information about the regulated industry as a whole and the individual firm in question too. Nonetheless government regulators, companies and consumers will always differ on the determination of reasonable profits.³³⁶

Local, state and federal governments in the US agreed on the following basic approach for industries with natural monopolies: The States usually created public utility commissions serving to regulate utilities. Additionally the federal governments, who have the constitutional authority over interstate commerce, established agencies to regulate those industries whose economic impacts crossed the lines of the States, e.g. the Federal Power Commission.³³⁷

This resulted, depending on the industry structure, in local, regional or national monopoly franchise. In return for receiving the monopoly franchise the undertaking had to guarantee service to anyone who could pay for it. The US government then regulated certain aspects of these businesses, for example rates or capital expansion. The aim was to arrive at a socially beneficial outcome by combining prices close to those in a theoretical competitive market and the scale of economics of production in a monopolistic market.³³⁸

This approach was favoured by large companies which ties in with the Capture and the Contractual Theory described above.³³⁹ However, there were some companies that

³³⁵ *Cole/Grossman*, Antitrust and Regulated Industries 381.

³³⁶ *Cole/Grossman*, Antitrust and Regulated Industries 381.

³³⁷ *Cole/Grossman*, Antitrust and Regulated Industries 381.

³³⁸ *Cole/Grossman*, Antitrust and Regulated Industries 381 - 382.

³³⁹ See chapter III A 2 b The Capture Theory and III A 2 d The Contractual Theory.

challenged parts of this regulatory process.³⁴⁰ One example is *Federal Power Commission v. Natural Gas Pipeline Co.*³⁴¹, where the gas company challenged the Federal Power Commission's decision to lower their prices for natural gas. In 1942 the Supreme Court sided with the government and held as follows:

*"The argument that the provisions of the statute applied in this case are unconstitutional on their face is without merit. The sale of natural gas originating in one State and its transportation and delivery to distributors in any other State constitutes interstate commerce, which is subject to regulation by Congress. It is no objection to the exercise of the power of Congress that it is attended by the same incidents which attend the exercise of the police power of the State. The authority of Congress to regulate the prices of commodities in interstate commerce is at least as great under the Fifth Amendment as is that of the States under the Fourteenth to regulate the prices of commodities in intrastate commerce."*³⁴²

In essence the plaintiff challenged the Natural Gas Act of 1938 which gave the Federal Power Commission the power to control regulation of interstate natural gas sales. This decision made clear that the regulation of commodities both interstate and intrastate by the designated authorities was not unconstitutional while also confirming the validity of the Natural Gas Act and the extensive powers of the Federal Power Commission.

D. Origins of Antitrust Law: The Sherman Act and Monopolistic Markets

In the US certain business enterprises grew to extraordinary wealth and size during the second half of the nineteenth century. They responded in three ways to competition:

- *Trusts*: Undertakings combined themselves in a trust to create a monopolistic entity, e.g. the *Northern Securities Trust*.
- *Cartels*: Undertakings formed cartels to set prices and allocate market shares. However, these efforts were often unsuccessful since individual members frequently could not resist fast profits by defecting from the cartel agreement.

³⁴⁰ *Cole/Grossman*, Antitrust and Regulated Industries 382.

³⁴¹ *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942).

³⁴² *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 582, (1942).

An example of a “successful” cartel over a substantial period of time was the *railroad express cartel*.³⁴³

- *Legal monopoly*: Some undertakings tried to establish themselves as legal monopolies so as not to be subject to antitrust rules.³⁴⁴

Small businessmen and farmers were threatened by the growing market power of trusts and cartels and asked for government protection. The Congress responded to these developments with the Sherman Antitrust Act in 1890. The Sherman Antitrust Act served as the first major antimonopoly law. It made a business “*in the form of trust or otherwise, or conspiracy in restraint of trade or commerce*”³⁴⁵ illegal and outlawed the monopolisation of trade. Even the attempt to form a cartel or monopoly was made a criminal act punishable with jail sentence. The filing of civil suits in this regard was made possible too.

The term antitrust was a response to the trusts as mentioned above. They were operated by a board of trustees who had legal control over the trust. They held stocks in competing undertakings and therefore had the possibility to manage the affairs of the respective industry they operated in.³⁴⁶

Therefore I will refer to US competition rules as antitrust rules and to EU competition rules as competition rules.

The language of the Sherman Antitrust Act was vague and for example no definitions of “*restraint of trade*” or “*conspiracy*” were given. Moreover it was ineffectual in dealing with collusive pricing and created high measurement problems, i.e. transaction costs.³⁴⁷ An example for its vagueness is found in the very first decision where a court interpreted the Sherman Antitrust Act. It ruled that manufacture was not commerce and therefore outside of the scope of the act. Then, veering in the opposite direction, for a short time it was the

³⁴³ In the most of the second half of the nineteenth century the railroad express cartel controlled much of the parcel post transport in the US. For further information about this special cartel see *Grossmann*, The Dynamics of a Stable Cartel: The Railroad Express 1851-1913, in *Economic Enquiry* 34(2), 01/1996, via: http://www.researchgate.net/publication/5211064_The_Dynamics_of_a_Stable_Cartel_The_Railroad_Express_1851-1913.

³⁴⁴ *Cole/Grossman*, Antitrust and Regulated Industries 364-365.

³⁴⁵ *Cole/Grossman*, Antitrust and Regulated Industries 366.

³⁴⁶ *Dabbah*, International and Comparative Competition Law (2010) 228.

³⁴⁷ *Cole/Grossman*, Antitrust and Regulated Industries 366.

law that all restraints were forbidden, because Section 1 of the act condemned every trade restraint. Exceptions to this rule quickly arose. By 1911, the rule of reason was adopted.³⁴⁸ The further development of the US antitrust law will be discussed on the basis of landmark cases in the following.

1. *Northern Securities Co. v the United States*³⁴⁹

a. *Introduction*

This case is of great importance since it illustrates some of the problems with the ambiguous wording of the Sherman Antitrust Act and demonstrates how the government tried to constrain the size and power of undertakings.

This is relevant since it shows how dominant undertakings were treated in the US shortly after the Sherman Antitrust Act was enacted. In contrast to the EU, case law is of much more importance in the US and US case law on dominant undertakings and regulated networks evolved over time. To understand the current US approach and its contrasting position to the EU approach it is necessary to trace the US approach to its beginnings.

b. *Parties to the dispute*

Two railroads which operated from the Midwest to the West Coast, the Great Northern and the Northern Pacific were merged to the Northern Securities Company in 1901, a New Jersey-based holding company. The railroads sold their stocks to the latter.

The government of the United States, at that time then led by President Theodore Roosevelt³⁵⁰, aimed to dissolve the merger under the Sherman Antitrust Act.

c. *Arguments*

The railroad undertakings fought the lawsuit on a number of grounds, e.g. their legality was not a federal issue, but rather a state issue since they were state-created corporations. Importantly, it was not shown that they were a restraint to trade and the two railroads did

³⁴⁸ Facey/Assaf/Roberts, Competition and Antitrust Law: Canada and the United States (2006) 14.

³⁴⁹ *Northern Securities Co. v. United States*, 193 U.S. 197 (1904).

³⁵⁰ Theodore Roosevelt (1858 – 1919) 26th President of the United States from 1901 to 1909.

not merge, but merely contracted with Northern Securities Company, and it was argued by the railroads that the Congress could not infringe on their liberty to contract.

d. Decision

The Supreme Court majority rejected the arguments of the railroad companies. However, Justice Oliver Wendell Holmes dissented and argued that mergers were not by their definition a restraint of trade.

Justice John Marshall Harlan for the majority held that the merger is a trust; but if not it is still a combination restraining interstate and international commerce, which is enough to bring it under the scope of the Sherman Antitrust Act.³⁵¹ Every conspiracy or combination which would eliminate competition between competing railroads which are engaged in interstate trade or commerce and which would restrain such commerce or trade is illegal under the act.³⁵²

*“To vitiate a combination [...] it is only essential to show that, by its necessary operation, it tends to restrain interstate or international trade or commerce, or tends to create a monopoly in such trade or commerce, and to deprive the public of the advantages that flow from free competition.”*³⁵³

A State cannot, by creating a corporation or in any other way, project its own authority into another State to prevent Congress from exerting its powers over interstate and international commerce.³⁵⁴

Justice Holmes, dissenting, made the following important statements:

*“Great cases, like hard cases, make bad law. For great cases are called great not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment.”*³⁵⁵

“A partnership is not a contract or combination in restraint of trade between the partners unless the well known words are to be given a new meaning invented for the purposes of this act. [...] The law, I repeat, says nothing about competition, and only

³⁵¹ *Northern Securities Co. v. United States*, 193 U.S. 197, 198.

³⁵² *Northern Securities Co. v. United States*, 193 U.S. 197, 198.

³⁵³ *Northern Securities Co. v. United States*, 193 U.S. 197, 199.

³⁵⁴ *Northern Securities Co. v. United States*, 193 U.S. 197, 199.

³⁵⁵ *Northern Securities Co. v. United States*, 193 U.S. 197, 400.

prevents its suppression by contracts or combinations in restraint of trade, and such contracts or combinations derive their character as restraining trade from other features than the suppression of competition alone. To see whether I am wrong, the illustrations put in the argument are of use. If I am, then a partnership between two stage drivers who had been competitors in driving across a state line, or two merchants once engaged in rival commerce among the States whether made after or before the act, if now continued, is a crime. For, again I repeat, if the restraint on the freedom of the members of a combination caused by their entering into partnership is a restraint of trade, every such combination, as well the small as the great, is within the act."³⁵⁶

e. Analysis

One commentator alleges that there was no restraint of competition in the case. Instead the merger was an “*efficient and eminently sensible consolidation of rail properties*”³⁵⁷. An example of that efficiency is that between November 1901 and 1903 the rail rates declined on the Hill-Morgan lines. The Supreme Court took no account of economic facts and analysis.³⁵⁸

Even though the Supreme Court might have been correct in prohibiting the merger (railroads unfortunately were infamous for anticompetitive behaviour) the decision was flawed. Economic analysis should be vital in an antitrust case. It is necessary to take account of economic facts otherwise any conclusion that a restraint of trade or a monopoly might be the consequence of the proposed merger is meaningless. So why were the numbers ignored? The majority essentially viewed all mergers as cartels. This is why Justice Holmes dissented; he thought that the Sherman Antitrust Act may be used to attack any merger regardless of its potential to restrain trade.

E. The Expansion of US Antitrust Law

Since the Sherman Antitrust Act had a number of shortcomings (as explained above) Congress took an effort to better define behaviour constituting a restraint of trade and in 1914 two further sets of legal rules were introduced.³⁵⁹

³⁵⁶ *Northern Securities Co. v. United States*, 193 U.S. 197, 410-411.

³⁵⁷ Armentano, Antitrust and Monopoly - Anatomy of a Policy Failure (1992) 54.

³⁵⁸ Armentano, Antitrust and Monopoly 54-55.

³⁵⁹ *Cole/Grossman*, Antitrust and Regulated Industries 370.

The Clayton Antitrust Act of 1914 identified different types of monopolistic behaviour, e.g. mergers between competitors, price discrimination and exclusive dealing arrangements. A number of sections dealt with exclusionary practices.³⁶⁰ Certain practices were illegal if they tended to create a monopoly or substantially lessened competition. This wording created ambiguity too.³⁶¹

The FTC Act served to create a body specifically designated to investigate and prosecute antitrust violations. It declared that “*unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in and affecting commerce, are [...] unlawful*”³⁶². This wording left room open for interpretation and a lot of discretion was therefore left to the courts.³⁶³

1. *United States v Aluminium Co. of America, et al.*³⁶⁴

a. *Introduction*

This is a landmark case addressing the issue whether an undertaking should be broken up merely because it controls a large percentage of the market, even if it does not appear to act like an inefficient monopolist.³⁶⁵

This is relevant since it shows the early US stance for monopolists. As explained above, it is necessary to understand where US antitrust law regarding dominant undertakings or monopolists comes from to understand the current US position. Also these landmark cases still get cited in the antitrust decisions regarding regulated networks.

b. *Parties to the Dispute*

The US government attempted to break up the Aluminium Company of America (Alcoa). At the time Alcoa controlled a large share of the production and sale of virgin aluminium ingot; today this would probably be called recycled aluminium.³⁶⁶

³⁶⁰ Facey/Assaf/Roberts, Competition and Antitrust Law 15-16.

³⁶¹ Cole/Grossman, Antitrust and Regulated Industries 370.

³⁶² Cole/Grossman, Antitrust and Regulated Industries 370.

³⁶³ Cole/Grossman, Antitrust and Regulated Industries 370-371.

³⁶⁴ *United States v. Aluminium Co. of America et al.*, 148 F.2d 416 (1945).

³⁶⁵ Cole/Grossman, Antitrust and Regulated Industries 371.

There was a competitive market for that product which put limits on Alcoa's pricing power. However, during the 1930s Alcoa controlled approximately 90 per cent of domestic US sales and the remaining 10 per cent of sales came mainly from import. Furthermore, Alcoa held a lot of patents for the processes. Importantly Alcoa had far lesser market shares in other parts of the aluminium business but was prominent in fabricated aluminium.³⁶⁷

c. *Decision*

Circuit Judge Learned Hand handed down his opinion in the case and stated that it is hard to say that Alcoa made exorbitant profits on ingot. In such an industry a profit of ten per cent could hardly be considered extortionate.³⁶⁸ Justice Learned Hand then described in an important statement the purposes of the Sherman Antitrust Act regarding monopoly power, that objectives other than economics are relevant and why a system of a number of small producers is advantageous:

"[...] Having proved that 'Alcoa' had a monopoly of the domestic ingot market, the plaintiff had gone far enough; if it was an excuse, that 'Alcoa' had not abused its power, it lay upon 'Alcoa' to prove that it had not. But the whole issue is irrelevant anyway, for it is no excuse for 'monopolizing' a market that the monopoly has not been used to extract from the consumer more than a 'fair' profit. The Act has wider purposes. Indeed, even though we disregarded all but economic considerations, it would by no means follow that such concentration of producing power is to be desired, when it has not been used extortionately. Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. Such people believe that competitors, versed in the craft as no consumer can be, will be quick to detect opportunities for saving and new shifts in production, and be eager to profit by them. In any event the mere fact that a producer, having command of the domestic market, has not been able to make more than a 'fair' profit, is no evidence that a 'fair' profit could not have been made at lower prices. True, it might have been thought adequate to condemn only those monopolies which could not show that they had exercised the highest possible ingenuity, had adopted every possible economy, had anticipated every conceivable improvement, stimulated every possible demand. No doubt, that would be one way of dealing with the matter, although it would imply constant scrutiny and constant supervision, such as courts are unable to provide. Be that as it may, that was

³⁶⁶ Cole/Grossman, Antitrust and Regulated Industries 371.

³⁶⁷ Cole/Grossman, Antitrust and Regulated Industries 371.

³⁶⁸ *United States v Aluminium Co. of America*, 148 F.2d 416, 426-427 (1945).

not the way that Congress chose; it did not condone 'good trusts' and condemn 'bad' ones; it forbade all. Moreover, in so doing it was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few. These considerations, which we have suggested only as possible purposes of the Act, we think the decisions prove to have been in fact its purposes."³⁶⁹

As a result of this ruling Alcoa was not split but production facilities were sold to two companies that later became the competitors of Alcoa. This neither improved efficiency or social welfare nor reduced prices.³⁷⁰

d. Analysis

In this case it was evident that Alcoa was convicted because of its size and not because it restrained trade or charged high prices. To be fair, however, Alcoa engaged in exclusionary practices too. This seems to bear out the fears of Justice Holmes in the aforementioned *Northern Securities* case. However, the court argued that the social goal Congress had in mind overrode an efficiency argument, i.e. a competitive industry with small producers had an indirect but positive effect on society. This means it is better to have a competitive market since such a market makes for a better society.³⁷¹

The implication of the *Alcoa* ruling was that bigness was *per se* problematic, which guided the opinion of the US courts for the next 25 years. In the recent decades, however, this perspective was not always adopted, but the issue of monopoly and bigness still persists.³⁷²

To convict an undertaking merely because of its bigness seems unjustified and unproportionate to me. Also it does not fit within the meaning and applicability of §2 Sherman Antitrust Act. This section declares that an undertaking shall not monopolize or attempt to monopolize. Importantly the mere possession of monopoly power and the charging of monopoly power are not unlawful. Only if accompanied by some kind of anticompetitive behaviour is monopoly power to be found unlawful. Accordingly the main

³⁶⁹ *United States v. Aluminium Co. of America*, 148 F.2d 416, 427 (1945).

³⁷⁰ *Cole/Grossman*, Antitrust and Regulated Industries 373.

³⁷¹ *Cole/Grossman*, Antitrust and Regulated Industries 373.

³⁷² *Cole/Grossman*, Antitrust and Regulated Industries 373

factor in an antitrust case should be whether the economics prove that the behaviour in question was a restraint of trade. In general it is certainly not desirable from an economic point of view to simply penalise a company because of its success as this can result in inefficient outcomes. This is evident in the *Alcoa* case as neither social welfare nor efficiency was improved. Contrary to the current US position merely competitor welfare was improved after two production facilities were sold to companies that later became competitors of Alcoa. However, as a large undertaking has lots of power to influence the market its business practices should be under closer surveillance than those of other companies. Also, since such an undertaking has so much power it has more responsibility; accordingly one could argue that its actions are looked at more strictly.

Another relevant point of this decision was that *Alcoa* clarified the relationship between regulation and antitrust rules. The then Federal Power Commission (now the Federal Energy Regulatory Commission) was required to consider the unregulated retail charges when setting the wholesale prices in order to avoid a price squeeze. Also public utility wholesale rates were not outside the scope of the Sherman Antitrust Act since they could use administrative processes and thereby threaten competitors.³⁷³

Objectives other than economics were taken account of, which is not the case nowadays in the US when antitrust litigation is pending. However, this is a position sitting more comfortable with the EU, where equality of opportunity is taken regard of in dominance cases. One might argue that the EU with its - compared to the US - rather recent competition rules is now at a point where the US was already at the time of the *Alcoa* case and that the US's antitrust rules and objectives are more advanced than the EU ones. On the other hand I believe that the equality of opportunity stance in the EU stems from its goal of achieving a competitive internal market.

³⁷³ *Cavaleri*, Vanderbilt Journal of Transnational Law, October 2010, 1077 (1088-1089).

2. *The Microsoft Case*³⁷⁴

a. *Introduction*

This case is a development of the case law regarding dominant undertakings and monopolists. Microsoft was not charged merely because of its size but because of anticompetitive behaviour which is certainly a welcome development since an undertaking should not be persecuted merely for its success but for unlawful behaviour only.

After IBM Corporation chose Microsoft Corporation's (Microsoft) software to be its standard operating system in the early 1980s, the latter's software became standard. Accordingly Microsoft became the dominant player on the market for PC operating systems. Microsoft was close to a monopolist. Due to its size, dominance and financial success Microsoft became an issue for the Federal Trade Commission (FTC).³⁷⁵

In 1991 the FTC launched an investigation into Microsoft's practices. After two years of investigating they decided not to bring a formal complaint.³⁷⁶

In the meantime, however, the Department of Justice (DOJ) launched its own investigation regarding Microsoft's practice to package application software with its operating system. In 1994 Microsoft settled with the DOJ and agreed that they would not require the PC makers anymore to accept its application software along with its Windows operating system.³⁷⁷

In 1997 the DOJ went to court alleging that Microsoft had violated their agreement since it bundled its Internet browser, Explorer, with its operating system, Windows. In this case tying was at issue and not monopolization *per se*. In January 1998 Microsoft agreed to give PC makers the choice to remove or hide Explorer, even though Microsoft still said that they were not engaging in anticompetitive behaviour. Nevertheless the DOJ and attorney generals of 20 US States filed antitrust charges against Microsoft.³⁷⁸

³⁷⁴ *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9 (1999).

³⁷⁵ *Cole/Grossman*, Antitrust and Regulated Industries 374.

³⁷⁶ *Cole/Grossman*, Antitrust and Regulated Industries 374.

³⁷⁷ *Cole/Grossman*, Antitrust and Regulated Industries 374.

³⁷⁸ *Cole/Grossman*, Antitrust and Regulated Industries 374-375.

b. *Alleged Conduct*

Microsoft was accused of mainly three types of anticompetitive behaviour:

- Tying
- Exclusionary contracts with Internet providers
- Collusion with its competitor Netscape to divide the browser market³⁷⁹

c. *District Court Decision*

The ruling by District Court Judge Jackson was issued two years after the charges were brought. Essentially he held that Microsoft had excluded its competitors by acting as default browser of choice for most of the PC users and created a certain system, making it hard for competitors to write certain middleware Internet and network application programs, such as instant messaging. This hurt competitors and ultimately consumers too.

Judge Jackson stated that the Internet Explorer's debut and its rapid improvement motivated Netscape to improve the quality of its Navigator at a competitive rate. General familiarity with the Internet was increased since Internet Explorer was included with Windows at no extra charge. This in turn reduced the cost for the public to gain access to it at least partly since it somehow forced Netscape to stop charging for Navigator. As a result these actions contributed to improve the quality of Web browsing software, lowered its costs and increased availability which in turn benefitted consumers.³⁸⁰

However, to the detriment of consumers Microsoft had engaged in a concerted series of actions to protect the barriers to entry and therefore its monopoly power from middleware products, including Netscape's Web browser and Sun's implementation of Java. These actions have harmed consumers directly as well as indirectly by distorting competition.³⁸¹

“Most harmful of all is the message that Microsoft's actions have conveyed to every enterprise with the potential to innovate in the computer industry. Through its conduct toward Netscape, IBM, Compaq, Intel, and others, Microsoft has demonstrated that it will use its prodigious market power and immense profits to harm any firm that insists on pursuing initiatives that could intensify competition against one of Microsoft's core

³⁷⁹ *Cole/Grossman*, Antitrust and Regulated Industries 375.

³⁸⁰ *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 111 (1999).

³⁸¹ *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 111 (1999).

products. Microsoft's past success in hurting such companies and stifling innovation deters investment in technologies and businesses that exhibit the potential to threaten Microsoft. The ultimate result is that some innovations that would truly benefit consumers never occur for the sole reason that they do not coincide with Microsoft's self-interest."³⁸²

This judgment was flawed as Judge Jackson did not consider whether the social benefits of tying in this case outweighed the costs of the theoretical consumer harm he argued. In a later ruling he even ordered the breaking up of Microsoft in two distinct companies: one application company and one operating system company each selling the distinct products. Microsoft appealed and the Court of Appeals issued its ruling in June 2001.³⁸³

d. Court of Appeal Decision

The Court of Appeals³⁸⁴ rightly overturned most of Judge Jackson ruling but held that Microsoft had broken antitrust laws by maintaining its monopoly in the operating system market. Also Microsoft had engaged in anticompetitive actions regarding middleware. However, the tying charge and acting to monopolize the browser market were not proven.³⁸⁵

But the most important part of that judgment was that the proposed remedy of Judge Jackson was declared wholly inappropriate. The court had failed to provide an adequate explanation for the relief it ordered. In its decision the District Court did not even explain how the remedies it ordered would accomplish these objectives.³⁸⁶

In the Court of Appeal decision it was stated that the Supreme Court had explained that remedies in an antitrust case must seek to

*"[...] 'unfetter a market from anticompetitive conduct,' to 'terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future'."*³⁸⁷

³⁸² *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9,112 (1999).

³⁸³ *Cole/Grossman*, Antitrust and Regulated Industries 376-377.

³⁸⁴ *United States of America, Appellee v. Microsoft Corporation, Appellant*, 253 F.3d 34 (2001).

³⁸⁵ *Cole/Grossman*, Antitrust and Regulated Industries 377.

³⁸⁶ *United States of America v. Microsoft Corporation*, 253 F. 3d 34, 259 (2001).

³⁸⁷ *United States of America v. Microsoft Corporation*, 253 F. 3d 34, 258 (2001).

e. Remedies

The case came to end in November 2002. The remedies were the provision of middleware interfaces and codes by Microsoft to application writers to make sure that Windows could be used as a platform for a number of competitors. Moreover, no more agreements between Microsoft and Internet access providers requiring the latter to use only Microsoft products were to be entered into. Finally, for five years Microsoft must offer uniform licensing agreements with leading computer manufacturers.³⁸⁸

These remedies were at the time surely suitable to achieve the objectives the Court of Appeal wanted to achieve. Most importantly the markers for competition, i.e. making sure that Windows as a platform may be used by competitors on a technical level as well as opening up the practical possibility to do so by not prohibiting it per contract, were laid down.

f. Analysis

This case is a good example of how US law in this area evolved over time. Firstly, Microsoft was not charged because of its mere size but because of certain anticompetitive behaviour which indicates a step into the direction Justice Holmes in the *National Securities* case preferred. Secondly, the remedies ordered were suitable to achieve the antitrust objectives. Thirdly, it served as a deterrent for other companies not to violate an agreement with the DOJ or to interpret it too narrowly or wrongly.

However, not only the case law regarding dominant and monopolistic undertakings evolved over time, but also the case law on the relationship between sector-specific regulation and antitrust law developed. Both developments are relevant to understand the differences between the US and the EU since questions on dominance and monopolies tie in with regulated networks where usually at least one of the market players is dominant (often due to being the former incumbent monopolist) or even still monopolistic.

³⁸⁸ *Cole/Grossman*, Antitrust and Regulated Industries 377.

F. Sector-Specific Regulation vs Antitrust Law

In the US there is continuous development on the relationship between sector-specific regulation and antitrust law. This development will be illustrated below in detail.

1. Express or Implied Repeal

The role of antitrust might be limited where there is an express exemption from antitrust liability in the federal regulatory statute. The Shipping Act of 1984 for example provides for such exemptions as is contains antitrust-like rules applying to common carriers which are regulated by the Federal Maritime Commission.³⁸⁹

Another possibility is an antitrust immunity granted by the federal agency; however, an antitrust court can second guess the fact determinations and the legal interpretation by the federal agency.³⁹⁰

Just like the second possibility the third one is also very narrow: Where the regulatory statute does not say anything on this issue a limitation or exemption may be implied.³⁹¹ In such a case the Supreme Court held as follows:

*“Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavoured, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions.”*³⁹²

2. Traditional Approach – Determination of Pervasiveness

The traditional approach in the US used to be that antitrust was unwelcome or seriously confined in a regulated market. The antitrust tribunal had to determine the “pervasiveness” of the regulatory rules in place. In case the regulatory regime was deemed pervasive, then the activities within these rules were exempt from antitrust scrutiny. This approach has changed due to the deregulation movement, since the perception of regulation changed. Regulation is no more regarded as comprehensive but rather as imperfect. Irrespective of how “thick” the regulatory regime is, this does not mean that an agency collects and

³⁸⁹ Hovenkamp, Federal Antitrust Policy - The Law of Competition and its Practice⁴ (2011) 771.

³⁹⁰ Hovenkamp, Federal Antitrust Policy 771.

³⁹¹ Hovenkamp, Federal Antitrust Policy 771.

³⁹² *United States v. Philadelphia National Bank*, 374 U.S. 321, 350-351, 83 S.Ct. 1715, 1735 (1963) cited in Hovenkamp, Federal Antitrust Policy 771-772.

considers all relevant information and facts. Furthermore, *all* markets are regulated to some degree.³⁹³

This approach is flexible which on the one hand is not ideal from a legal certainty point of view but on the other it can be adapted well to the specific circumstances of the case and market in question.

3. Implied Immunity Doctrine

Accordingly, it is to consider which regime regulates the activity in question and whether that activity was instigated or approved by the authority or whether the activity results from unsupervised conduct of an undertaking.³⁹⁴ In the *MCI* decision the Seventh Circuit held that the existence of immunity was dependent on either “*the activities that are subject of MCI’s complaint were required or approved by the [agency], pursuant to its statutory authority, in a way that is incompatible with antitrust enforcement*” or whether the “*activities were so pervasively regulated that ‘Congress must be assumed to have forsworn the paradigm of competition’*”³⁹⁵.

The traditional approach of pervasiveness was replaced by determining whether the conduct in question was instigated or approved by the authority. Hovenkamp summed the necessary questions to ask up as follows:

- Was the conduct challenged within the agency’s jurisdiction?
- Was the conduct challenged presented for review to the agency?
- Did the agency review any potential anticompetitive consequences appropriately?
- Would the application of antitrust rules result in inconsistent mandates or would it frustrate the regulatory process?

³⁹³ *United States v. Philadelphia National Bank*, 374 U.S. 321, 350-351, 83 S.Ct. 1715, 1735 (1963) cited in *Hovenkamp*, Federal Antitrust Policy 772.

³⁹⁴ *United States v. Philadelphia National Bank*, 374 U.S. 321, 350-351, 83 S.Ct. 1715, 1735 (1963) cited in *Hovenkamp*, Federal Antitrust Policy 772.

³⁹⁵ *MCI Communications Corporation and Mci Telecommunicationscorporation v. American Telephone and Telegraph Company*, 708 F.2d 1081, 1102 (7th Cir. 1983) cited in *Hovenkamp*, Federal Antitrust Policy 773.

- Does the agency possess special expertise not available to the antitrust tribunals for evaluating the conduct challenged?³⁹⁶

One of the most recent case in this regard is the *Credit Suisse* case where the Supreme Court inter alia stated that the “centrality” of the conduct challenged to the supervisory role of the Security Exchange Commission (SEC), i.e. the regulatory agency, was crucial in determining that there was an immunity from the antitrust rules. The challenged activities were all within the SEC’s jurisdiction and there was nothing to suggest that they did not carry out their regulatory mandate appropriately. Furthermore, the Supreme Court was especially concerned about multiple tribunals coming to inconsistent conclusions when evaluating the same conduct and that these results would get exacerbated by the generalist nature of such antitrust proceedings.³⁹⁷ Similar to the *Trinko* case below the Court concluded that “any enforcement-related need for an antitrust lawsuit is unusually small” since the SEC can step in to avoid collusion.³⁹⁸ Furthermore the Court emphasized the limitations of judges and juries as non-experts in the financial sector as well as the “unusually high risk that different courts will evaluate similar factual circumstances differently”³⁹⁹. Additionally the risk of false positives was emphasized as “antitrust courts are likely to make unusually serious mistakes in this respect”⁴⁰⁰.

As described in detail below when taking regard of the *Trinko* judgment such an argumentation is flawed.

Even though the approach changed in the last thirty years as the Supreme Court has become more critical of regulation enforced by agencies and it seems like antitrust rules will not be trumped simply because of pervasive regulation the immunity grant in *Credit Suisse* is quite broad. This might be explained by the fact that the Supreme Court is sceptical about private antitrust litigation.⁴⁰¹

³⁹⁶ *MCI v. AT&T*, 708 F.2d 1081, 1102 (7th Cir. 1983) cited in *Hovenkamp*, Federal Antitrust Policy 773.

³⁹⁷ *MCI v. AT&T*, 708 F.2d 1081, 1102 (7th Cir. 1983) cited in *Hovenkamp*, Federal Antitrust Policy; *Credit Suisse Securities (USA), LLC v. Billing*, 551 U.S. 264, 127 S.Ct. 2383 (2007).

³⁹⁸ *Credit Suisse Securities (USA), LLC v. Billing*, 127 S.Ct. 2383, 2396 (2007) .

³⁹⁹ *Credit Suisse Securities (USA), LLC v. Billing*, 127 S.Ct. 2383, 2395 (2007) .

⁴⁰⁰ *Credit Suisse Securities (USA), LLC v. Billing*, 127 S.Ct. 2383, 2396 (2007) .

⁴⁰¹ *MCI v. AT&T*, 708 F.2d 1081, 1102 (7th Cir. 1983) cited in *Hovenkamp*, Federal Antitrust Policy 775.

4. Amount of Regulatory Oversight and State Action Compared

The question that follows the *Credit Suisse* case regards the quantum of regulatory oversight necessary to make challenged conduct immune from the antitrust rules.

So far the Supreme Court said little on this question for federally regulated industries; however, it said a lot on “*active supervision*” a state regulatory agency has to engage in before private conduct meets the requirements for a state action exemption. According to Hovenkamp there is no reason why the standard of active state supervision should be different to the standard of active federal supervision.⁴⁰²

Together with the *Credit Suisse* case the *Trinko* and *Linkline* Supreme Court decisions make for the current US stance on the relationship between sector-specific regulation and antitrust rules. They exclude the respective behaviour from antitrust scrutiny if the anticompetitive behaviour is covered by sector-specific regulation. These cases also account for the best examples of how the EU and the US position on this issue are contrasting.

5. *Verizon Communications Inc. v. Trinko*

a. Introduction

The so-called *Trinko*⁴⁰³ case involved the obligation of an incumbent telephone carrier to interconnect with rivals so that they were able to access the telecommunications system.

The Telecommunications Act of 1996 (1996 Act) imposes a number of duties upon incumbent local telephone companies to facilitate market entry by competitors. This act also establishes a regime for monitoring and enforcing. The *Trinko* case regarded the question whether a complaint alleging a breach of the incumbent’s duty under the 1996 Act, i.e. sharing its network, states a §2 Sherman Antitrust Act claim.⁴⁰⁴

The 1996 Act has as one of its main purposes to require incumbent local telephone monopolists to give access and thereby open the market to entry to competitive carriers.

⁴⁰² *MCI v. AT&T*, 708 F.2d 1081, 1102 (7th Cir. 1983) cited in *Hovenkamp*, Federal Antitrust Policy 775.

⁴⁰³ *Verizon v. Trinko*, 540 U.S. 398 (2004).

⁴⁰⁴ *Verizon v. Trinko*, 540 U.S. 398 (2004) 3398.

Furthermore, the 1996 Act ends the antitrust supervision of the telecommunications industry by the District of Columbia” district court and places jurisdiction for these markets under the Federal Communications Commission (FCC). Importantly the 1996 Act contains an antitrust savings clause providing that “*nothing in this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws*”⁴⁰⁵. One would think that this clause provides that antitrust remedies are available if competition is frustrated but since *Trinko* the remedy for denial of access in the market for local telephone markets is exclusively found in the 1996 Act and its implementing regulations but not in antitrust law.⁴⁰⁶

b. *Parties to the Dispute*

Verizon Communications Inc. (Verizon) is the incumbent local exchange carrier (LEC) and serves the New York State. Verizon is a product of a merger. NYNEX used to be the incumbent LEC for New York State but merged with Bell Atlantic Corporation. After a further merger Verizon was established. Before the 1996 Act an exclusive franchise right within its local service was enjoyed by Verizon just like other incumbent LECs. However, the 1996 Act introduced competition and a central feature of it is the incumbent LEC’s obligation to share with its competitors its network. This includes the provision of access to individual elements of the network in question on an unbundled basis. New entrants, i.e. competitive LECs, resell those unbundled network elements (UNEs), recombined either with each other or with other elements which belong to the LECs. To comply with the 1996 Act Verizon signed interconnection agreements with its rivals, e.g. AT&T. Verizon also took the opportunity the 1996 Act gave to enter the long-distance market. That required Verizon to inter alia satisfy a checklist of statutory requirements including complying with the network-sharing duties the 1996 Act set out. Furthermore the Federal Communications Commission was responsible for long-distance approval and it approved Verizon’s application for New York in December 1999.⁴⁰⁷

⁴⁰⁵ 110 Stat. 143, 47 U.S.C. §152, note.

⁴⁰⁶ Rubin/Hawker/Candeup, Access remedies after *Trinko* in Moss, Network Access, Regulation and Antitrust (2012) 58.

⁴⁰⁷ *Verizon v. Trinko*, 540 U.S. 398, 402-403 (2004) .

Under § 251(c)(3) 1996 Act part of Verizon's UNE obligation is to provide access to operations support systems (OSS). This is a set of systems which incumbent LECs use to provide service to their customers and to ensure quality. The interconnection agreement by Verizon and long-distance authorization each specify the mechanics by which its OSS obligation would be met. A LEC sends its order for service via an electronic interface with the ordering system of Verizon and when Verizon completes certain steps in fulfilling the order, it sends confirmation to the LEC through the same interface. Without access to the OSS the rival is not able to fulfil the orders of its customers.⁴⁰⁸

In 1999 competitive LECs complained to the regulators about many orders going unfulfilled in breach of Verizon's obligation to provide access to the OSS functions. Accordingly parallel investigations were ordered by the Public Service Commission (PSC) and FCC. The investigation by PSC led to a number of orders as well as liability to the competitive LECs of \$10 million. The investigation of the FCC led to a consent decree and Verizon undertook to make a "*voluntary contribution*" of \$3 million to the U.S. treasury. Furthermore Verizon was subjected to new performance measurements and reporting requirements to the PSC and the FCC under both the orders and the consent decree. Noncompliance would have led to additional penalties. However in June 2000 the consent decree was terminated by the FCC and one month later the PSC relieved Verizon of its heightened reporting requirements.⁴⁰⁹

Law Offices of Curtis V. Trinko, LLP, the respondent, was a New York City based law firm. It filed a complaint in the District Court for the Southern District of New York a day after Verizon entered its consent decree with the FCC. The respondent filed its complaint on behalf of itself and other customers which were similarly situated. The complaint alleged the following:

*"Verizon had filled rivals' orders on a discriminatory basis as part of an anticompetitive scheme to discourage customers from becoming or remaining customers of competitive LECs, thus impeding the competitive LECs ability to enter and compete in the market for local telephone service."*⁴¹⁰

⁴⁰⁸ *Verizon v. Trinko*, 540 U.S. 398, 403 (2004).

⁴⁰⁹ *Verizon v. Trinko*, 540 U.S. 398, 403-404 (2004).

⁴¹⁰ *Verizon v. Trinko*, 540 U.S. 398, 404 (2004).

The complaint sought damages as well as injunctive relief for violation of §2 of the Sherman Antitrust Act and further alleged violation of the 1996 Act too.⁴¹¹

c. *District Court and Court of Appeal*

The complaint was dismissed by the District Court in its entirety. According to the District Court the allegation of deficient assistance to rivals did not meet the requirements of §2. On the other hand the Court of Appeal for the Second Circuit reinstated part of the complaint including the antitrust claim.⁴¹²

d. *Supreme Court Decision*

Justice Scalia speaking for the majority relied on two lines of arguments reversing the reinstatement of the antitrust claim by the Second Circuit. For this thesis his first line of argument is relevant, namely that if two federal statutes pertain to the same subject matter and therefore conflict with each other then one of these federal statutes must yield to the other. His second line of argument is that the amended complaint did not state a §2 Sherman Antitrust Act claim under existing antitrust laws.⁴¹³

According to the Supreme Court the wide-ranging nature of the Telecommunications Act 1996 can be interpreted as a stand-alone regulatory regime. It follows that firms subject to the rules of this Act would be immune from competition law. This implied immunity doctrine aims to avoid conflicting decisions between the two regimes. However, since the Telecommunications Act 1996 expressly allows for competition law in certain circumstances any implied immunity is excluded. The behaviour in question was not covered within the interpretation of §2 Sherman Antitrust Act since §2 cannot be used for services which the dominant did not offer to anyone (unlike *Aspen Skiing*⁴¹⁴). Here it is important to note that US law has a restrictive attitude to using competition law to impose duties to deal upon dominant firms.⁴¹⁵

On page 412 of the judgment to core of the Supreme Courts' reasoning is found:

⁴¹¹ *Verizon v. Trinko*, 540 U.S. 398, 405 (2004).

⁴¹² *Verizon v. Trinko*, 540 U.S. 398, 405 (2004).

⁴¹³ *Rubin/Hawker/Candeup*, Access remedies after Trinko 60.

⁴¹⁴ *Aspen Skiing v. Aspen Highlands Skiing*, 472 U.S. 585 (1985).

⁴¹⁵ *Larouche*, Contrasting legal solutions 78-79.

*“One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, 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. Where, by contrast, ‘[t]here is nothing built into the regulatory scheme which performs the antitrust function,’ [...] the benefits of antitrust are worth is sometimes considerable disadvantages.”*⁴¹⁶

The Supreme Court also found that the Telecommunications Act 1996 contains an elaborate set of rules which made it *“an effective steward of the antitrust function”*⁴¹⁷.

The rather short Supreme Court opinion concentrates on the discussion of the relationship between sector-specific regulation and competition law and on whether a claim under §2 of the Shearman Antitrust Act was established by the claimant.

To start the Court states that it is first necessary to determine the effects the 1996 Act has on the application of traditional antitrust principles. The 1996 Act imposes a number of duties upon incumbent LECs and the most intrusive of them is the duty to offer access to UNEs according to §251(c)(3) 1996 Act on *“just, reasonable and non-discriminatory”* terms.⁴¹⁸

*“That Congress created these duties, however, does not automatically lead to the conclusion that they can be enforced by means of an antitrust claim. Indeed, a detailed regulatory scheme such as that created by the 1996 Act ordinarily raises the question whether the regulated entities are not shielded from antitrust scrutiny altogether by the doctrine of implied immunity.”*⁴¹⁹

The Court continues stating the 1996 Act’s enforcement scheme is a *“good candidate”* for the implication of an antitrust immunity. Such immunity would serve to avoid judgment conflict with the agency’s regulatory scheme.⁴²⁰

“Congress, however, precluded that interpretation. Section 601(b)(1) of the 1996 Act is an antitrust-specific saving clause providing that ‘nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws.’ [...] This bars a finding of implied immunity.

⁴¹⁶ *Verizon v. Trinko*, 540 U.S. 398, 412 (2004), thereby citing *Silver v. New York Stock Exchange*, 373 US 341, 358 (1963).

⁴¹⁷ *Verizon v. Trinko*, 540 U.S. 398, 698 (note 5) (2004).

⁴¹⁸ *Verizon v. Trinko*, 540 U.S. 398, 405-406 (2004).

⁴¹⁹ *Verizon v. Trinko*, 540 U.S. 398, 406 (2004).

⁴²⁰ *Verizon v. Trinko*, 540 U.S. 398, 406 (2004).

As the FCC has put the point, the saving clause preserves those claims that satisfy established antitrust standards.”⁴²¹

This savings clause is interpreted by the Court as meaning the following:

“[the] 1996 Act preserves claims that satisfy existing antitrust standards, it does not create new claims that go beyond existing antitrust standards; that would be equally inconsistent with the saving clause’s mandate that nothing in the Act ‘modify, impair, or supersede the applicability’ of the antitrust laws.”⁴²²

This interpretation is indeed astonishing since clearly the intent of Congress was that 1996 Act would not be inconsistent with the antitrust rules. This interpretation by the Court is also one of the reasons why this judgment was heavily criticised by commentators since the legal conflict addressed involves the issue of implied antitrust immunity, which was repudiated due to the savings clause. Antitrust claims are barred by implied immunity where there is “*a convincing showing of clear repugnancy between the antitrust laws and the regulatory system*”⁴²³.⁴²⁴ The court however decided that Congress did not intend that the firms regulated under the 1996 Act receive antitrust immunity. Commentators then suggest that “*while the majority’s recognition of the legal effect of the savings clause was immediate their disappointment at not being able to do legally immunize monopolies regulated under the 1996 Act was not well disguised*”⁴²⁵. The court accordingly decided that the 1996 Act was a detailed regulatory scheme and therefore a good candidate for the implication of antitrust immunity. This may be interpreted as the Supreme Court believing that the antitrust laws and the 1996 Act are repugnant. This is just wrong because Congress did not intend to pre-empt antitrust laws through the 1996 Act and the Supreme Court clearly used the doctrine of implied immunity to infer a legislative intent that wasn’t there in the first place. The savings clause undoubtedly evidences that Congress did not mean to imply that undertakings subject to the 1996 Act should be outside of the scope of antitrust law. Accordingly the drafters of the 1996 Act were not of the opinion that the statutes were conflicting legal regimes. The language of the savings clause does not mean that the co-existence between antitrust laws and the 1996 Act is to be ruled out. Therefore the majority

⁴²¹ *Verizon v. Trinko*, 540 U.S. 398, 406 (2004).

⁴²² *Verizon v. Trinko*, 540 U.S. 398, 407 (2004).

⁴²³ *United States v. National Association of Securities Dealers, Inc.*, 422 U.S. 694, 719-20 (1975).

⁴²⁴ *Rubin/Hawker/Candeup*, Access remedies after *Trinko* 61.

⁴²⁵ *Rubin/Hawker/Candeup*, Access remedies after *Trinko* 61.

was correct in stating that Congress had precluded that the 1996 Act as immunising the telecommunications industry from liability under the antitrust laws.⁴²⁶

The Court then goes on to determine the meaning and applicability of §2. This section declares that an undertaking shall not monopolize or attempt to monopolize. The mere possession of monopoly power and the charging of monopoly power are not unlawful; rather they are important elements of a free-market system. Furthermore monopoly power will only ever be found unlawful if it is accompanied by some kind of anticompetitive behaviour.⁴²⁷

The Court also talks about access to infrastructure by stating that firms may acquire monopoly power by creating infrastructure which makes them uniquely suited to serve their customers.

*“Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities.”*⁴²⁸

Another critique by the Court in this regard is the courts are ill-suited to enforce sharing as they are no central planners responsible for identifying what the appropriate price, quantity or other terms of dealing are. Importantly the Court also states that collusion, *“the supreme evil of antitrust”* may be facilitated if competitors are compelled to negotiate with each other.⁴²⁹

In the last chapter I will describe in detail why such reasoning is flawed. Suffice it to say for the moment that on a day-to-day basis courts rule on cases where they have no expertise of the non-legal issues of the case in question. Also they can order expert opinions and have other possibilities to gain enough information they can understand for coming to a resolution. Furthermore it is not the task of a court to simply exchange one evil for an even worse evil by stating that collusion may be facilitated of competitors are forced to negotiate with each other thereby ignoring that refusal to deal is also a very harmful anticompetitive behaviour.

⁴²⁶ Rubin/Hawker/Candeup, Access remedies after Trinko 61.

⁴²⁷ Verizon v. Trinko, 540 U.S. 398, 407 (2004).

⁴²⁸ Verizon v. Trinko, 540 U.S. 398, 407-408 (2004).

⁴²⁹ Verizon v. Trinko, 540 U.S. 398, 408 (2004).

A detailed discussion on the right to refuse to deal follows. A refusal to cooperate with ones rivals can constitute anticompetitive conduct and therefore violate §2 under certain circumstances.⁴³⁰

The Court goes on to set out the details of the leading refusal to deal case under §2, the *Aspen Skiing*⁴³¹ case. Four mountains made up the Aspen Ski area. The plaintiff owned one of those mountain areas and the defendant owned the other three. Plaintiff and defendant had cooperated on joint all-area ski tickets for years. The defendant then repeatedly demanded a higher share of the proceeds and then cancelled the joint ticket. What followed were a number of increasingly desperate measures by the plaintiff to re-create the joint ticket since he was concerned that when not offering joint tickets the skiers would bypass his mountain area. One of those measures was to buy tickets off the defendant for the retail price but even that was refused.⁴³²

*"[...] the unilateral termination of a voluntary (and thus presumably profitable) course of dealing suggested a willingness to forsake short term profits to achieve an anticompetitive end [...] Similarly, the defendant's unwillingness to renew the ticket even if compensated at retail price revealed a distinctly anticompetitive bent."*⁴³³

The Court then continued with its analysis on whether Verizon's behaviour accounted for anticompetitive refusal to deal by comparing the cases and finding that the refusal to deal alleged in the present does not fit within the limited *Aspen Skiing* exception. This is so since the complaint does not state that Verizon voluntarily engaged in business with its rival or would have done so without compulsion by regulation. Accordingly the prior conduct sheds not light upon the motivation of the refusal to deal – *"upon whether its regulatory lapses were prompted not by competitive zeal but by anticompetitive malice"*⁴³⁴. Additionally the difference between the cases is heightened by the pricing behaviour. In *Aspen Skiing* the defendant didn't want to sell at its own retail price which suggested that its future monopoly retail price would be higher. In the present case Verizon's reluctance to interconnect at a cost based rate of compensation does not tell the Court anything about dreams of monopoly. The nature of the 1996 Act makes the present case distinct from

⁴³⁰ *Verizon v. Trinko*, 540 U.S. 398, 408 (2004).

⁴³¹ *Aspen Skiing v. Aspen Highlands Skiing*, 472 U.S. 585, 601 (1985).

⁴³² *Verizon v. Trinko*, 540 U.S. 398, 408-409 (2004).

⁴³³ *Verizon v. Trinko*, 540 U.S. 398, 409 (2004).

⁴³⁴ *Verizon v. Trinko*, 540 U.S. 398, 409 (2004).

Aspen Skiing. In the latter the defendant refused to provide a product that it already sold at retail. In the present case however, the services allegedly withheld were not available to the public.⁴³⁵

This comparison is somewhat astonishing. The cases are mainly distinguished on the basis of former availability of the product (or service) in question. If a product or service is essential to rivals to inject competition now why does it matter whether the product or service used to be available before? In a refusal to deal case the central question should be whether the product or service at issue is really essential for the competitor to serve the market. And especially in an ever developing industry like telecommunications such a distinction is out of place.

*"[...] that Verizon's alleged insufficient assistance in the provision of service to rivals is not a recognized antitrust claim under this Court's existing refusal-to-deal precedents. This conclusion would be unchanged even if we considered to be established law the 'essential facilities' doctrine crafted by some lower courts, under which the Court of Appeals concluded respondent's allegations might state a claim. [...] We have never recognized such a doctrine, see Aspen Skiing Co."*⁴³⁶

The Court continues by stating the following

*"The 1996 Act's extensive provision for access makes it unnecessary to impose a judicial doctrine of forced access. To the extent respondent's essential facilities argument is distinct from its general §2 argument, we reject it."*⁴³⁷

This last paragraph on the 1996 Act's extensive provisions fits in with existing case law described so far, namely that if an act is covered by regulation it is not under antitrust scrutiny.

The Court then goes on to set out the relationship between sector-specific regulation and antitrust law which I will cite extensively due to their very importance to the US position on this issue:

"Finally, we do not believe that traditional antitrust principles justify adding the present case to the few existing exceptions from the proposition that there is no duty to aid competitors. Antitrust analysis must always be attuned to the particular structure

⁴³⁵ *Verizon v. Trinko*, 540 U.S. 398, 409-410 (2004).

⁴³⁶ *Verizon v. Trinko*, 540 U.S. 398, 410-411 (2004).

⁴³⁷ *Verizon v. Trinko*, 540 U.S. 398, 411 (2004).

and circumstances of the industry at issue. Part of that attention to economic context is an awareness of the significance of regulation. As we have noted, 'careful account must be taken of the pervasive federal and state regulation characteristic of the industry. [...] [A]ntitrust analysis must sensitively recognize and reflect the distinctive economic and legal setting of the regulated industry to which it applies.'"⁴³⁸

*"One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, 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. Where, by contrast, '[t]here is nothing built into the regulatory scheme which performs the antitrust function,' Silver v. New York Stock Exchange, 373 U.S. 341, 358 (1963), the benefits of antitrust are worth its sometimes considerable disadvantages. Just as regulatory context may in other cases serve as a basis for implied immunity, see, e.g., United States v. National Assn. of Securities Dealers, Inc., 422 U. S., at 730–735, it may also be a consideration in deciding whether to recognize an expansion of the contours of §2. The regulatory framework that exists in this case demonstrates how, in certain circumstances, 'regulation significantly diminishes the likelihood of major antitrust harm'."*⁴³⁹

This view is too general in my opinion and does not take account of case specificities. What counts in practice is whether the regulatory structure in question really does remedy the anticompetitive harm, i.e. what did the regulatory authority do so far? How far do the powers of the regulatory authority extend and is it in the power of the regulatory authority to effectively remedy the anticompetitive harm? As in the EU it is relevant whether the regulatory authority takes regard of antitrust rules when making its decisions. Also this will be discussed in detail below as I want to omit repetitions.

The Court continues by describing the duties imposed on Verizon under the regulatory regime as well as the commitments which are enforceable by the FCC through continuous oversight. It also sets out how the regulator dealt with Verizon's behaviour.

"The regulatory response to the OSS failure complained of in respondent's suit provides a vivid example of how the regulatory regime operates. When several competitive LECs complained about deficiencies in Verizon's servicing of orders, the FCC and PSC responded. The FCC soon concluded that Verizon was in breach of its sharing duties under §251(c), imposed a substantial fine, and set up sophisticated measurements to gauge remediation, with weekly reporting requirements and specific penalties for failure. The PSC found Verizon in violation of the PAP even earlier, and imposed additional financial penalties and measurements with daily reporting

⁴³⁸ *Verizon v. Trinko*, 540 U.S. 398, 411 (2004).

⁴³⁹ *Verizon v. Trinko*, 540 U.S. 398, 412 (2004).

*requirements. In short, the regime was an effective steward of the antitrust function.*⁴⁴⁰

Here it is necessary to note that also commentators describe the regulator as effective which is a difference to the initial situation in the EU cases.

The Court then sets out the costs of applying the antitrust principles to cases where the alleged anticompetitive behaviour is dealt with under sector-specific regulation.

*“Against the slight benefits of antitrust intervention here, we must weigh a realistic assessment of its costs [...] The cost of false positives counsels against an undue expansion of §2 liability. One false-positive risk is that an incumbent LEC’s failure to provide a service with sufficient alacrity might have nothing to do with exclusion. Allegations of violations of §251(c)(3) duties are difficult for antitrust courts to evaluate, not only because they are highly technical, but also because they are likely to be extremely numerous, given the incessant, complex, and constantly changing interaction of competitive and incumbent LECs implementing the sharing and interconnection obligations.... Judicial oversight under the Sherman Act would seem destined to distort investment and lead to a new layer of interminable litigation, atop the variety of litigation routes already available to and actively pursued by competitive LECs.”*⁴⁴¹

The Court continues by stating that a further problem is an antitrust court is no appropriate institution to deal with cases where some kind of oversight is needed to remedy the anticompetitive behaviour at hand.

*“Effective remediation of violations of regulatory sharing requirements will ordinarily require continuing supervision of a highly detailed decree. We think that Professor Areeda got it exactly right: No court should impose a duty to deal that it cannot explain or adequately and reasonably supervise. The problem should be deemed irremedia[ble] by antitrust law when compulsory access requires the court to assume the day-to-day controls characteristic of a regulatory agency...In this case, respondent has requested an equitable decree to [p]reliminarily and permanently enjoin [Verizon] from providing access to the local loop market [...] to [rivals] on terms and conditions that are not as favorable as those that Verizon enjoys [...]. An antitrust court is unlikely to be an effective day-to-day enforcer of these detailed sharing obligations.”*⁴⁴²

Also this is discussed in detail in the last chapter. Suffice it to say that the arguments put forward by the Court might be persuading at first glance but when looking into them they

⁴⁴⁰ *Verizon v. Trinko*, 540 U.S. 398, 413 (2004).

⁴⁴¹ *Verizon v. Trinko*, 540 U.S. 398, 414 (2004).

⁴⁴² *Verizon v. Trinko*, 540 U.S. 398, 414-415 (2004).

are flawed. Especially since they are general and do not take account of the fact that complex cases such as those cited need to be looked at flexibly and dynamically on a case-by-case basis by taking account of the relevant market and the regulator and his powers to remedy the anticompetitive harm.

Finally the Court even compares the ambitions of the 1996 Act and the Sherman Antitrust Act as follows:

*“The 1996 Act is in an important respect much more ambitious than the antitrust laws. It attempts to eliminate the monopolies enjoyed by the inheritors of AT&T’s local franchises[...].Section 2 of the Sherman Act, by contrast, seeks merely to prevent unlawful monopolization. It would be a serious mistake to conflate the two goals.”*⁴⁴³

It seems ironic to me that the Court compares these acts and describes the 1996 Act as being more ambitious than the antitrust laws while at the same time not recognising the essential facilities doctrine thereby stating that there was no need to recognise or repudiate it. In *Trinko* the Supreme Court further rejected decisions of lower courts recognising a monopoly leveraging claim, i.e. a claim based on the monopolist using its monopoly in one market to gain a competitive advantage in another market, even in cases where successfully monopolizing that other market was no probability.⁴⁴⁴ If the 1996 Act was really more ambitious than the Sherman Antitrust Act, then any anticompetitive behaviour by a monopoly that serves to maintain its monopoly power should be persecuted under the 1996 Act; this includes refusal to deal.

The Supreme Court then reversed the Court of Appeals’ judgment and remanded the case for proceedings consistent with this Supreme Court opinion. The dissenting opinion holds that the claimants have no standing and accordingly the issues at hand do not have to be decided upon.⁴⁴⁵

e. Analysis

The judgment can be interpreted as holding that no added value could follow from using competition rules on top of sector-specific regulation; it may even be counter-productive.

⁴⁴³ *Verizon v. Trinko*, 540 U.S. 398, 415 (2004).

⁴⁴⁴ *ABA*, Monopolization in Telecom 288-289.

⁴⁴⁵ *Rubin/Hawker/Candeup*, Access remedies after *Trinko* 60.

Accordingly “*regulation significantly diminishes the likelihood of major antitrust harm*”⁴⁴⁶. To sum up, the Supreme Court in *Trinko*⁴⁴⁷ ruled that antitrust rules are trumped by sector-specific regulation. This decision allows no or very little scope for antitrust claims where sector-specific regulation “covers the field”.

This landmark judgment sparked extensive academic discussion. In its Telecom Antitrust Handbook the American Bar Association (ABA) stated that “*Trinko raises the bar for alleged refusals to deal by a single firm – even a lawful monopoly – particularly in highly regulated industries*”⁴⁴⁸. The ABA further stated that by reducing *Aspen Skiing* to its facts, the Supreme Court in *Trinko* limited antitrust liability for a refusal to deal by a monopolist to a single circumstance only, i.e. a case where the defendant is willing to sacrifice short-term profits for longer-term profits as a monopolist.⁴⁴⁹

The *Concord v. Boston Edison Co.*⁴⁵⁰ case is also relevant in this regard. The question in this case was whether a prize squeeze in a fully regulated industry violated antitrust law.⁴⁵¹ According to the First Circuit there was no violation of antitrust laws since “*regulation [made the] critical difference in terms of antitrust harms, benefits and administrative considerations*”⁴⁵². This means that intervention by antitrust laws did not improve the situation because of enough regulatory oversight provided by the administrative agency. In the *Trinko* case the majority argues similarly and the commentators state that while the 1996 Act was designed to eliminate lawful monopolies the antitrust laws seek to prevent unlawful monopolization. As Justice Scalia found it would be a mistake to conflate these two distinct goals. Therefore principles of antitrust illegality shall yield the 1996 Act which is more detailed and comprehensive. Three factors motivated the majority to apply the *Town of Concord* rule. Firstly, since an antitrust function is performed by the 1996 Act, there is merely a low probability of antitrust violations in markets governed by the 1996 Act. As a result there is only little risk of harm from a false negative under the antitrust

⁴⁴⁶ *Verizon v. Trinko*, 540 U.S. 398, 412-413 (2004). quoting *Town of Concord, et al. v. Boston Edison Company*, 915 F.2d 17, 25 (1st Cir. 1990).

⁴⁴⁷ *Verizon v. Trinko*, 540 U.S. 398 (2004). .

⁴⁴⁸ ABA, Monopolization in Telecom and Media Markets in ABA, Telecom Antitrust Handbook (2013) 286.

⁴⁴⁹ ABA, Monopolization in Telecom 287-288.

⁴⁵⁰ *Town of Concord v. Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990).

⁴⁵¹ *Rubin/Hawker/Candeup*, Access remedies after *Trinko* 62.

⁴⁵² *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 23 (1st Cir. 1990).

rules. Secondly, the antitrust remedies required are burdensome, perhaps, as suggested by the Court even irremediable. Thirdly, having regard to the two former factors, antitrust litigation is not cost effective as it would lead to only a small benefit at the cost of very burdensome remedies.⁴⁵³

Regarding the first principal factor it has to be noted that it does not reflect the actual situation. According to the FCC the administrative remedies of the 1996 Act are insufficient to deter anticompetitive behaviour in the market. Furthermore the high amount of complaints suggests that the antitrust function the 1996 Act was supposed to fulfil did not work too well.⁴⁵⁴

The second principal factor essentially suggests that courts cannot establish interconnection regimes that are workable; accordingly this task should be left to the regulators.⁴⁵⁵ Thereby the court did not consider that there is a history of deregulation of telecommunications suggesting that it is indeed possible for courts to establish workable interconnection regimes. According to commentators the court in this case seems to *"have an exaggerated opinion of the ability of the regulatory regime to do the job"*⁴⁵⁶. So far the federal courts have vacated three sets of unbundling rules drafted by the FCC. One of the difficulties the FCC faces is that it needs to tailor the rules to each local market individually. Courts are better suited to assess case-by-case requirements; therefore the rejection by the majority of antitrust litigation for irremediability may have elevated form over substance.⁴⁵⁷

The third principal factor may be summarised as antitrust inefficiency since antitrust rules have only little or even nothing to add to the regulatory rules provided in the 1996 Act. Nevertheless the conduct in question was easy to identify as anticompetitive since it was repudiated in 1996 Act condemning refusal-to-deals by the Local Incumbent Monopolist Telephone Companies (ILECs). Also forced shares are unlikely to affect incentives for the ILECs or its competitors (Competitive Local Exchange Companies, CLECs) or even both to invest in interconnection services. Especially CLEC could invest

⁴⁵³ Rubin/Hawker/Candeup, Access remedies after Trinko 62.

⁴⁵⁴ Rubin/Hawker/Candeup, Access remedies after Trinko 63.

⁴⁵⁵ Rubin/Hawker/Candeup, Access remedies after Trinko 63.

⁴⁵⁶ Rubin/Hawker/Candeup, Access remedies after Trinko 64.

⁴⁵⁷ Rubin/Hawker/Candeup, Access remedies after Trinko 64.

in services ILECs do not yet offer.⁴⁵⁸ According to the commentators the most perplexing thing about the invocation of *Town of Concord* in the *Trinko* case is that the situations in the cases were the opposite. In the *Town of Concord* case there was a regulatory scheme designed to lessen or improve the risk of antitrust-like innovations. In the *Trinko* case however a transition away from regulation towards competition was involved. It makes sense to withhold antitrust scrutiny where there is regulation in place for the purpose of discouraging anti-competitive conduct. This cannot be said where regulation is abandoned in favour of a competitive market. Accordingly antitrust liability was withheld in cases where a protective regulatory scheme was in place as well as in a case where such regulations are being abandoned to transition to competition. This means that actually *Town of Concord* applied correctly is in favour of applying the antitrust rules to the telecommunications industry subject to the 1996 Act and not, as incorrectly held by the majority is in favour of eliminating the protections the antitrust rules afford.⁴⁵⁹

In 2004 Alfred Kahn discussed this decision shortly in his book on lessons from deregulation. He writes he “*only plead schizophrenia*” to the question raised in *Trinko*, i.e. whether the defendant’s behaviour should also be subject to competition rules if there are already exhaustive administrative rules. I will quote his consistent subscription extensively due to their importance having regard to the fact that Kahn is one of the most distinguished experts in the field of regulated networks and liberalization:

*“the predilection of most economists [...] to entrust the responsibility for managing the transition from regulation to deregulation to the antitrust authorities, with their presumed superior expertise in comprehending the requirements of effective competition, rather than to the former regulatory agencies, particularly because of the demonstrated proclivities of those agencies to protectionism and cartelization, including a tendency to condemn any and all price-cutting as ‘predatory’ or ‘destructive’. Closely related are the tendencies of regulators to seize opportunities to produce reductions in the rates for still-regulated services and visible competitors, at the expense of competition, in the unregulated markets.”*⁴⁶⁰

Kahn also offers his recognition in such regulatory proceedings as a long term participant as follows:

⁴⁵⁸ Rubin/Hawker/Candeup, Access remedies after *Trinko* 64-65.

⁴⁵⁹ Rubin/Hawker/Candeup, Access remedies after *Trinko* 65.

⁴⁶⁰ Kahn, Lessons from Deregulation - Telecommunications and Airlines after the Crunch (2004) 41.

“I cannot yet bring myself to deny the regulatory agencies a central role in the transition of public utilities to competition, in view of the special circumstances of those industries: the necessity for settling out and tracking the collection of strandable costs; the more pervasive possibilities in those industries of tying competitive to monopoly services, directly or subtly, and of cross-subsidization, strictly defined; the consequent need for accounting separations and the monitoring of transactions between still-regulated utilities and unregulated affiliates; and, finally, the pervasiveness of essential facilities controlled by incumbents – not to mention competitive advantages deriving solely from their historical franchised monopolies, requiring an administrative agency to define them and to prescribe the terms and conditions of sharing.”⁴⁶¹

Kahn next quotes his initial reaction upon hearing of the *Trinko* case:

“Oh my God! I have spent the last seven years (at least) involved in endless administrative proceedings under Sections 251 and 271 of the Telecommunications Act and under state regulatory statutes before that – mainly on behalf of Baby Bells – in the latter of which the Bells had to demonstrate to the FCC (with the Department of Justice playing an advisory role) compliance with the highly detailed provisions requiring demonstration that they had opened their local markets to competition – accommodations costing, as I recall, billions of dollars; and under which (as I once again recall) the CLECs and would-be CLECS retained the right to complain to the public utility commission of asserted acts of noncompliance (such as alleged refusal of ILECs to permit employees of CLECSs located in their exchange offices to use the bathroom) – the notion of re-litigating these cases before juries gives me nightmares. [I might as well have added that the act imposes on the ILECs obligations to positively assist competitors going far beyond even the most liberal interpretation of the essential facilities doctrine in antitrust.] And yet I have no answer to the principle that assertedly injured parties must not be denied remedy under the antitrust laws – unless Congress may reasonably be interpreted to have intended to substitute the administrative arrangements for antitrust.”⁴⁶²

Especially the reaction of an extremely experienced expert like Kahn shows what confusion the *Trinko* case caused and how difficult it is under US law to find an answer to the policy question at issue.

As we have seen commentators attach different meanings to the case. Verizon itself interpreted the decision as a “categorical rejection of antitrust enforcement in regulated industries”. This interpretation is rejected by Dogan and Lemley as going too far. Another interpretation is that the judgment rejects the essential facility doctrine as well as the unilateral refusal to deal doctrine. Also this interpretation is rejected by Dogan and Lemley

⁴⁶¹ Kahn, Lessons from Deregulation 41-42.

⁴⁶² Kahn, Lessons from Deregulation 42.

since even though the Court "*appears hostile to those claims*" it nevertheless discussed the regulatory structure of the market and how it makes the use of antitrust rules unnecessary, at length. Another interpretation is that the case offers a "*more flexible, discretionary principle*" in which judges have the opportunity to consider the competencies of regulators and courts before intervening in regulated sectors. Regardless of how commentators interpret the decision, the Supreme Court's decision makes antitrust law less important in regulated industries.⁴⁶³

Courts now typically follow *Trinko* in refusal to deal cases arising in regulatory contexts similar to *Trinko*, i.e. where the terms of access are prescribed by a regulatory body, and decline antitrust liability. In other contexts however, case law on refusal to deal cases is unsettled. In some post-*Trinko* decisions Courts have extracted from the distinction made to the *Aspen* case a specific rule that refusal to deal requires the defendant to refuse to continue an existing business relationship. Other Courts however read *Trinko* more broadly. The Antitrust Modernization Commission (AMC) saw a further exception to the general rule of permitting unilateral refusal, i.e. "*the defendant's refusal to provide to a customer rival the same service that it provided to other customers*"⁴⁶⁴. Since there is no further guidance there is reluctance by some post-*Trinko* courts to dismiss before trial refusal to deal claims. However, where a plaintiff seems to seek a free ride on the investments the monopolist made and furthermore wants judicial imposition of for the monopolist unprofitable terms, such claims will usually be dismissed.⁴⁶⁵

A further interpretation of the decision could be that where the plaintiff demonstrates that refusal to deal or some aspect of it cannot be remedied under the regulatory regime in place then rivals or consumers may have a viable claim under §2 Sherman Antitrust Act.⁴⁶⁶

⁴⁶³ Lemley/Dogan, Antitrust Law and Regulatory Gaming, in Texas Law Review, March Volume 87 No. 4 (2009) 685 (693-694).

⁴⁶⁴ ABA, Monopolization and Dominance Handbook (2011) 150.

⁴⁶⁵ ABA, Monopolization and Dominance 150-151.

⁴⁶⁶ Meriwether, Putting the "Squeeze" on Refusal to Deal Cases: Lessons from *Trinko* and *Linkline*, in Antitrust (2010) 65 (68).

6. *Linkline*

a. *Introduction*

The judgment of the Supreme Court in the very recent *LinkLine*⁴⁶⁷ case takes the *Trinko* thinking even further by holding that an obligation to deal imposed by an instrument other than an antitrust order results in ruling out the applicability of an antitrust action for that part of the offence. However, existing regulation at the wholesale level does not mean that antitrust rules are not applicable for a predation claim at the retail level.⁴⁶⁸ The effect of this case might be that margin squeeze cases will now be under the scrutiny of the FCC, the federal regulatory agency for telecommunications.

b. *Case Details*

The issue in this case was whether a prize-squeeze claim may be brought under §2 of the Sherman Antitrust Act when there is no antitrust obligation for the claimant to sell. The Supreme Court held that such a claim may not be brought.⁴⁶⁹

The market for digital subscriber line (DSL) service in California was at issue. DSL is a method to connect to the Internet at high speeds over telephone lines.⁴⁷⁰

The petitioners consisted of a number of entities and subsidiaries and for simplicity were referred to in the Supreme Court opinion as AT&T. AT&T owned a lot of the facilities and infrastructure needed to provide DSL service in California. Particularly AT&T controlled most of the so-called "last mile" lines; these are the lines connecting homes and businesses to the telephone network. To serve their customers competing DSL needed to obtain access to AT&T's facilities. Until 2005 the FCC required incumbent phone companies to sell to independent DSL providers transmission service to inject competition into the market. However in 2005 this forced-sharing requirement was largely abandoned since a competitive market beyond DSL service for high-speed Internet

⁴⁶⁷ *Pacific Bell Telephone Co., dba AT&T California, et al. v. linkLine Communications, Inc.*, 555 U.S. 438, 129 S. Ct. 1109 (2009).

⁴⁶⁸ *Alexiadis/Cave*, Regulation and Competition Law 13.

⁴⁶⁹ *Pacific Bell v. linkLine*, 555 U.S. 438, 442 (2009).

⁴⁷⁰ *Pacific Bell v. linkLine*, 555 U.S. 438, 442 (2009).

emerged. This means that there is now competition faced by DSL from cable companies and wireless and satellite services.⁴⁷¹

Even though the forced-sharing requirement was largely abandoned, AT&T remained bound by this condition due to a merger (remedy). Accordingly AT&T was obliged to provide to independent firms wholesale DSL transport service at no greater price than the retail price.⁴⁷²

Four independent Internet Service providers (ISPs) competing with AT&T in the DSL retail market were the plaintiffs. Since they did not own all of the facilities needed to provide their customers with Internet service they had to lease DSL transport service from AT&T. In contrast AT&T engaged in both the wholesale and retail DSL market and therefore provided the plaintiffs and other independent ISPs with wholesale DSL transport service as well as retail DSL service to consumers.⁴⁷³

In July 2003 the plaintiffs brought their claim in the District Court and alleged that AT&T violated §2 of the Sherman Antitrust Act by monopolizing the Californian DSL market. According to the complaint AT&T refused to deal with the plaintiffs, denied them access to essential facilities and engaged in prize squeezing. With regard to the prize squeeze the plaintiffs alleged that AT&T set a high wholesale price for DSL transport and a low retail price for DSL Internet service. This behaviour by AT&T excluded and impeded competition thereby allowing AT&T to preserve and maintain its monopoly over DSL access to the Internet.⁴⁷⁴

Shortly after the Supreme Court issued the *Trinko* decision AT&T moved for judgment and argued that the claim was foreclosed due to *Trinko*. This was so since it was held in *Trinko* that "a firm with no antitrust duty to deal with its rivals at all is under no obligation to provide those rivals with a 'sufficient' level of service."⁴⁷⁵

⁴⁷¹ *Pacific Bell v. linkLine*, 555 U.S. 438, 442-443 (2009).

⁴⁷² *Pacific Bell v. linkLine*, 555 U.S. 438, 443 (2009).

⁴⁷³ *Pacific Bell v. linkLine*, 555 U.S. 438, 443 (2009).

⁴⁷⁴ *Pacific Bell v. linkLine*, 555 U.S. 438, 443-444 (2009).

⁴⁷⁵ *Pacific Bell v. linkLine*, 555 U.S. 438, 444 (2009).

c. *District Court and Court of Appeal*

The District Court held that there was no antitrust duty for AT&T to deal with the plaintiffs. Nevertheless it denied the motion to dismiss the claims regarding the price-squeeze acknowledging that AT&T's arguments had certain logic to them but the *Trinko* case did not involve prize-squeeze claims. Furthermore, several Circuits have already recognized price-squeeze claims under existing antitrust standards.⁴⁷⁶

The plaintiffs then filed their amended complaint at the District Court's request thereby providing more detail on the prize-squeeze claims. AT&T moved to dismiss the case stating that only if the two established requirements for predatory pricing are met; i.e. below-cost retail pricing and a "dangerous probability" that any lost profits will be recouped by the defendant (*Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222-224 (1993)), the case could proceed. Since the District Court held that the amended complaint (generously construed) met the *Brooke Group* requirements, it did not discuss whether it is necessary that all prize-squeeze claims must meet those criteria. On the question whether "*Trinko bars price squeeze claims where the parties are compelled to deal under the federal communications laws*"⁴⁷⁷ the District Court certified its order for interlocutory appeal.

The Court of Appeal for the Ninth Circuit affirmed the District Court's decision to deny AT&T's motion for judgment regarding the prize-squeeze claims. Since *Trinko* did not involve a price-squeezing theory and such a theory was part of traditional antitrust law before the *Trinko* case such claims should remain viable. Accordingly the plaintiffs' original complaint was a potentially valid claim under §2 of the Sherman Antitrust Act. Judge Gould dissented and noted that the *Brooke Group* requirements were not satisfied.⁴⁷⁸

⁴⁷⁶ *Pacific Bell v. linkLine*, 555 U.S. 438, 444 (2009).

⁴⁷⁷ *Pacific Bell v. linkLine*, 555 U.S. 438, 444 (2009).

⁴⁷⁸ *Pacific Bell v. linkLine*, 555 U.S. 438, 445 (2009).

d. *Supreme Court Decision*

The Supreme Court granted certiorari to decide whether a plaintiff could bring prize-squeeze claims under § 2 of the Sherman Antitrust Act in a case where the defendant has no antitrust duty to deal with the plaintiff.⁴⁷⁹

The Supreme Court started off by stating that the plaintiffs now agree with the dissenting position of Judge Gould, namely that prize-squeeze claims must meet the predatory pricing requirements according to the *Brooke Group* case. Therefore they asked the Supreme Court to vacate the decision in their favour and remand it with instruction to give them leave to amend their complaint to a *Brooke Group* claim.⁴⁸⁰ The Supreme Court however believed it is appropriate to proceed to address the question it has presented (see above).⁴⁸¹

The Supreme Court then went on to explain §2 of the Sherman Antitrust Act as well as the duty to deal thereby holding that the complaint made does not contain allegations meeting the *Brooke Group* requirements.⁴⁸²

In this case the challenge focused on retail prices, where there is no predatory pricing, as well as on the terms of dealing, where there is no duty to deal. Usually price-squeeze plaintiffs claim that a fair or adequate margin must be left to them between the wholesale and retail price by the defendants. In the case at hand the Supreme Court had to consider whether the plaintiff can state a price-squeeze claim when there is no obligation to deal at wholesale level by the defendant under the antitrust laws.⁴⁸³

The Supreme Court went on to compare the case at hand with *Trinko* and stated the following:

“[...] a straightforward application of our recent decision in Trinko forecloses any challenge to AT&T’s wholesale prices. In Trinko, Verizon was required by statute to lease its network elements to competing firms at wholesale rates [...] We held that the plaintiff’s claims were not actionable under §2. Given that Verizon had no antitrust

⁴⁷⁹ *Pacific Bell v. linkLine*, 555 U.S. 438, 445-446 (2009).

⁴⁸⁰ *Pacific Bell v. linkLine*, 555 U.S. 438, 446 (2009).

⁴⁸¹ *Pacific Bell v. linkLine*, 555 U.S. 438, 447 (2009).

⁴⁸² *Pacific Bell v. linkLine*, 555 U.S. 438, 448 (2009).

⁴⁸³ *Pacific Bell v. linkLine*, 555 U.S. 438, 449 (2009).

duty to deal with its rivals at all, we concluded that ‘Verizon’s alleged insufficient assistance in the provision of service to rivals’ did not violate the Sherman Act. [...] Trinko thus makes clear that if a firm has no antitrust duty to deal with its competitors at wholesale, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous. In this case, as in Trinko, the defendant has no antitrust duty to deal with its rivals at wholesale; any such duty arises only from FCC regulations, not from the Sherman Act. [...] There is no meaningful distinction between the ‘insufficient assistance’ claims we rejected in Trinko and the plaintiffs’ price-squeeze claims in the instant case. The Trinko plaintiffs challenged the quality of Verizon’s interconnection service, while this case involves a challenge to AT&T’s pricing structure. But for antitrust purposes, there is no reason to distinguish between price and nonprice components of a transaction.”⁴⁸⁴

The Supreme Court further holds the following:

“the nub of the complaint in both Trinko and this case is identical—the plaintiffs alleged that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market. Trinko holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal.”⁴⁸⁵

The Supreme Court then turned to the District Court and Court of Appeals decisions holding that even though it is technically true that *Trinko* did not directly address prize-squeeze claims, its reasoning applies with equal force to prize-squeeze claims. This is so since AT&T could have squeezed the profits of its competitors just as effectively by providing poor-quality interconnection service to the plaintiffs, as was what Verizon allegedly did in *Trinko*. However, “a firm with no duty to deal in the wholesale market has no obligation to deal under terms and conditions favorable to its competitors”⁴⁸⁶. AT&T would have not run afoul of the Sherman Act if it had stopped to provide DSL transport service to the plaintiffs. In this case AT&T was not required to offer its service at a wholesale price that the plaintiffs would have preferred.⁴⁸⁷

Furthermore the other component of a price-squeeze claim is the allegation of “too low” retail prices by the defendants. Also regarding this the plaintiffs’ claims find no support.⁴⁸⁸ Accordingly the Supreme Court held that the plaintiffs’ price-squeeze claim is “*nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at*

⁴⁸⁴ *Pacific Bell v. linkLine*, 555 U.S. 438, 449-450 (2009).

⁴⁸⁵ *Pacific Bell v. linkLine*, 555 U.S. 438, 450 (2009).

⁴⁸⁶ *Pacific Bell v. linkLine*, 555 U.S. 438, 450-451 (2009).

⁴⁸⁷ *Pacific Bell v. linkLine*, 555 U.S. 438, 451 (2009).

⁴⁸⁸ *Pacific Bell v. linkLine*, 555 U.S. 438, 451 (2009).

the wholesale level”⁴⁸⁹. An undertaking is not required to price at wholesale and retail level in a manner that preserves its competitors’ profit margins if there is no duty to deal at the wholesale level as well as no predatory pricing at the retail level.⁴⁹⁰

One commentator described the Court’s arguments as “*seductive in its simplicity*”. She wrote that the Court, following *Trinko*, essentially held that if there is antitrust duty to deal with a competitor at wholesale level then certainly there is no duty to deal under the terms and conditions that rivals find commercially advantageous. With this argument all antitrust claims regarding price in the upstream market are ruled out. Only claims concerning too low prices in the downstream market remain valid.⁴⁹¹

But somehow the *Linkline* decision is paradox since the Court assumed that there was no duty to deal other than the duty based on regulation. The Court further stated that a duty to deal by AT&T based on monopoly power was unlikely since the market for high-speed internet services was seen as competitive by the regulatory authority. But, if there is no monopoly power in the upstream market, then there can’t be liability under antitrust law, whether based on a price squeeze or a duty to deal, because the §2 condition of monopoly power is not met as both monopoly power and anticompetitive conduct are necessary. Accordingly it is right that a plaintiff cannot bring a price squeeze claim under §2 when the defendant has no monopoly power.⁴⁹² One might argue that because of this the impact of *Linkline* is uncertain.

Public policy issues related to the recognition of such claims are also dealt with in part C of the opinion. As in *Trinko* the Supreme Court emphasised the importance of clear rules in antitrust law and that courts are not suited “*to act as central planners*”⁴⁹³ (see the discussion on this issue above in *Trinko*). Additionally it was held that for courts it is difficult enough to identify and remedy an alleged anticompetitive practice at one level, e.g. predatory pricing in retail markets or a violation of a duty to deal in wholesale markets. By recognising price-squeeze claims courts would be required to simultaneously police retail and wholesale price to ensure that rivals are not being squeezed. Thereby courts

⁴⁸⁹ *Pacific Bell v. linkLine*, 555 U.S. 438, 452 (2009).

⁴⁹⁰ *Pacific Bell v. linkLine*, 555 U.S. 438, 452 (2009).

⁴⁹¹ *Cavaleri Rudaz*, *Vanderbilt Journal of Transnational Law*, Vol. 43 No. 4 (2010), 1082-1083.

⁴⁹² *Cavaleri Rudaz*, *Vanderbilt Journal of Transnational Law*, Vol. 43 No. 4 (2010), 1106-1107.

⁴⁹³ *Pacific Bell v. linkLine*, 555 U.S. 438, 452 (2009).

would be aiming at a moving target because it is the interaction between retail and wholesale prices that may result in a price-squeeze.⁴⁹⁴

Another issue of importance in this regard is that undertakings trying to avoid price-squeeze liability won't have a safe harbour for their practices of pricing. Undertakings know that they will not incur liability for predatory pricing if their retail prices are above cost.⁴⁹⁵

The Supreme Court then went to state that the most common standard for price squeezes is that a fair or adequate margin between wholesale and retail price must be left to the rivals by the defendant.⁴⁹⁶ This was followed by highlighting the flaws of this concept.

*"[...] an upstream monopolist with no duty to deal is free to charge whatever wholesale price it would like; antitrust law does not forbid lawfully obtained monopolies from charging monopoly prices [...] Similarly, the Sherman Act does not forbid—indeed, it encourages— aggressive price competition at the retail level, as long as the prices being charged are not predatory [...] If both the wholesale price and the retail price are independently lawful, there is no basis for imposing antitrust liability simply because a vertically integrated firm's wholesale price happens to be greater than or equal to its retail price."*⁴⁹⁷

Even though it is true that under the antitrust rules a monopolist is not supposed to be prosecuted simply because of its power it should not be forgotten that prices should turn anticompetitive when a price squeeze occurs. Stating that there is no basis for antitrust liability merely because the wholesale and retail prices are independently lawful even though the wholesale price is greater than or equal to the retail price is oversimplifying and misinterpreting the situation. One has to look at both prices together and their meaning to consumers and competitors.

In part IV of the opinion the Supreme Court then dealt with the plaintiffs wish to leave them to amend their complaint so as to bring a predatory pricing claim according to the *Brooke Group* requirements. Since their grant of certiorari was merely limited to whether

⁴⁹⁴ *Pacific Bell v. linkLine*, 555 U.S. 438, 453 (2009).

⁴⁹⁵ *Pacific Bell v. linkLine*, 555 U.S. 438, 453 (2009).

⁴⁹⁶ *Pacific Bell v. linkLine*, 555 U.S. 438, 454 (2009).

⁴⁹⁷ *Pacific Bell v. linkLine*, 555 U.S. 438, 454-455 (2009).

price-squeeze claims are to be recognised if there is no antitrust duty to deal, the plaintiffs' wish needed not be answered.⁴⁹⁸

Regarding the amended complaint filed at the District Court the Supreme Court stated that the District Court will have to decide whether the amended complaint states a claim upon which relief may be granted to bring a claim under *Brooke Group* claim.⁴⁹⁹

On the last page of the opinion the Supreme Court summarizes as follows:

“In this case, plaintiffs have not stated a duty-to-deal claim under Trinko and have not stated a predatory pricing claim under Brooke Group. They have nonetheless tried to join a wholesale claim that cannot succeed with a retail claim that cannot succeed, and alchemize them into a new form of antitrust liability never before recognized by this Court. We decline the invitation to recognize such claims. Two wrong claims do not make one that is right.

*The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion”*⁵⁰⁰

In a concurring opinion Justice Breyer joined by three other justices stated that he would remand the case to allow the District Court to determine whether the respondents may proceed with a predatory pricing claim as discussed by Judge Gould in his dissenting Ninth Circuit opinion. He further stated that a purchaser from a regulated firm cannot win an antitrust case by showing a price squeeze. When a regulatory structure exists that deters and remedies anticompetitive harm then the costs of antitrust enforcement are likely to be greater than the benefits of antitrust enforcement. In this case the wholesale prices were controlled by the regulator; however the respondents do not claim that this makes a difference. As far as Justice Breyer can tell the respondents could have turned to the regulator to ask for the petitioners' wholesale prices to be lowered having regard to the alleged price squeeze.⁵⁰¹

⁴⁹⁸ *Pacific Bell v. linkLine*, 555 U.S. 438, 455 (2009).

⁴⁹⁹ *Pacific Bell v. linkLine*, 555 U.S. 438, 456 (2009).

⁵⁰⁰ *Pacific Bell v. linkLine*, 555 U.S. 438, 457 (2009).

⁵⁰¹ *Pacific Bell v. linkLine*, 555 U.S. 438, 457-459 (2009).

In the concurring opinion Justice Breyer finally states that it shall be for the District Court to determine whether there are indications in the procedural history of the case at hand that may bar the respondents from asserting the alleged claim for predatory pricing.⁵⁰²

e. Analysis

In sum the opinion of the majority, by the way the five most conservative justices joined in on this opinion, is quite formalistic and narrowly applicable.⁵⁰³ Also this case may be described as an emerging view in the US that antitrust enforcement should stay away when federal regulators are there and available to address competitive problems in an industry. This marks a shift in American policy which had been closer to the European view allowing for only a limited regulated conduct defense to antitrust claims.⁵⁰⁴

Just like the *Trinko* case the present case sparked extensive academic discussion. Rightly so, Dogan and Lemley view this case as "*the death knell for price squeezes as stand-alone antitrust claims*". In their opinion it makes no sense as a matter of law or economics to exclude antitrust laws from partially regulated industries. They recognise that predatory-pricing claims require proof other things like a monopoly power and a likelihood of recoupment. Therefore only in rare cases will price-squeeze claims be successful.⁵⁰⁵ "*Their rarity, however, appropriately owes itself to stringent standards of substantive antitrust law, rather than absolute deference to regulators in even partial regulated markets.*"⁵⁰⁶

It has to be noted that Chief Justice Roberts relied mainly on the *Trinko* case rather than the economic reasoning in *Town of Concord*. The price squeeze claim was considered as a new form of antitrust liability, which the Court saw no need to recognise.⁵⁰⁷

Rightly the American Bar Association in its Telecoms Handbook points out that the concurrence seems to suggest only if the government acts as plaintiffs, such as in *Alcoa*, a

⁵⁰² *Pacific Bell v. linkLine*, 555 U.S. 438, 459 (2009).

⁵⁰³ *Crane*, Linkline's Institutional Suspicions, in *Cato Supreme Court Review* (2008-2009) 111 (118).

⁵⁰⁴ *Brunell*, *Antitrust Law Journal* 2012, 280.

⁵⁰⁵ *Lemley/Dogan*, *Texas Law Review*, 87/4, March 2009, 728-729.

⁵⁰⁶ *Lemley/Dogan*, *Texas Law Review*, 87/4, March 2009, 728-729.

⁵⁰⁷ *Cavaleri Rudaz*, *Vanderbilt Journal of Transnational Law*, Vol. 43 No. 4 (2010), 1090.

price squeeze claim may be established. However, there cannot be a price squeeze claim where a competitor/plaintiff complains to the FCC about too high wholesale prices.⁵⁰⁸

One commentator analyzed the case having regard to the Harvard and Chicago Schools. This is interesting since modern US antitrust law is a product of these different Schools; accordingly case law is strongly influenced by these two Schools. Richard Posner, Frank Easterbrook, Robert Bork, Antonin Scalia and others favor or are part of the Chicago School whereas Phillip Areeda, Donald Turner, Herbert Hovenkamp, Stephen Breyer and others are part of the Harvard School. Both Schools distrust several of the institutional actors in the antitrust system and each other too. Nevertheless in cases like *Linkline* they more than not reach common ground on the outcomes. Both see private antitrust cases as problematic since they involve “*untrustworthy private plaintiffs*”, their lawyers and (treble) damages which are in the province of juries. For the Chicago School this is problematic since juries do not understand the economic complexities of antitrust cases. The Harvard School concurs and is primarily concerned with institutional competence and prefers decision-making by experts to lays. These Schools however diverge when it comes to the regulator. The Harvard School favours technocratic regulation whereas the Chicago School does not favour regulators over market solutions since they trust the market which the former doesn't. However the Schools agree that if regulators are present then antitrust solutions should be rejected.⁵⁰⁹

From a policy point of view one might argue that the present is consistent with US antitrust policy. Consumer welfare is the policy objective for US antitrust law; accordingly the low retail prices by AT&T were unlikely to violate antitrust laws since they resulted in more affordable prices for consumers. Even if competitors were harmed it must be remembered that under US antitrust law competitor welfare is no policy goal. Accordingly traditional antitrust principles were upheld by the Court.⁵¹⁰ This is however a contrast to the abovementioned *Alcoa* decision.

⁵⁰⁸ ABA, Monopolization in Telecom and Media Markets 294.

⁵⁰⁹ Crane, *Linkline's Institutional Suspicions* 123-127.

⁵¹⁰ *Evans*, Price-Squeeze Claims are no longer cognizable pursuant to §2 of the Sherman Act absent an Antitrust Duty to Deal at the Wholesale Level or Predatory Pricing at the Retail Level: *Pacific Bell Telephone Co. v. Linkline Communications, Inc.*, in *Duquesne Business Law Journal* 2010, 291 (310).

The same commentator believes that the role of the Courts is to set clear rules and remedies and not to administer pricing practices. Furthermore, the judiciary can't assume the functions characteristic of a regulatory agency. Therefore the Court applied *Trinko* and *Brooke Group* correctly and future courts must not agonise over what constitutes a fair price or whether the retail price is at a high enough level that the rival can also make a profit.⁵¹¹

As will be discussed in detail below this view is quite narrow-minded and flawed since it puts too much emphasis on general rules which won't fit well in a many situations instead of giving the courts instruments to deal with these complex cases in a way as to take account of the case specificities.

As in *Trinko* there are a number of noteworthy, interesting and well-argued opinions on this case. Nevertheless they all have one thing in common: antitrust laws are excluded from partially regulated industries.

7. *Federal Trade Commission v. Actavis, Inc. et al*⁵¹²

a. *Introduction*

This case regards pharmaceutical and patent law and is relevant for the thesis since its implications may be transferable to regulated networks as pharmaceuticals are also regulated and therefore usually outside of antitrust scrutiny. In my opinion this case could offer a change in the US position on the relationship between sector-specific regulation and antitrust laws since some statements made by the Supreme Court can – per analogy – be taken as applicable to other regulated industries too.

The Drug Price Competition and Patent Term Restoration Act of 1984 (Hatch-Waxman Act) is a federal law and deals with regulation of generic drugs.

This act created specific procedures for identifying and resolving patent disputes between the manufacturers of brand-name and generic drugs. In this case the rules regarding the infringement of the brand-name's patents are relevant. A prospective generic

⁵¹¹ *Evans*, Duquesne Business Law Journal 2010, 311.

⁵¹² *Federal Trade Commission v Actavis, Inc., et al.*, 133 S.Ct. 2223 (2013).

manufacturer is required to assure the Food and Drug Administration (FDA) that it will not infringe the patent of the brand-name's drug. The so-called "paragraph IV" route is one way to provide such an assurance by certifying that any listed, relevant patent "is invalid or will not be infringed by the manufacture, use or sale"⁵¹³ of the generic drug.

In 1999 Solvay Pharmaceuticals (Solvay) filed a New Drug Application for its drug AndroGel. This application was approved by the FDA in 2000. In 2003 Solvay obtained a patent for this drug and disclosed this fact to the FDA.⁵¹⁴

In 2003, after Solvay obtained the patent, Actavis (then still known as Watson Pharmaceuticals) filed an Abbreviated New Drug Application regarding a generic drug modelled after Solvay's AndroGel drug and then Paddock filed an Abbreviated New Drug Application for its own generic drug modelled after AndroGel. Both Actavis and Paddock certified under the paragraph IV route that Solvay's patent was invalid and therefore their generic drugs did not infringe that patent. Par Pharmaceutical (Par) joined forces with Paddock and did not file an application but agreed to share the litigation costs for a share of profits in case Paddock would obtain an approval for its generic drug.⁵¹⁵

Subsequently Solvay sued Actavis and Paddock claiming patent infringement. The FDA then approved Actavis first-to-file generic product 30 months later. However in 2006 the parties settled. Actavis entered into a "reverse payment" settlement with Solvay instead of bringing its generic drug straight into market. Under the reverse payment settlement Actavis agreed not to bring its generic drug to the market until August 31, 2015, i.e. 65 months before Solvay's patent expired. Actavis further agreed to promote AndroGel to doctors (urologists) in exchange for millions of dollars. Paddock and Par entered into similar reverse payment agreements with Solvay. In turn Solvay agreed to pay \$19-\$30 million annually, for nine years to Actavis, \$12 million in total to Paddock and \$60 million in total to Par.⁵¹⁶

⁵¹³ 21 U.S.C. § 355(j)(A)(vii)(IV) Hatch-Waxman Act.

⁵¹⁴ *FTC v. Actavis*, 133 S.Ct. 2223, 2229 (2013).

⁵¹⁵ *FTC v. Actavis*, 133 S.Ct. 2223, 2229 (2013).

⁵¹⁶ *FTC v. Actavis*, 133 S.Ct. 2223, 2229 (2013).

b. *Alleged Misconduct*

On 29 January 2009 the FTC in turn filed suit against Actavis, Solvay, Paddock and Par alleging a violation of section 5 of the Federal Trade Commission Act since the respondents unlawfully agreed to abandon their patent challenges by refraining to launch their low-cost generic drugs and receive a share in Solvay's monopoly profits. Even though the respondents alleged that the payments amounted to compensation for other services the FTC had the opinion that these services had only little value. The FTC thought that the payments were made to compensate for not competing against AndroGel until 2015.⁵¹⁷

c. *District and Appeal Court Decisions*

The District Court dismissed the complaint. This decision was affirmed by the Eleventh Circuit holding that a settlement is immune from antitrust scrutiny if its anticompetitive effects fall within the scope of the patent's exclusionary potential. The Eleventh Circuit also noted that the FTC had not alleged that the reverse payment settlements excluded competition to greater extent than would the patent, if valid. Furthermore the court recognised that a court might declare a patent invalid if the parties do not settle. Public policy however favors the settlement of disputes; accordingly courts cannot require parties to continue litigating to avoid antitrust liability.⁵¹⁸

d. *Supreme Court Decision*

The Supreme Court held that the Eleventh Circuit erred in affirming the dismissal of the FTC's complaint since even if the anticompetitive effects of the settlement might fall within the scope of the exclusionary potential this does not make the agreement immune from antitrust scrutiny. It would be incongruous to simply determine antitrust legality by merely measuring the settlement's anticompetitive effect solely against patent law policy and not against antitrust policy. According to *United States v. Line Material Co.*⁵¹⁹ both are relevant to determine the scope of antitrust immunity and monopoly. Accordingly the antitrust question should be answered by considering traditional factors of antitrust. Furthermore there are court precedents making clear that patent-related settlements can

⁵¹⁷ *FTC v. Actavis*, 133 S.Ct. 2223, 2229-2230 (2013).

⁵¹⁸ *FTC v. Actavis*, 133 S.Ct. 2223, 2230 (2013).

⁵¹⁹ *United States v. Line Material Co.*, 333 U.S. 287, 310-311 (1948).

sometimes violate antitrust laws.⁵²⁰ Finally the general pro-competitive thrust of the Hatch-Waxman Act suggests a view contrary to that of the Eleventh Circuit.

At this point it is important to remember that the Telecommunications Act 1996 also has a general pro-competitive thrust as explained above and even takes regard of the antitrust rules.

Justice Breyer delivered the opinion of the Supreme Court for the majority:

*“Solvay’s patent, if valid and infringed, might have permitted it to charge drug prices sufficient to recoup the reverse settlement payments it agreed to make to its potential generic competitors. And we are willing to take this fact as evidence that the agreement’s ‘anticompetitive effects fall within the scope of the exclusionary potential of the patent.’ But we do not agree that that fact, or characterization, can immunize the agreement from antitrust attack.”*⁵²¹

Justice Breyer then continued citing that “[a] valid patent excludes all except its owner from the use of the protected process or product”⁵²². Due to such exclusion a patent-owner may charge a higher-than-competitive price for its product. For an invalidated patent there is no such right. Nevertheless “even a valid patent confers no right to exclude products or processes that do not actually infringe”⁵²³.

Per analogy a monopoly also enjoys a number of advantages due to its special position in the market; nevertheless it is not allowed to act anticompetitively by taking advantage of its position.

The form of settlement in this case was unusual since millions of dollars were paid by Solvay in return for its competitors to stay out of the market even though the competitors had no claim that Solvay was liable for damages.⁵²⁴

*“Given these factors, it would be incongruous to determine antitrust legality by measuring the settlement’s anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well.”*⁵²⁵

⁵²⁰ *United States v. Singer Mfg. Co.* 374 U.S. 174 (1963); *United States v. New Wrinkle, Inc.*, 342 U.S. 371 (1952); *Standard Oil Company v. United States*, 283 U.S. 163 (1931).

⁵²¹ *FTC v. Actavis*, 133 S.Ct. 2223, 2230 (2013).

⁵²² *United States v. Line Material Co.*, 333 U. S. 287, 308 (1948).

⁵²³ *FTC v. Actavis*, 133 S.Ct. 2223, 2231 (2013).

⁵²⁴ *FTC v. Actavis*, 133 S.Ct. 2223, 2231 (2013).

The Court then continued stating that it has already indicated that both patent and antitrust policies are relevant when determining the scope of the patent monopoly and consequently the scope of antitrust immunity conferred by a patent.⁵²⁶

The same applies to the telecommunications sector where both antitrust and telecommunications policy are relevant when determining the allegedly anti-competitive behavior in question.

Justice Breyer continued by citing questions to be asked to determine whether the behavior falls under antitrust scrutiny and then summarizes by stating the following;

*"[...] in short, rather than measure the length or amount of a restriction solely against the length of the patent's term or its earning potential, as the Court of Appeals apparently did here, this Court answered the antitrust question by considering traditional antitrust factors such as likely anticompetitive effects, redeeming virtues, market power, and potentially offsetting legal considerations present in the circumstances, such as here those related to patents [...] Whether a particular restraint lies 'beyond the limits of the patent monopoly' is a conclusion that flows from that analysis and not, as THE CHIEF JUSTICE suggests, its starting point."*⁵²⁷

Furthermore there are Supreme Court precedents making clear that sometimes patent-related settlements can violate the antitrust rules⁵²⁸, e.g. *United States v. Singer Mfg. Co.*⁵²⁹ Moreover even without the settlement context there were cases where the Supreme Court struck down restrictive patent licensing agreements.⁵³⁰ In these cases the Supreme Court aimed to accommodate patent and antitrust policies. It follows that there is nothing novel about this approach even though the dissenting opinion states so. The Court then gave further examples.⁵³¹

Importantly Justice Breyer then mentioned that there is a difference between a party with a claim or counterclaim for damages receiving a sum which is equal or less than then value of the initial claim and a reverse payment settlement where a party with no claim for

⁵²⁵ *FTC v. Actavis*, 133 S.Ct. 2223, 2231 (2013).

⁵²⁶ *FTC v. Actavis*, 133 S.Ct. 2223, 2231 (2013).

⁵²⁷ *FTC v. Actavis*, 133 S.Ct. 2223, 2231-2232 (2013).

⁵²⁸ *FTC v. Actavis*, 133 S.Ct. 2223, 2232 (2013).

⁵²⁹ *United States v. Singer Mfg. Co.*, 374 U. S. 174 (1963).

⁵³⁰ *United States v. General Electric Co.*, 272 U.S. 476, 489 (1926); *United States v. Line Material Co.*, 333 U.S. 287 (1948); *United States v. New Wrinkle*, 342 U.S. 371 (1952); and *Standard Oil Co.*, 283 U.S. 163 (1931).

⁵³¹ *FTC v. Actavis*, 133 S.Ct. 2223, 2232-2233 (2013).

damages receives money merely for staying away from the patentee's market. By citing the *Trinko* case the court states that collusion is "*the supreme evil of antitrust*".⁵³²

That collusion is the anticompetitive behavior that is regarded the worst is known. So why did the Court cite *Trinko* in this regard? This sentence seems to be superfluous. In the *Trinko* case the Court made this statement to emphasise its point that collusion may be facilitated if competitors are compelled to negotiate with each other.⁵³³ However, in the present case it seems like the Court wanted to show that collusion was also very likely in situations where the competitors were not supposed to negotiate with each other. Therefore the danger of collusion is always around no matter whether the market members are forced to negotiate with each, i.e. to allow access, or not.

Justice Breyer then went on to emphasise the procompetitive thrust of the Hatch-Waxmann Act.⁵³⁴ As an analogy also the 1996 Act has procompetitive thrust.

The Supreme Court also addressed the Eleventh Circuit's statements in regard to the general legal policy favoring settlement of disputes and stated that this patent-related factor should not determine the result in this case. Rather five sets of considerations lead the court to conclude that the FTC should have been given the opportunity to prove the claim under the antitrust rules.⁵³⁵

The first consideration is that the restraint at issue had indeed the potential for an adverse effect of competition. In this regard the majority is of the opinion that under the settlement the payment for staying out of the market serves to keep the prices for the drug in question at patentee-set levels. The monopoly return is then divided between the challenged patentee and the patent challengers. Both gain; however the consumer loses.⁵³⁶

Also in the telecommunications cases above the restraint at issue potentially had an adverse effect on competition in the market.

⁵³² *FTC v. Actavis*, 133 S.Ct. 2223, 2233 (2013).

⁵³³ *Verizon v. Trinko*, 540 U.S. 398, 408 (2004).

⁵³⁴ *FTC v. Actavis*, 133 S.Ct. 2223, 2234 (2013).

⁵³⁵ *FTC v. Actavis*, 133 S.Ct. 2223, 2234 (2013).

⁵³⁶ *FTC v. Actavis*, 133 S.Ct. 2223, 2235 (2013).

The second consideration is that at least sometimes these anticompetitive results will prove unjustified. It may be possible that reverse payment settlements do not bring about anticompetitive consequences; however, that possibility is no justification for dismissing the FTC's complaint. In an antitrust proceeding the defendant may show that legitimate justifications are present thereby explaining the presence of the alleged anticompetitive term and under the rule of reason showing the lawfulness of the term in question.⁵³⁷

In the telecommunications cases above the Courts could have taken a similar position; i.e. taking on the case and considering whether the behavior at issue brings about anticompetitive results or not. However, they merely handed over the responsibility to the regulators who naturally have other public policy goals than antitrust.

The third consideration is that in instances where the reverse payment settlement threatens to result in unjustified anticompetitive harm, it is likely that the patentee has the power to bring that harm about in practice. Justice Breyer describes that the size of the reverse payment is already an indication of power. Furthermore there are studies showing that *“reverse payment agreements are associated with the presence of higher-than competitive profits—a strong indication of market power”*⁵³⁸.

Also a price squeeze or a refusal to deal prove how much power the accused has as its implications for the market indicate how important their (non-)service is. In the telecommunications cases above the undertakings accused of anticompetitive behavior had lots of market power.

The fourth consideration is that it is likely that antitrust litigation is more feasibly administrated than the Eleventh Circuit believes.⁵³⁹ To answer the antitrust issue in question it is normally not necessary to litigate the validity of the patent.

*“In a word, the size of the unexplained reverse payment can provide a workable surrogate for a patent’s weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself.”*⁵⁴⁰

⁵³⁷ *FTC v. Actavis*, 133 S.Ct. 2223, 2235-2236 (2013).

⁵³⁸ *FTC v. Actavis*, 133 S.Ct. 2223, 2236 (2013).

⁵³⁹ *FTC v. Actavis*, 133 S.Ct. 2223, 2236 (2013).

⁵⁴⁰ *FTC v. Actavis*, 133 S.Ct. 2223, 2236-2237 (2013).

Especially this point is relevant for antitrust litigation arising in instances where the behaviour might be covered by sector-specific regulation. Antitrust litigation often only entails the antitrust issues and not detailed knowledge or discussion about issues where a regulatory authority has more experience. Accordingly the argument that regulatory authorities are better equipped (experience and knowledge) than antitrust courts to deal with regulated networks is weak when it comes to anticompetitive behaviour. However, one might say that this should be decided on a case-by-case basis. On the other hand, where antitrust litigation would include complex sector-specific issues the court could still use expert opinions, which is the usual thing to do in all such litigation entailing requiring expert knowledge in fields apart from law. One also wonders why in the field of patents, which is certainly much more complex than e.g. telecommunications or energy, the Supreme Court suddenly is of the opinion that antitrust litigation was more feasibly administrated than the Eleventh Circuit believed. This might be regarded as implying a general change of mind in the relationship between sector-specific regulation and antitrust rules since surely antitrust litigation for regulated networks is even more easily administrated than for patents.

The fifth consideration is that the fact that a large and unjustified reverse payment risks liability under the antitrust rules does not prevent the parties to the litigation to settle their lawsuit. As in other industries they may settle in other ways. Justice Breyer emphasises even though parties have reasons to prefer settlements which include reverse payments the relevant antitrust question to ask is what the reasons behind such a settlement were. In case the aim was to maintain and share monopoly profits generated by the patent then, subject to possible justifications, such an arrangement will likely be forbidden by antitrust rules.⁵⁴¹

“In sum, a reverse payment, where large and unjustified, can bring with it the risk of significant anticompetitive effects; one who makes such a payment may be unable to explain and to justify it; such a firm or individual may well possess market power derived from the patent; a court, by examining the size of the payment, may well be able to assess its likely anticompetitive effects along with its potential justifications without litigating the validity of the patent; and parties may well find ways to settle patent disputes without the use of reverse payments. In our view, these considerations, taken together, outweigh the single strong consideration—the desirability of

⁵⁴¹ *FTC v. Actavis*, 133 S.Ct. 2223, 2237 (2013).

settlements—that led the Eleventh Circuit to provide near-automatic antitrust immunity to reverse payment settlements.”⁵⁴²

Also the parties to the telecommunications cases could have settled.

The statements the majority makes may be interpreted as applying generally to sectors which are heavily regulated, e.g. regulated networks.

The majority then declines the FTC’s wish to hold that reverse payment settlement agreements are presumptively unlawful and that courts should use a ”quick look” approach rather than a ”rule of reason“ approach when reviewing such agreements.

“That is because the likelihood of a reverse payment bringing about anticompetitive effects depends upon its size, its scale in relation to the payor’s anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification. The existence and degree of any anticompetitive consequence may also vary as among industries. These complexities lead us to conclude that the FTC must prove its case as in other rule-of-reason cases.”⁵⁴³

Again the majority refers to other industries. This serves to widen the application of the judgment and it may well be argued that a way to a shift in the relationship between sector-specific and antitrust litigation was paved through this very to the point judgment.

In its last paragraph the majority states the following:

“As in other areas of law, trial courts can structure antitrust litigation so as to avoid, on the one hand, the use of antitrust theories too abbreviated to permit proper analysis, and, on the other, consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question—that of the presence of significant unjustified anticompetitive consequences [...] We therefore leave to the lower courts the structuring of the present rule-of-reason antitrust litigation.”⁵⁴⁴

Also this last paragraph may be interpreted as applying generally to sectors where it is usually argued that special knowledge is needed and therefore regulatory authorities are better to deal with them. Trial courts can structure antitrust litigation on a case-by-case basis deciding how much expert knowledge is necessary to answer the basic antitrust question at trial.

⁵⁴² *FTC v. Actavis*, 133 S.Ct. 2223, 2237 (2013)..

⁵⁴³ *FTC v. Actavis*, 133 S.Ct. 2223, 2237 (2013).

⁵⁴⁴ *FTC v. Actavis*, 133 S.Ct. 2223, 2238 (2013).

The dissenting opinion is given by Chief Justice Roberts. Essentially the minority concludes that patent settlements are except from antitrust rules if the settlement in question is within the scope of the patent.⁵⁴⁵ This is also the traditional US approach on industries under sector-specific regulation. However, when settling the patent holder must act within the scope of the patent. If the actions of the patent holder go beyond the monopoly powers conferred by the patent then such actions are subject to antitrust scrutiny. If the actions are within the patent's scope they are not subject to antitrust scrutiny; but there are two exceptions to this, i.e. settling sham litigation and litigation involving a patent obtained through fraud on the Patent and Trademark Office.⁵⁴⁶

Chief Justice Roberts then goes on stating that the Court in its majority opinion announced a new rule:

*"It is willing to accept that Solvay's actions did not exceed the scope of its patent [...] But it does not agree that this is enough to 'immunize the agreement from antitrust attack.' [...] According to the majority, if a patent holder settles litigation by paying an alleged infringer a 'large and unjustified' payment, in exchange for having the alleged infringer honor the patent, a court should employ the antitrust rule of reason to determine whether the settlement violates antitrust law."*⁵⁴⁷

Importantly the minority mentions the *Linkline* case to make clear their stance that if the actions at issue are within the patent's scope they are not subject to antitrust scrutiny thereby stating the following:

*"Good luck to the district courts that must, when faced with a patent settlement, weigh the 'likely anticompetitive effects, redeeming virtues, market power, and potentially offsetting legal considerations present in the circumstances.' [...] but see Pacific Bell Telephone Co. v. linkLine Communications, Inc., 555 U. S. 438, 452 (2009)('We have repeatedly emphasized the importance of clear rules in antitrust law')."*⁵⁴⁸

⁵⁴⁵ *FTC v. Actavis*, 133 S.Ct. 2223, 2238 (2013).

⁵⁴⁶ *FTC v. Actavis*, 133 S.Ct. 2223, 2239 (2013).

⁵⁴⁷ *FTC v. Actavis*, 133 S.Ct. 2223, 2239 (2013).

⁵⁴⁸ *FTC v. Actavis*, 133 S.Ct. 2223, 2245 (2013).

e. *Analysis*

The main difference between antitrust law and patent law is that the latter inherently promotes exclusivity whereas the former seeks to police actions taking place outside a reasonably competitive sphere.⁵⁴⁹

Essentially the Court laid out a rationale for considering antitrust liability extensively; however, it did not provide a complete framework to do so for these kinds of settlements. A plaintiff has to demonstrate that the anticompetitive effects of the settlement outweigh the procompetitive effects. This requires a case-by-case analysis. As guidance the Court merely stated that large payment sums should be analysed more carefully. Furthermore if the scale of the settlement is too large compared to the cost of litigation in the future or there is no other reasonable justification available a reverse payment settlement may anticompetitive.⁵⁵⁰

Nevertheless it is possible to interpret the case as a change of mind of the Supreme Court. In my opinion especially two important points were made. Firstly, taking account of both antitrust policy and rules when analysing behaviour actually covered by sector-specific regulation were emphasised by the Supreme Court. Secondly, antitrust litigation in a very complex area, i.e. patents, was feasible to administer, this has to apply to industries, where not the same amount of expertise as patents is required, too. Moreover, the wording of the judgment implies that its statements apply to other regulated industries too.

⁵⁴⁹ *Schmitt*, Competition Ahead? The Legal Landscape for Revers Payment Settlements after Federal Trade Commission v. Actavis, Inc., in *Berkely Technology Law Journal*, 2014, 493 (506).

⁵⁵⁰ *Schmitt*, *Berkely Technology Law Journal*, 2014, 513.

VI The Liberalisation Process in the EU

A. The EU Approach - Introduction

The demonopolisation and liberalisation of network industries can be described as one of the most dramatic developments in economics in Europe in the 1980s and 1990s. These industries had been reserved for state-owned monopolies for decades. Accordingly, the process of demonopolisation and liberalisation was combined with (partial) privatisation of such state-owned undertakings.⁵⁵¹

The EC Treaty mentioned public undertakings to which Member States grant special or exclusive rights in Article 86 and was neutral with respect to ownership in Article 295; accordingly public and private undertakings were subject to the same rules on competition. Article 86 allowed Member States to grant to certain undertakings exclusive or special rights for legitimate national objectives. Nevertheless by granting such rights especially Articles 12 (prohibiting discrimination as to nationality) and 81 to 89 (practices distorting or eliminating competition in the internal market) had to be adhered to. According to commentators the implementation of Article 86 was a taboo in the EC. This changed in the 1980s and 1990s since on their very own initiative some Member States started privatising formerly publicly owned undertakings and since 1980 the Commission began to enforce more rigorously the equality between privately and publicly owned undertakings, especially with regard to state aids.⁵⁵²

This was essentially the start of the liberalisation movement in the EC.

B. Motives for Liberalisation

According to Van Miert⁵⁵³ the liberalisation process in the European Union was an “*unavoidable consequence of the establishment of the internal market*”⁵⁵⁴. For him it was

⁵⁵¹ *Whish*, Competition Law (2009) 970.

⁵⁵² *Pelkmans*, European Integration - Methods and Economic Analysis (2001) 140.

⁵⁵³ Karel Van Miert (17 January 1942 – 22 June 2009), Vice-Chairman of the European Commission and European Commissioner for Competition 1993-1999.

obvious that the national monopoly system was not in line with an internal market which is based on the free circulation of goods, services, people and capital and of course on competition.⁵⁵⁵

Essentially the goals of the European liberalisation policy were twofold, i.e. consumer benefit and the promotion of economic integration in the internal market. There has always been resistance by Member States when it came to liberalisation. In general liberalisation was more accepted when it came to the air transport and telecommunications sectors as opposed to the energy or postal sectors. The strength of the resistance influenced the shape and reach of liberalisation for each sector. Liberalisation was aimed for services of general economic interest only; not for non-economic activities of general interest, e.g. social security or matters of vital national interest, like diplomacy or security.

The European Commission was responsible for ensuring a balance between the Single Market and public service; this is rooted in the Treaty itself, since it is “*based on the assumption that in general free competition is the best way to satisfy consumer needs*”⁵⁵⁶.

C. The Path to Liberalisation

Across the Member States the United Kingdom played a leading role regarding liberalisation as it was the first Member State to liberalise the transport, utilities and telecommunications sector. It also pushed for EU-wide liberalisation through sector-specific regulation.⁵⁵⁷

As explained above network industries used to be excluded from competition for economic and/or political reasons since they were considered natural monopolies and provided public services that all citizens should be able to access in their position as citizens and not as consumers. However, there were three kinds of considerations which lead to the questioning of the necessity of state-owned monopolies:

⁵⁵⁴ Van Miert, Liberalization of the Economy of the European Union: The Game is not (yet) Over, in The Liberalization of State Monopolies in the European Union and Beyond (2000) 1.

⁵⁵⁵ Van Miert, Liberalization of the Economy 2.

⁵⁵⁶ Van Miert, Liberalization of the Economy 2.

⁵⁵⁷ Szyszczak, The Regulation of the State 141.

- *Economic considerations:* There was increasing dissatisfaction with performance and state management and the realisation that competition could enhance efficiency.
- *Technological considerations:* The natural monopoly argument was weakened by technical innovations.
- *Political considerations:* In the public eye there was a shift in the conception of the role of the state.⁵⁵⁸

As one commentator put it:

*"The traditional to public life, based on stewardship and public duty, has been replaced by a market-oriented approach to the delivery of public goods and services."*⁵⁵⁹

Accordingly the features of the relationship between the state and the network industry, i.e. state ownership, support and control have been replaced by the following four characteristics:

- *Privatisation:* State-owned industries were sold.
- *Liberalisation:* Permission for new market players to enter the market and compete.
- *Re-Regulation:* Necessity of control of the former monopolists to make sure that new entrants are able to compete in the market.
- *Independent bodies carrying out regulatory tasks:* Use of such independent bodies to carry out regulatory tasks in the interest of the public.⁵⁶⁰

D. The First Sector to Become Liberalised: Telecommunications

1. Introduction

In Europe the United Kingdom, Sweden and Finland were the first to liberalise their national telecommunications sector. These tendencies worked their way into EU policy in the 1980s. All Member States used monopolies which fragmented the European market. Therefore they could not benefit from economies of scale and the European market was

⁵⁵⁸ Monti, EC Competition Law (2007) 441.

⁵⁵⁹ Monti, EC Competition Law 441, citing *McEldowney*, Public Management Reform and Administrative Law in Local Public Service in the UK, *International Review of Administrative Sciences* 69 (2003), 79.

⁵⁶⁰ *Hancher/Larouche*, The Coming of Age of EU Regulation 441.

less competitive than the liberalised Japan and US markets. The demand for better coordinated communications networks within the EU and increased globalisation led to the liberalisation of this sector.⁵⁶¹ In most of the Member States the Telecoms monopoly was combined with the postal monopoly.⁵⁶²

2. The British Telecommunications Judgment

The *British Telecommunications* judgment in 1984⁵⁶³ can be seen as a breakthrough of the scope of Community law. The Court held that competition law was applicable to the telecommunications sector. Nevertheless it ties in seamlessly with the precedents on the applicability of competition rules where sector-specific regulation is in place as described in the *Deutsche Telekom* judgment.

This case regarded BT prohibiting message-forwarding agencies in the United Kingdom retransmitting telex messages which originated in locations abroad and destined for locations abroad. The European Commission held that this practice constituted an infringement of then Article 82(b) EC. Even though product introductions and changes of design were in principle lawful; however there may be exceptional cases where evidence shows that a product merely introduced or modified to render products of the competitor incompatible thereby excluding the competitor from the market. Such practice would be to the detriment of the consumer.⁵⁶⁴

3. Liberalisation

However, the process of liberalisation in this sector is regularly traced back to the EC Commission's Green Paper on the Development of a Common Market for Telecommunications in 1987.⁵⁶⁵ The Commission used a two-pronged approach in the first 15 years of liberalisation to address the liberalisation alongside the harmonisation of

⁵⁶¹ Szyszczak, *The Regulation of the State* 144.

⁵⁶² Pelkmans, *European Integration* 156.

⁵⁶³ ECJ 16 June 1987, 118/85, *Italian Republic v Commission of the European Communities*.

⁵⁶⁴ *Fatur*, *Unilateral Exclusionary Conduct* 156.

⁵⁶⁵ Szyszczak, *The Regulation of the State* 144; Commission of the European Communities 30 June 1987, COM(87) 290, *Towards a dynamic European Community, Green Paper on the Development of a Common Market for Telecommunications Services and Equipment*.

standards. On 1 January 1998 the telecommunications sector was fully liberalised and perceived as one of the major achievements during the 1990s.⁵⁶⁶

From the 1980s through to the time when liberalisation was achieved in telecommunications in 1998 a dividing line between liberalised services and reserved services which could stay monopolies was made in EU regulation.⁵⁶⁷

In the liberalisation of telecommunications the borderline between reserved services and liberalised services was gradually shifted until no more reserved services existed any longer.⁵⁶⁸

In the original liberalisation package of Directive 90/388 the whole infrastructure and public voice telephony⁵⁶⁹ were kept as reserved services. Accordingly more than 80 per cent of the telecommunications sector was left in the reserved services category and therefore not liberalised.⁵⁷⁰

At first mobile and satellite communications⁵⁷¹ were not reserved any longer, then cable TV networks⁵⁷², then infrastructure used to provide for liberalised services, i.e. alternative infrastructure⁵⁷³, and finally on 1 January 1998 all remaining monopoly rights⁵⁷⁴ were removed.⁵⁷⁵

a. *Why Regulate?*

When it became clear that the reserved services dichotomy would vanish, a different justification for regulation was to be found. The issue of “why regulate?” turned up.

⁵⁶⁶ Szyszczak, *The Regulation of the State* 145.

⁵⁶⁷ Hancher/Larouche, *The Coming of Age of EU Regulation* 746.

⁵⁶⁸ Hancher/Larouche, *The Coming of Age of EU Regulation* 746.

⁵⁶⁹ Public voice telephony was defined intricately to allow the liberalisation of fixed telecommunications services to business customers. Hancher/Larouche, *The Coming of Age of EU Regulation* 746.

⁵⁷⁰ Hancher/Larouche, *The Coming of Age of EU Regulation* 746.

⁵⁷¹ Commission Directive 94/46/EC of 13 October 1994 amending Directive 88/301/EEC and Directive 90/388/EC in particular with regard to satellite communications.

⁵⁷² Commission Directive 95/51/EC of 18 October 1995 amending Directive 90/388/EEC with regard to the abolition of the restrictions on the use of cable television networks for the provision of already liberalized telecommunications services.

⁵⁷³ Commission Directive 96/19/EC of 13 March 1996 amending Directive 90/388/EEC with regard to the implementation of full competition in telecommunications markets.

⁵⁷⁴ Commission Directive 96/19/EEC.

⁵⁷⁵ Hancher/Larouche, *The Coming of Age of EU Regulation* 746.

Hancher and Larouche found three possible answers and elaborated on them having regard to the newly liberalised telecommunications network:

“History: regulation aims to mitigate the ongoing consequences of the ‘original sin’ of special or exclusive rights, in which case it will typically be targeted at firms which used to hold such rights;

Technology: regulation aims to ensure that a technological system performs in line with expectations as they might have been formulated in policy. For that purpose, certain elements or features in the system might require regulation;

Economics: regulation aims to ensure that the operation of market forces in a given sector produces the desired effects, as defined in policy. Regulation is then required when there is a risk of market failure, and it will be imposed following economic analysis, upon such firms and under such circumstances as are required to address that risk.”⁵⁷⁶

In Directive 96/19/EC the Commission did not at length set out the foundation for future regulation. A historic approach was chosen as regulation was attached to those telecommunications organisations holding special or exclusive rights.⁵⁷⁷

In the run-up to the Open Network Provision (ONP) 1998 Directives⁵⁷⁸ it was necessary to choose a more forward-looking approach. Economics were chosen as the main articulation for regulation; however, neither worked out nor was applied in a consistent manner. Still firms with Significant Market Power (SMP)⁵⁷⁹ are regulated and the content of such regulation is set out in the Directive. Additionally the ONP 1998 framework is full

⁵⁷⁶ Hancher/Larouche, The Coming of Age of EU Regulation 747.

⁵⁷⁷ Hancher/Larouche, The Coming of Age of EU Regulation 747.

⁵⁷⁸ Council Directive 90/387/EEC of 28 June 1990 on the establishment of the internal market for telecommunications services through the implementation of open network provision (as amended by Directive 97/51/EC of the European Parliament and of the Council of 6 October 1997 amending Council Directives 90/387/EEC and 92/44/EEC for the purpose of adaption to a competitive environment in telecommunications); Council Directive 92/44/EEC of 5 June 1992 on the application of open network provision to leased lines (as amended by Directive 97/51/EC); Directive 97/33/EC of the European Parliament and of the Council of 30 June 1997 on interconnection in Telecommunications with regard to ensuring universal service and interoperability through application of the principles of Open Network Provision (ONP); Directive 98/10/EC of the European Parliament and of the Council of 26 February 1998 on the application of open network provision (ONP) to voice telephony and on universal service for telecommunications in a competitive environment; Directive 97/13/EC of the European Parliament and of the Council of 10 April 1997 on a common framework for general authorizations and individual licences in the field of telecommunications services.

⁵⁷⁹ Defined as a 25 percent share of one on a number of pre-defined markets. There is the possibility to stray away from that threshold either way according to Council Directive 97/33 Article 4 (3). The pre-defined markets are set out in Annex 1 of Council Directive 97/33 as (i) fixed public telephone network, (ii) fixed public telephone services, (iii) leased lines, as well as (iv) interconnection for mobile networks and services.

of technical definitions such as “telecommunication network”, “interconnection”, “public networks and services”, etc.⁵⁸⁰

b. The 2002 Framework

The current framework for electronic communications is the 2002 framework which is embodied in four Directives enacted in 2002.⁵⁸¹ It resulted from the review of the aforementioned ONP 1998 framework. According to Hancher und Larouche the 2002 framework provides for the best illustration “*of the integrative paradigm in the regulation of network industries in the EU*”⁵⁸².

*“The choice for an economics-based approach is confirmed and enshrined, as reflected in two key principles of the 2002 framework, namely reliance on economic analysis and technological neutrality.”*⁵⁸³

Regarding the reliance on economic analysis the 2002 framework mimics competition law analysis as to the SMP regime, the main component of the 2002 framework. Firstly, markets are defined and also selected for analysis. Secondly, the degree of competition in these markets is evaluated to identify undertakings holding SMP. Thirdly, remedies are imposed when one or more undertakings are found to have SMP. The available remedies to choose from are found in legislation⁵⁸⁴ without a specific remedy being prescribed for any given case.

Even though the 2002 framework relies on economic analysis as does competition law it does not follow the same analytical method. The three-criterion test for market selection, i.e. “*high and persistent barriers to entry, limited prospect for effective competition behind*

⁵⁸⁰ Hancher/Larouche, The Coming of Age of EU Regulation 747-748.

⁵⁸¹ 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); Directive 2002/20/EC (Authorisation Directive); 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); 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); Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services.

⁵⁸² Hancher/Larouche, The Coming of Age of EU Regulation 748.

⁵⁸³ Hancher/Larouche, The Coming of Age of EU Regulation 748.

⁵⁸⁴ Other remedies may be imposed by regulatory authorities if the Commission approves: Directive 2002/19/EC Art 8 (3).

such barriers, comparative inefficiency of competition law”⁵⁸⁵ has no alike method in competition law.

c. The Two Remaining Instances of Separation

i. The Separation Between Network and Content

In EU electronic communications regulation it is the case that networks and content are seen as two separate matters. Content, i.e. what is carried on over the networks, is even expressly left out of the 2002 framework. Rather content is covered in the Audiovisual Media Services Directive⁵⁸⁶ and the E-commerce Directive^{587, 588}.

The problem with such an approach is that it leads to pigeonholing: Services fall under “electronic communications services”, “Information Society Services” (E-commerce Directive) or “audiovisual media services”. Accordingly firms wanting their services or products to fall under a specific scheme may navigate around the definitions to fit into the scheme they prefer. An example can be found in the reform of broadcasting regulation where energies were dedicated to position broadcasting (or linear) and on-demand (or non-linear) audiovisual media services within one or the other box. This had the consequence that network neutrality - this involves the relationship between network operators and providers of content - cannot be addressed within the scheme for SMP but has to be addressed either via specific regulation or competition law.⁵⁸⁹

ii. Competition Law and Sector-Specific Regulation

Even though competition law and sector-specific regulation are closely aligned in the EU they are still different, e.g. the former operating *ex-post* and the latter operating *ex-*

⁵⁸⁵ *Hancher/Larouche*, The Coming of Age of EU Regulation 749

⁵⁸⁶ Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities, as amended Directive 2007/65/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directive 89/552/EEC on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities;; Directive 2010/13/EU of the European Parliament and of the Council of 10 March 2010 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the provision of audiovisual media services (Audiovisual Media Services Directive).

⁵⁸⁷ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (“Directive on electronic commerce”).

⁵⁸⁸ *Hancher/Larouche*, The Coming of Age of EU Regulation 751.

⁵⁸⁹ *Hancher/Larouche*, The Coming of Age of EU Regulation 751-752.

ante. Hancher and Larouche explain that Larouche⁵⁹⁰ has sought to demonstrate that these two sets of law are largely overlapping. "[...] *A corollary of that mainstream opinion is that sector-specific regulation is bound to vanish, so that ultimately the sector would be policed through competition law alone*"⁵⁹¹. However, even if it disappears in certain areas it appears again in other areas. "*A perverse consequence of the mainstream opinion, however, is that regulatory authorities behave very expansively in seeking new regulatory endeavours, in order to stave off the sunset of regulation and their own disappearance.*"⁵⁹² Hancher and Larouche therefore argue that instead of separating the two regimes, it might be better that some regulation stays in place, as long as such regulation is no more than necessary and in close integration with competition law.

Larouche's view adds a new dimension to the discussion on the relationship of competition law and sector-specific regulation even though his arguments were made in relation to the telecommunications sector. He essentially argues that regulatory authorities behave in a way to make sure that regulation stays in place to fight their own disappearance. Since the mainstream opinion is that ultimately sector-specific regulation is to be reduced until it vanishes to achieve a competitive market with a level playing field and fulfil the liberalisation goals, the objectives of the NRA's seem to conflict with those of policy makers. However, one shall not forget that regulated networks are of special relevance to the economy and the consumers and due to their special characteristics they need special attention. I do not think that it makes sense to strive for a complete extermination of sector-specific rules, but rather for a successful and efficient co-existence of the two sets of rules.

4. Impact

The effect of liberalisation in the telecommunications sector is a matter of considerable debate between academics. A study in the effect of access regulation on investments in Europe even found a negative effect on incumbent investments and a neutral effect on

⁵⁹⁰ Larouche, A Closer Look at Some Assumptions Underlying EC Regulation of Electronic Communications (2002) 129.

⁵⁹¹ Hancher/Larouche, The Coming of Age of EU Regulation 752.

⁵⁹² Hancher/Larouche, The Coming of Age of EU Regulation 752.

entrant's investments. A study conducted at Harvard University found more favourable outcomes.⁵⁹³

According to the Commission the EU regulatory framework for telecommunications has brought benefits to consumers in terms of innovative and increasingly affordable communications services. Nevertheless some serious obstacles still need to be overcome. Such obstacles are for example the independence and effectiveness of NRAs and significant difference across the Member States in terms of wholesale and retail prices.⁵⁹⁴

Furthermore competition law continues to play an important and complementary role to sector-specific regulation. Competition law principles were taken into account when the Telecommunications Regulatory Framework was devised. Progressively removing *ex ante* regulation once the market becomes truly competitive is one of the objectives of the Regulatory Framework.⁵⁹⁵ Important changes in the sector, especially due to new technologies, emerge. Keeping abreast of these changes is a constant challenge to regulators. The EU and its Member States continue to use the legislative, regulatory and competition tools to address the objectives they pursue in the telecommunications market.⁵⁹⁶

A commentator describes the EU as one of the most competitive telecommunications markets in the world and even more competitive than the US telecommunications market.⁵⁹⁷ This shows how well the liberalisation of this industry worked if it is described even more competitive than in the role model country of liberalisation. A further interpretation is that the EU telecommunications market is so competitive because of the co-existence of sector-specific rules and competition law. In that case competition law (and the *Deutsche Telekom* and *Telefónica* decisions) may act as deterrent for telecommunications undertakings wanting to act anticompetitively. This also ties in with

⁵⁹³ *Baldwin/Cave/Lodge*, Understanding Regulation 462 citing *Grajek/Röller*, The Effect of Regulation on Investment in Network Industries: Evidence from the Telecommunications Industry (2009) and *Berkman Center, Harvard University*, Next Generation Connectivity: A review of Broadband Internet Transitions and Policy from around the World (2010).

⁵⁹⁴ *European Commission*, Progress Report on the Single European Electronic Communications Market 2009 (15th Report) SEC (2010) 630.

⁵⁹⁵ *Brandenburger/Good/Janssens*, EU Telecommunications: much achieved, where to next? in Practical Law Article 2009, 17.

⁵⁹⁶ *Brandenburger/Good/Janssens*, Practical Law Article 2009, 21.

⁵⁹⁷ *Bell*, Broadband Deregulation - Similar Legislation, Different Results: A Comparative Look at the United States and the European Union, in *Tulane Journal of Technology and Intellectual Property*, Fall 2007, 77 (107).

Kroes' statement below which emphasises that the complementary use of these two regimes is a reason for the success of the liberalisation efforts in the telecommunications sector.

Kroes, then EU Competition Commissioner stated in April 2009 the following:

*“[i]n sectors with persistent market failures, competition law is rarely going to be sufficient. Without question, sectors like energy and telecoms have proven that competition law alone does not create competition. The telecoms sector offers a good illustration of what successful joint work looks like. It is one of our best examples of the benefits that liberalised but well regulated markets can deliver – we got the balance right [...] besides enforcing competition law in selected cases, the role of the Commission is to foster a consistent application of competition rules and to ensure a common regulatory strategy based on competition law principles across the EU through the common regulatory Framework and the Article 7 notification procedure. So it is essential to understand from the beginning that regulation and competition law are parallel processes, not competition processes.”*⁵⁹⁸

This statement shows that the EU won't stop to use the sector-specific rules and the competition rules jointly to reach its goals since it is in the EU's opinion the best way to do so (as evidenced by its apparent success).

⁵⁹⁸ Neelie Kroes, European Commissioner for Competition Policy, The interface between regulation and competition law, (Speech at the Bundeskartellamt conference: Dominant Companies – The Thin Line between Regulation and Competition Law, Hamburg on 28 April 2009) http://europa.eu/rapid/press-release_SPEECH-09-202_en.htm?locale=en (accessed on 30 November 2014).

VII The Liberalisation Process in the US

A. The US Approach – Introduction

Since in the US regulated networks used to be private undertakings too (as opposed to merely public undertakings) the liberalisation process may also be described as a deregulation process. The deregulation process in the US is to be regarded as a role model for other countries.

In the US it was the case that most economic regulation was a compromise between a pricing approach as in a free market and some form of nationalisation or public ownership. The US model of regulation applied governmental requirements and restrictions to private undertakings rather than public ownership of undertakings. Public utility regulation was the most common form of regulation. Such regulation consisted of price regulation and the control of entry and quality of service. The key was to minimise competition and control prices. For political reasons the public utility regulatory scheme was also extended to industries where there was no or only a partial natural monopoly, like airlines and trucking.⁵⁹⁹ It was enough if the private property was “*affected with a public interest*”.⁶⁰⁰

Deregulation in the US took hold in the 1970s and 1980s, especially in arguably structurally competitive industries, i.e. airlines and trucking.⁶⁰¹

B. Motives for Liberalisation

The deregulation movement in the US began in the 1970s. Its theoretical foundations are found in two different economic theories:

⁵⁹⁹ *Aman*, Deregulation in the United States: Transition to the Promised Land, a New Regulatory Paradigm, or Back to the Future? in *Geradin (Ed.)*, The Liberalization of State Monopolies in the European Union and Beyond (2000) 263 (264-265).

⁶⁰⁰ *Munn v. Illinois*, 94 U.S. 133 (1877) cited in *Aman*, Deregulation in the United States 266.

⁶⁰¹ *Aman*, Deregulation in the United States 267-268.

1. The Theory of Contestable Markets

This theory has its origins in the neoclassical price theory and the Coarse Theorem, which both argue that the role of competition in highly concentrated or natural monopoly markets used to be underestimated.

“Contestable market theory emphasizes that competition for the market is, or can be, competition just as much as competition in the market, and can yield competitive pricing. The precondition is quick and costless entry.”⁶⁰²

This theory emphasises the cost of exit, i.e. in case I have to leave the market, how much of my investment will be lost?⁶⁰³ Essentially, this theory says that economies of scale are not important and therefore monopolies will tend to price at cost since there is always the threat of potential competition in industries where costs of entry and exit are cheap. Especially Chicago School economists were fond of this theory.⁶⁰⁴ Accordingly price regulation is not necessary and deregulation should be pursued.

The applicability of this theory is seriously open to question. For this theory to apply the incumbent undertaking must be vulnerable to hit-and-run entry, i.e. symmetry between the incumbent and the potential competitor, zero sunk costs and *“some positive interval between the entry of a new firm and the incumbent’s price response”*.⁶⁰⁵ Faster entry from the competitor than the price response from the incumbent is very unlikely in practice. Furthermore one shall not forget that utilities have huge sunk costs for their networks, even though they might not be as important for the provision of services over the networks.⁶⁰⁶

2. The Theory of Public Choice

According to this theory regulation represents interests of a few. Regulation - in many instances - is seen as result of the “capture”⁶⁰⁷ by interest groups.

“The regulation was passed, not because it was efficient, but because small, homogenous interest groups are disproportionately effective at getting their message

⁶⁰² Hovenkamp, Federal Antitrust Policy 768-769.

⁶⁰³ Hovenkamp, Federal Antitrust Policy 768-769.

⁶⁰⁴ Peritz, Competition Policy in America – History, Rhetoric, Law (2000) 263.

⁶⁰⁵ Armstrong/Cowan/Vickers, Regulatory Reform: Economic Analysis and British Experience, Cambridge/London (1994) 104.

⁶⁰⁶ Armstrong/Cowan/Vickers, Regulatory Reform 104.

⁶⁰⁷ Specific theory of regulatory capture.

*through, often at the expense of larger more heterogeneous groups such as consumers.*⁶⁰⁸

Even though this area of economic theory has little regard for the relationship between the rationale for regulation and the economic theory behind it, it may explain badly designed regulation.⁶⁰⁹

As described above, however, this theory links with lobbying which is known to influence law makers both in the US and in the EU. Deregulation is therefore aspired to end the influence of certain interest groups in the market.

3. Further Reasons for Liberalisation in the US

a. *Ideology*

In the 1970s the free market theory as an ideology was very popular and advocates of that theory, especially during the presidency of Ronald Reagan, thought that the market itself can allocate the resources more effectively than the government.⁶¹⁰

b. *Technical Changes*

Due to technological advancements, especially in the telecommunications industry, certain industries were no longer viewed as necessarily monopolistic. An example is the following: Before technological developments in the telecommunications sector took place all phone conversations passed through a set of wires. Now they are beamed to satellites or from microwave towers to other microwave towers. One undertaking therefore need not own an entire network to be competing in that industry. In contrast one company may even inhibit innovation whereas in a competitive market innovation is encouraged to get a competitive advantage. There is also increased choice for the consumers.⁶¹¹

⁶⁰⁸ *Hovenkamp*, Federal Antitrust Policy 770.

⁶⁰⁹ *Hovenkamp*, Federal Antitrust Policy 770.

⁶¹⁰ *Cole/Grossman*, Antitrust and Regulated Industries 383.

⁶¹¹ *Cole/Grossman*, Antitrust and Regulated Industries 383.

c. *No Existence of Economics of Scale in the First Place*

Economists found out that some of the economics of scale thought to make a monopoly necessary didn't even exist in the first place. An example is found in the energy sector: Some economics of scale regarding electric power production disappeared when electric generators grew larger. There were also instances where it was cheaper to build and operate smaller generators.⁶¹²

d. *New Analysis of the Natural Monopoly Theory*

Also economic theories advanced and Demsetz demonstrated in 1968 the following:

*“[...] that even in the event that a firm bore many of the characteristics of a natural monopoly, it would not necessarily be able to charge monopolistic prices. Notably, a firm may be prevented from setting prices if there is even the potential for other firms to enter the market, which may well be the case in most instances.”*⁶¹³

Taking a closer look at monopolies it became clear that some indeed had the potential to be a competitive market, e.g. airlines, which were contestable, i.e. entered and also contested by a number of firms in the market.⁶¹⁴

e. *The Global Context*

Deregulation was also a result of an increasingly global context as various domestic liberalisation reforms were occurring in the 1980s.⁶¹⁵

C. The First Sector to Become Liberalised: Airlines

The first sector to become deregulated was the airline sector. This sector originally was first regulated with the Civil Aeronautics Act of 1938.⁶¹⁶ At that time Congress was of the opinion that the air transport industry was in its infancy and that in the absence of regulation the at the time existing, competitive environment may impede its development. Nevertheless Congress wanted the sector to stay competitive and was opposed to

⁶¹² *Cole/Grossman*, Antitrust and Regulated Industries 383.

⁶¹³ *Cole/Grossman*, Antitrust and Regulated Industries 383.

⁶¹⁴ *Cole/Grossman*, Antitrust and Regulated Industries 384.

⁶¹⁵ *Aman*, Deregulation in the United States 267-268.

⁶¹⁶ Civil Aeronautics Act of 1938, 52 Stat. 973.

monopolisation.⁶¹⁷ Recommendation 9 of the Federal Aviation Commission in this regard stated the following:

*“It should be the general policy to preserve competition in the interest of improved service and technological development, while avoiding uneconomic paralleling of routes or duplication of facilities.”*⁶¹⁸

The 1938 Act was re-titled the Federal Aviation Act of 1958⁶¹⁹ and remained nearly unchanged. The Civil Aeronautics Board (CAB) supervised the whole industry and occasionally the President of the US intervened in decisions affecting international air transportation.⁶²⁰

The main motive for deregulation was emerging evidence showing the inefficiency of the regulatory system. Furthermore the regulatory system was very costly and allocated resources ineffectively. Studies showed that unregulated carriers who operated within the individual states offered their services for lower fares than interstate regulated carriers. Accordingly it was desired to improve efficiency by subjecting the publicly owned airline carriers to market pressures. Another strong motive was that the government wanted to reduce borrowing requirements for public sectors since aircrafts were very costly. Additionally the injection of private capital as well as management techniques into the industry was sought after.⁶²¹

The industry response to potential deregulation was to say the least not very enthusiastic. Airline officials were of the opinion that the intended regulatory reforms would be disastrous to the airline industry. At the Kennedy Hearings in support of continued regulation of the CAB they testified and said that deregulation would lead to even less competition since smaller carriers would be forced out of business. CAB had protected route authority; without that protection carriers with a lot of financial power would have the possibility to enter the markets of the smaller and weaker carriers and

⁶¹⁷ Dempsey/Goetz, *Airline Deregulation and Laissez-Faire Mythology* (1992) 159-162.

⁶¹⁸ Dempsey/Goetz, *Airline Deregulation* 162 quoting Senate Comm. On Interstate Commerce, Federal Aviation Commission, S. Doc. No. 15, 75th Cong., 1st Sess. (1935), at 61.

⁶¹⁹ 49 U.S.C. §§1301-1551 (1779), Federal Aviation Act has been re-codified in sections of 49 U.S.C. beginning at §40101.

⁶²⁰ Cheng-Jui, *International Airline Alliances: EC Competition Law/US Antitrust Law and International Air Transport* (2003) 24.

⁶²¹ *Organisation for Economic Co-Operation and Development* (OECD), *Deregulation and Airline Competition* (1988) 54.

charge lower fares. The quality and dependability of the industry would suffer. The industry had the feeling that incorrect economics were the reason for the deregulation movement.⁶²²

In 1978 Congress passed the Airline Deregulation Act of 1978. Price controls were gradually eliminated and the CAB, which was responsible for price and entry/exit control, was eliminated on 1 January 1985. Three periods of activity after deregulation were described by the Congressional Budget Office's 1988 report:

- 1977 to 1979: Competitive boom period. During that period airline fares were lowered, there was a significant increase in traffic and profit, as there were more consumers.
- 1980 to 1985: Proliferation period. During that period at least 20 new carriers entered interstate service.
- 1985 to 1987: Consolidation period. During that period there were a number of mergers and bankruptcy cases.
- 1988: Only a handful of new entrants were still operating.⁶²³

The 8 largest airlines had a market share of 80% in 1978; by 1992 their market share had grown to 95%. The three major airlines had a market share of 35% in 1985; by 1992 their market share had grown to 56%. This was due to significant consolidation in that sector.⁶²⁴

Airline fares declined rapidly. Between 1978 and 1986 they declined about 13 per cent and by 1988 the Federal Trade Commission even reported that fares have dropped by 25 per cent. A Brookings Institution study concluded in 1986 that airline deregulation resulted in savings of \$ 6 billion for Americans per year through better service and lower fares. This figure was recalculated to \$ 12 billion per year in 1988 by the Brookings Institution. These

⁶²² *Morgan*, Toward Deregulation in *Berman/Strassmann/Meyer/Oster*, Airline Deregulation – The Early Experience (1981) 43-44.

⁶²³ *Aman*, Deregulation in the United States 272.

⁶²⁴ *Aman*, Deregulation in the United States 272.

lower fares were one of the reasons why air traffic nearly doubled between 1979 and 1987. Nevertheless prices rose again in 1986.⁶²⁵

Furthermore about 114 small and medium-sized communities which used to be served by some air carriers were abandoned in 1984. The reductions in airfares were spread differentially since fares were reduced for competitive, high-density routes but went up for low-density, non-competitive routes. The latter routes were also subject to unexpected shifts in operating schedules.⁶²⁶

After deregulation the antitrust laws were hardly applied and as Alfred Kahn, the former CAB chairman and architect of airline deregulation, said, deregulation is an ineffective policy if antitrust rules are not enforced. Another problem was that by adapting to deregulation the industry had adopted structural developments, which limited competition; i.e. hub and spoke system, gate hoarding, congestion and slots, computer reservation systems and frequent flyer program and travel overrides.⁶²⁷ In the 1990s Congress passed a number of bills to increase competition in that sector.⁶²⁸

Deregulation caused a transformation of the major carriers' airline route maps from linear, i.e. point to point arrangements, to hub-and-spoke arrangements.⁶²⁹ Especially such hub and spoke networks were responsible for competitive problems in the airline market. These networks created a certain kind of value for consumers that could not be duplicated by airline carriers not being part of the network in question. Demand in airline markets is affected by transaction costs and production indivisibilities which can both be addressed by networks. Especially time- and transaction-cost-sensitive customers prefer to fly with an airline carrier being part of a network. Accordingly in the last thirty years nearly all US airlines irrelevant of their size have adopted some kind of network structures.⁶³⁰ As with

⁶²⁵ Horwitz, *The Irony of Regulatory Reform – The Deregulation of American Telecommunications* (1989) 268.

⁶²⁶ Horwitz, *The Irony of Regulatory Reform* 268-269.

⁶²⁷ Aman, *Deregulation in the United States* 272.

⁶²⁸ Aman, *Deregulation in the United States* 273-275.

⁶²⁹ Havel, *In Search of Open Skies: Law and Policy for a New Era in International Aviation – A Comparative Study of Airline Deregulation in the United States and the European Union* (1997) 201.

⁶³⁰ Levine, *Airline Alliances and Systems Competition: Antitrust Policy toward Airlines and the Department of Justice Guidelines*, in *Houston Law Review* 45/2, 2008, 333 (335).

other networks vertical integration, i.e. operating the feeder system and owning or leasing airport gates, contributes to anticompetitive behaviour.⁶³¹

The other four developments took advantage of hubs and therefore of the networks. One commentator analysed these developments as follows:

*“[...] the industry was modelled as being basically competitive and scope effects were seen as impediments to this competition being addressed through merger and agreement policy even if they couldn’t be addressed directly through regulation.”*⁶³²

Contestability still plays a role for those (leisure) travellers who are willing to substitute destinations, airports, flight times, flights, schedules and amenities for small price differences, e.g. Allegiant Air or Ryanair customers.⁶³³

Still nowadays most of the revenue in the airline market is earned in network structures since though their hubs and partner network airlines, airline carriers are able to offer a wide choice of destinations, flights and times to consumers. Networks compete with each other and there is ongoing competitive pressure from new networks on one hand and on the other hand from network expansion.⁶³⁴

Levine suggests that antitrust policy should be directed at preventing impediments for network consumers wanting to use non-network substitutes. Nevertheless declining to offer their networks or facilities to competitors should not constitute a violation of antitrust rules.⁶³⁵ This view is convincing when thinking of competitors wanted to use network services the incumbent incurred large costs for. Nevertheless it has to first be determined whether the specific network service in question is an essential facility, e.g. access to the airport by building gates or buying slots may be an essential facility where no other airport is nearby which may be seen as a substitute for the initial airport in question.

Another commentator wrote that airlines engaged in “destructive competition” as a consequence of how law defined the air travel market. By failing to revise the competitive

⁶³¹ Carstensen, The Poor Financial Performance of Deregulated Airlines: Competition as Causation or only Correlation? Reflections on Professor Dempsey’s Article, in Houston Law Review 45/2 (2008), 487 (502).

⁶³² Levine, Houston Law Review 45/2, 2008, 336.

⁶³³ Levine, Houston Law Review 45/2, 2008, 337.

⁶³⁴ Levine, Houston Law Review 45/2, 2008, 338.

⁶³⁵ Levine, Houston Law Review 45/2, 2008, 340-341.

legal framework the problems continued to persist. Accordingly a reform of airline regulation should be the objective. However, the “direct command-and-control” regulation by the CAB would be even worse.⁶³⁶ He also mentions that even two of the key players in deregulation, Levine (see above) and Kahn (see below), acknowledged that they have misunderstood the airline business.

Especially the failure to recognise that airline services have a network nature was a misunderstanding of the airline market. Related was the error that entry and exit into the market would nearly be costless and therefore nearly perfect competition would emerge.⁶³⁷

Another kind of error was the wrong assumption on how the deregulated airline market would function. In this regard of special importance was the wrong assumption that seats would be priced at a relatively uniform price comparable to those of commodities. What happened was that airlines did in fact differentiate among passengers’ demand elasticity.⁶³⁸

A final error was the wrong assumption that critical and robust oversight of mergers would be provided by antitrust law. Nevertheless the Department of Transportation being the then authority for mergers in the airline market authorised a number of anticompetitive mergers. In the meantime the Antitrust Division of the Department of Justice took over the merger review.⁶³⁹

However, there are ways to reform the legal regime. There should be changes in the airlines’ rights to restrict the use of tickets, e.g. introducing the right to transfer the ticket or parts of the ticket to third parties and to use only those segments of the ticket the customers wants to. Furthermore tickets should be sold on a one-way basis. Pricing requirements may also be introduced. Other reforms should be directed at stronger interventions, e.g. introducing certain capital adequacy requirements or requiring divestitures to specific

⁶³⁶ *Carstensen*, Houston Law Review 45/2 (2008), 488-489.

⁶³⁷ *Carstensen*, Houston Law Review 45/2 (2008), 496-497. See also chapter VIIB.1 The Theory of Contestable Markets.

⁶³⁸ *Carstensen*, Houston Law Review 45/2 (2008), 498.

⁶³⁹ *Carstensen*, Houston Law Review 45/2 (2008), 499.

operations related to the airports.⁶⁴⁰ The latter clearly relates to vertical integration and the advantages of unbundling in these cases.

Kahn wrote a book on lessons from deregulation having special regard to telecommunications and airlines after the crunch.⁶⁴¹

Airline deregulation “has been a nearly unqualified success” and hub-and-spoke systems are of the reasons for the enormous benefits consumers experienced through deregulation. However, lower fares are also due to the deterioration of quality of customer experience.⁶⁴²

Nevertheless the competitive advantages associated with hub and spoke network structures as explained above are weakening in his opinion. They are characterised by very high fixed costs, complex network operations and strong unions with high wage demands. Furthermore they are increasingly subjected to competition from low-cost carriers operating point-to-point.⁶⁴³

*“Just as the CAB effectively obstructed the industry’s realization of economies from hub-and-spoke operations – once deregulated, the industry quickly moved to the now model – so, today, it is inconceivable that any governmental authority would be capable of redesigning the industry to comport with the ever-changing realities of the market.”*⁶⁴⁴

*“The more relevant question today is to what extent the airlines should be left to seek salvation individually (with or without the protection of bankruptcy), to what extent collectively (with or without the benefit of exceptions from the antitrust laws).”*⁶⁴⁵

At the time he wrote the book in 2004 he was of the opinion that regulators should be more permissive of alliances proposed between hub-and-spoke carriers than about five years ago since hub operations were shrinking at that time.

Since then deregulation developed so as to not repeat the airline deregulation experience and to learn from it. Furthermore the network effect was taken into regard.

⁶⁴⁰ Carstensen, Houston Law Review 45/2 (2008), 503-505.

⁶⁴¹ Kahn, Lessons from Deregulation – Telecommunications and Airlines after the Crunch (2004).

⁶⁴² Kahn, Lessons from Deregulation 3.

⁶⁴³ Kahn, Lessons from Deregulation 5-6.

⁶⁴⁴ Kahn, Lessons from Deregulation 6-7.

⁶⁴⁵ Kahn, Lessons from Deregulation 7.

D. The Breakup of the American Telegraph & Telephone Company (AT&T)

The breakup of AT&T resulted in the introduction of competition into many parts of telecommunications industry. This case is interesting for this thesis since the two leading cases *Trinko* and *Linkline* are telecommunications cases.

AT&T had received its monopoly through government regulation. Ironically AT&T was then charged with violation of antitrust law by the DOJ. The DOJ saw long-distance telephone service and equipment manufacturing not as a monopolistic industry whereas the local telephone service was indeed a bottleneck monopoly. Since AT&T possessed the monopoly on the local telephone service sector it had the opportunity to discriminate against competitors in the long-distance telephone service and equipment manufacturing sector and deny access to the local network. In 1982 a Modification of Final Judgment was achieved whereby the local service operations were divested from AT&T's other activities. Divestiture was effected on 1 January 1984.⁶⁴⁶

Accordingly AT&T, after an antitrust case taking seven years, severed its connections with its twenty two local telephone operating companies. They were made into seven holding companies, i.e. the so-called regional Bell operating companies ("RBOCs"). The local Bell system operations were then subdivided into 161 local exchange and transport areas (LATAs). Each of those LATAs was then assigned to one of the seven RBOCs. RBOCs must not provide interLATA services. AT&T was allowed to keep its manufacturing division, Western Electric, its research and development division, Bell Labs, and Long Lines, which supplied intercity telecommunication services. Furthermore the 1956 consent decree preventing AT&T from entering unregulated markets was erased. The result of that break-up was that AT&T was no longer involved in monopoly markets.⁶⁴⁷

Even though the break-up of AT&T was supposed to inject competition into the market, *Trinko* and *Linkline* may be interpreted as taking behaviour covered by telecommunication statutes out of the scrutiny of antitrust laws which is a development no one at the time of

⁶⁴⁶ White, U.S. Public Policy 26-27.

⁶⁴⁷ Viscusi/Vernon/Harrington, Economics of Regulation and Antitrust (2000) 471.

the AT&T break-up thought would happen and which is not in line with the public policy objectives at the time of the break-up of AT&T.

VIII The Energy Sector

A. Introduction

I chose to dedicate a whole chapter to the energy sector in the EU and the US since in the EU the Third Energy Package was relatively recently introduced and importantly the Commission used its wide range of competition law instruments to make sure that they achieve their unbundling objective as part of their case law even before the implementation of the Third Energy Package. This feature sums up the EU position of joint application of sector-specific regulation and competition law instruments. Furthermore in the US there is a lot of experience with liberalisation of the energy sector and there are also examples of failure of sector-specific regulation (see California power crisis) from which one can draw lessons. Accordingly this sector serves as a good example on the treatment of regulated networks in the EU and the US.

Out of the different sources of energy the gas and electricity sectors have been subject to a complex legislative process in the US and the EU. Accordingly, I will handle the gas and electricity sectors in my doctoral thesis.

B. The Energy Sector

The energy sector is comprised of primary and secondary energy sources. Gas, oil, coal, hydro, renewables and nuclear are primary natural sources.⁶⁴⁸

Electricity is a secondary form of energy, derived from the above. The relationship between primary and secondary sources is complex. Electricity is sometimes in direct competition with primary sources.⁶⁴⁹ The energy market consists of a number of markets, since energy is suitable for different uses. Energy can be used as raw material, power or fuel. In these different markets the different types of energy can compete with each other, for example heating, where coal, oil, gas and electricity compete. However, there are also

⁶⁴⁸ *Bellamy & Child*, European Community Law of Competition⁶ (2007) 1103.

⁶⁴⁹ *Slot*, Energy (Electricity and Natural Gas) in *Geradin*, The Liberalization of State Monopolies in the European Union and Beyond (2000) 50.

very few markets where only one type of energy is suitable, for example oil for road transport.⁶⁵⁰

1. The Distinct Characteristics of Electricity and Gas

a. *Electricity*

The electricity sector consists of four components: generation, transmission, distribution and aggregation. Generation is the conversion of energy into electricity. Energy can be derived from hydroelectric, renewable, fossil or other sources. Transmission is the transportation of that electricity from the generator to substations located close to load centres. Distribution is the delivery of electricity from the substation to the consumer. Aggregation is the planning of the total needs of the consumer and the procuring of enough resources to meet those demands.⁶⁵¹

b. *Gas*

The natural gas sector consists of six components: exploration and production, pipeline transportation, wholesale, distribution, retail sale and storage. The exploration and production activity is self-explanatory; by pipeline transportation the transportation from gas field to local market is meant. The third activity is the sale at wholesale level to the distribution companies. The fourth activity is the distribution of the natural gas from the pipeline to the consumer. The retail sale to consumer and storage are self-explanatory too.⁶⁵²

2. The Similar Characteristics of Gas and Electricity

Gas and electricity share a number of characteristics that explain the involvement of governments in their operation.

Firstly, a natural monopoly is possible for both. A monopoly in transmission and distribution activities stimulates vertical integration. The integrated companies enjoy exclusive rights in return for an obligation by the government to supply gas and

⁶⁵⁰ *Ritter/Braun*, European Competition Law: A Practitioner's Guide (2004³) 914.

⁶⁵¹ *Hempling*, Regulating Public Utility Performance (2013) 72.

⁶⁵² *Hempling*, Regulating Public Utility Performance 76.

electricity.⁶⁵³ In contrast, the supply of oil and coal is not affected by bottleneck considerations, which is why there is free trade and free market practice.

Secondly, both are essential services for any community. The government obliges the companies to supply energy and prices are often controlled by the government.

Thirdly, both are of strategic importance for the overall economy and for the military capability of a state.

Fourthly, the market structures are similar. Both sectors are capital-intensive industries and involve a high degree of technical complexity. These factors create high entry barriers and require for technical coordination. In the EU the national systems are very distinctive.⁶⁵⁴ Accordingly the organisation of the energy industries varies in each Member State. There is also a broad distinction between centralised and decentralised energy systems. Centralised systems are characterised by the presence of a vertically integrated utility controlling a dominant share of over 70% of national electricity or gas production, transmission and distribution.⁶⁵⁵ Decentralised systems are characterised by a plurality of utilities. A decentralised system is different in every Member State. They can be under public, private or mixed ownership.⁶⁵⁶ In practice, the industries in the EU range from national monopolies to more liberal systems, where private or public firms operate independently under regional monopolies to fully liberalised systems.⁶⁵⁷ Also in the US energy undertakings are under public, private or mixed ownership.

Finally, the regulatory status of one sector influences the other because of integration between the energy sub-sectors.

⁶⁵³ *Bellamy & Child*, European Community Law of Competition 1099.

⁶⁵⁴ *Cini/McGowan*, Competition Policy in the European Union (1998) 170.

⁶⁵⁵ *Cross*, Electric Utility Regulation the European Union (1996) 21.

⁶⁵⁶ *Cross*, Electric Utility Regulation 121.

⁶⁵⁷ *Ritter/Braun*, European Competition Law 915-916.

C. EU Approach in the Energy Sector

1. Historical Background

In 1957 when the Treaty of Rome⁶⁵⁸ was concluded energy was at the centre of attention for the Member States. Coal was the most important source of energy at the time and the six founding Member States centred their interest in energy in the European Coal and Steel Community (ECSC)⁶⁵⁹. In the area of nuclear energy the Euratom Treaty ensured cooperation; at that time the thinking was that nuclear energy was going to be the other primary energy source serving for energy independence of the Community. Accordingly in 1951 the ECSC Treaty and the Euratom Treaty in 1957⁶⁶⁰ offered a legal basis for a common energy policy.⁶⁶¹

Like the Treaty of Rome the Maastricht Treaty of 1992⁶⁶² was a framework treaty and integrated the Treaties existing at the time. Even though the ECSC and the Euratom Treaty were explicitly integrated energy was not further addressed as a policy issue.⁶⁶³ In the list of objectives in Article 2 energy was explicitly excluded from the areas of shared competence:

*“The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities referred to in Article 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.”*⁶⁶⁴

Accordingly the undertakings active in the energy sector were of the opinion that they were exempt from the basic principles of the Treaty because of the specific tasks assigned to them. Nevertheless, the energy sector has been treated as a normal sector since the late

⁶⁵⁸ Traité instituant la Communauté Économique Européenne 25 Mars 1957 (the “Treaty of Rome”).

⁶⁵⁹ Traité instituant la Communauté Européenne du Charbon et de l’Acier 18 Avril 1951 (European Coal and Steel Community).

⁶⁶⁰ Treaty establishing the European Atomic Energy Community (Euratom) 25 March 1957 (consolidated version 2012/C 327/01).

⁶⁶¹ *Hancher/Salerno*, Energy Policy after Lisbon 368.

⁶⁶² Treaty on European Union 29 July 1992, 92/C 191/01 (the „Maastricht Treaty“).

⁶⁶³ *Hancher/Salerno*, Energy Policy after Lisbon 369.

⁶⁶⁴ Treaty on European Union Art. 2.

1980s.⁶⁶⁵ This approach was confirmed by the Maastricht Treaty in 1992, where the Community notwithstanding Article 2 received powers to take measures in “*the spheres of energy, civil protection and tourism*”⁶⁶⁶. Special rights granted are subject to the EC Treaty principle of the free movement of goods (within the limits Article 106 TFEU).⁶⁶⁷ Also in the late 1980s the Commission realised that the energy sector should be liberalised.⁶⁶⁸ The Member States were very reluctant regarding the liberalisation of the energy sector. Furthermore they won a point of principle in the *Campus Oil* decision⁶⁶⁹ which was interpreted as allowing Member States broad latitude for securing energy supplies and protecting their domestic industries from the Internal Market and competition rules.⁶⁷⁰

Due to the lack of progress regarding liberalisation the Commission brought infringement actions against Spain, The Netherlands, Italy and France.⁶⁷¹ The threat of further infringement actions finally persuaded the Member States to adopt liberalisation Directives.⁶⁷² So far three packages of energy directives have been passed.

In the Constitutional Treaty in 2004 energy was then enshrined as one of the eleven areas of shared competence. This was due to particular pressure of the United Kingdom which led to the re-insertion of energy.⁶⁷³

In the TFEU a separate energy title XXI consisting of a single Article, Article 194, is included. This Article specifies how the competences regarding energy are to be shared:

“1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to:

(a) ensure the functioning of the energy market;

⁶⁶⁵ Roggenkamp/Boisselau, *Energy & Law 2: The Regulation of Power Exchanges in Europe* (2005) 1.

⁶⁶⁶ Treaty on European Union Art. 3u.

⁶⁶⁷ Ritter/Braun, *European Competition Law* 914.

⁶⁶⁸ Cini/McGowan, *Competition Policy* 169.

⁶⁶⁹ ECJ 10 July 1984, 72/83, *Campus Oil Limited and others v Minister for Industry and Energy and others*.

⁶⁷⁰ Szyszczak, *The Regulation of the State* 166-167.

⁶⁷¹ ECJ 23 October 1997, C-157/94, *Commission of the European Communities v Kingdom of the Netherlands*; ECJ 23 October 1997, C-158/94, *Commission of the European Communities v Italian Republic*; ECJ 23 October 1997, C-159/94, *Commission of the European Communities v French Republic*; ECJ 23 October 1997, C-160/94, *Commission of the European Communities v Kingdom of Spain* cited in Szyszczak, *The Regulation of the State* 167.

⁶⁷² Szyszczak, *The Regulation of the State* 168.

⁶⁷³ Hancher/Salerno, *Energy Policy after Lisbon* 371.

(b) ensure security of energy supply in the Union;

(c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and

(d) promote the interconnection of energy networks.

2. Without prejudice to the application of other provisions of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall establish the measures necessary to achieve the objectives in paragraph 1. Such measures shall be adopted after consultation of the Economic and Social Committee and the Committee of the Regions.

Such measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article 192(2)(c).

3. By way of derogation from paragraph 2, the Council, acting in accordance with a special legislative procedure, shall unanimously and after consulting the European Parliament, establish the measures referred to therein when they are primarily of a fiscal nature.”⁶⁷⁴

In the last years it was clear from the Commission’s actions that its use of competition law in the energy sector increased, e.g. the sector enquiry leading up to the Third Package of Energy Directives and a number of settlements regarding the ownership of energy transmission networks like E.ON, RWE and ENI. Furthermore the growing powers of the NRAs can be linked to the introduction of stronger unbundling provisions.⁶⁷⁵

2. First and Second Package of Energy Directives

The First and Second Package aimed to ensure market access by removing barriers, namely formal, national regulatory and organisational, which had served to privilege the national energy undertakings.⁶⁷⁶

The First Package of energy directives consisted of the First Electricity Directive in 1996⁶⁷⁷ and the First Gas Directive in 1998⁶⁷⁸. They were essentially framework measures

⁶⁷⁴ TFEU Art. 194.

⁶⁷⁵ Johnston/Block, EU Energy Law (2012) 36 Recitals 3.02 and 3.03.

⁶⁷⁶ Hancher/Larouche, The Coming of Age 753.

⁶⁷⁷ Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity.

⁶⁷⁸ Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas.

which left substantial discretion to the Member States with regards to the speed of liberalisation and the methods to achieve liberalisation. Traditional market privileges the incumbent energy business had enjoyed were removed, e.g. import/export rights and monopolies over the generation of energy and transport. A so-called twin-track approach was established: unbundling of the natural monopolistic function of transmission system operators (TSO) and introduction of *ex ante* regulatory functions. The latter were separated from operational functions.⁶⁷⁹ This approach exemplified well in what direction the EU decided to continue, i.e. the simultaneous application of both sets of rules.

The First Electricity and Gas Directives were then replaced by the Second Electricity Directive in 2003 (2003/54/EC)⁶⁸⁰ and the Second Gas Directive also in 2003 (2003/55/EC)⁶⁸¹. The Second Package elaborated the aforementioned twin-track approach since regulations were adopted as part of these packages too. The Directives laid down a system of rules to create an internal electricity and gas market. Especially access was seen as an essential precondition for competition.⁶⁸²

The Second Package also provided for legal unbundling measures.⁶⁸³ Functional unbundling was further elaborated upon and further legal separation of the transmission function was also laid down. Accordingly the Transmission System Operators (TSOs) were required to create separate legal entities to operate their transmission networks and had to introduce “firewalls” and compliance codes to ensure that they did not discriminate in favour of their own generation and trading subsidiaries. Administrative unbundling was only established for distribution companies.⁶⁸⁴

Also a larger group of consumers, including non-domestic users became eligible to choose their supplier from another Member States or from a domestic competitor to a local incumbent. All consumers were able to choose their suppliers by July 2007. Furthermore

⁶⁷⁹ *Hancher/Larouche*, The Coming of Age 753.

⁶⁸⁰ Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC - Statements made with regard to decommissioning and waste management activities.

⁶⁸¹ Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

⁶⁸² *Hancher*, Cross-border regulatory risk: the EU exemption regime in *Dimitroff (Ed.)*, Risk and Energy Infrastructure: Cross Border Dimensions (2011) 129 (130-131).

⁶⁸³ *Hancher*, Cross-border regulatory risk 130-131.

⁶⁸⁴ *Hancher/Larouche*, The Coming of Age 753.

certain regulatory concepts, such as “suppliers of last resort” and universal supply obligations were established for vulnerable consumers.⁶⁸⁵

The Second Package sharpened regulation for the energy sector too. Independent NRAs had to be established by the Member States. These bodies were enhanced with *ex ante* powers by two regulations regarding cross-border trade in electricity and gas. The NRAs now had the power to regulate transmission access tariff methodologies and conditions as well as addressing technical issues, e.g. congestion management, i.e. the allocation of capacity, balancing and related services. This process was extended by the Comitology procedure and in turn served for a further important development: Increasing harmonization. That is harmonization of so-called non-essential, i.e. technical measures and tariff methodologies.⁶⁸⁶

However, the Member States kept the power to decide on economic decisions, e.g. tariff rates. Furthermore they still had the freedom to regulate generation and supply as there were only minimal harmonization requirements. The NRAs had no powers to deal with antitrust issues like the abuse of market power. Antitrust issues were left to the Commission or the National Competition Authorities. The second package unfortunately did not provide a harmonized regulatory framework on cross-border issues.⁶⁸⁷

The Italian *Federutility* case⁶⁸⁸ is a good example of the regulatory shortcoming of the Second Package. In this case the Court was required to set out the limits of the Italian NRA’s role in imposing certain public service obligations on the liberalised gas market when there was effective competition in the market. Using *ex ante* regulation the Italian NRA had fixed reference prices for the sale of gas to specific consumers. The Court held that from 1 July 2007 onwards the price for the supply of gas must be determined by the market forces alone; this is a consequence of the liberalisation of the gas market and the very purpose of liberalisation.⁶⁸⁹ On the other hand the Court stated that the Second Gas Directive also served to guarantee high standards of public service as well as the protection

⁶⁸⁵ *Hancher/Larouche*, The Coming of Age 753-754.

⁶⁸⁶ *Hancher/Larouche*, The Coming of Age 754.

⁶⁸⁷ *Hancher/Larouche*, The Coming of Age 754.

⁶⁸⁸ CoJ 20 April 2010, C-265/08, *Federutility, Assogas, Libarna Gas SpA, Collino Commercio SpA, Sadori Gas SpA, Egea Commerciale, E.On Vendita Srl, Sorgenia SpA v Autorità per l’energia elettrica e il gas*.

⁶⁸⁹ *Hancher/Larouche*, The Coming of Age 754.

of the final consumer.⁶⁹⁰ Article 3(2) of the Second Gas Directive entailed an express allow for the Member States to impose gas companies with public service obligations which could also relate to the price of supply. Member States were additionally entitled to set out the scope of their public service obligations themselves taking account of their national policy objections and the circumstances. Accordingly the Court held that even under the Second Package of Directives and after 1 July 2007 the Member States were allowed to assess whether it is necessary to order measures to safeguard that the price of supply of gas for final consumers is at a reasonable level. However, the Court also laid down a number of conditions to ensure the proportionality of national measures:⁶⁹¹

“[...] it is for the referring court to verify whether [...] taking account in particular of the objective of establishing a fully operational internal market for gas and of the investments necessary in order to exert effective competition in the natural gas sector [...] such intervention is required.”⁶⁹²

In short, these Directives required the functional, accounting and later on also legal separation of entities engaged in generation, transmission, distribution and supply of energy. There were minimum provisions for harmonization, which, however, allowed some Member States to go even further. For example the United Kingdom introduced full ownership unbundling for transmission system operators in both the electricity and gas market.⁶⁹³

3. Sector Inquiry

Given the importance of the energy sector the Commission launched a sector inquiry into the European gas and electricity sectors in mid-2005 pursuant to Article 17 Regulation 1/2003.⁶⁹⁴ A sector inquiry is an investigation of a specific sector where there are indications that competition may be restricted or even distorted.⁶⁹⁵

Eight key areas of the European energy market were examined, i.e. market concentration/market power, vertical foreclosure, lack of market integration, lack of

⁶⁹⁰ CoJ 20 April 2010, C-265/08, para 20

⁶⁹¹ *Hancher/Larouche*, The Coming of Age 755.

⁶⁹² CoJ 20 April 2010, C-265/08, para 37.

⁶⁹³ *Johnston/Block*, EU Energy Law 37 Recital 3.05.

⁶⁹⁴ *Roggenkamp/Hammer*, Energy & Law 7: European Energy Law Report V (2008) 4.

⁶⁹⁵ *ABA*, Monopolization in Telecom and Media Markets 461.

transparency, price formation, downstream markets, balancing markets and liquefied natural gas (LNG).⁶⁹⁶

In January 2007 the Commission launched the final report on the Sector Inquiry. Out of the main shortcomings, vertical foreclosure is the most interesting one for this doctoral thesis. It demonstrated that unbundling under the Second Package of energy Directives did not go far enough.⁶⁹⁷

In short, vertically integrated energy companies engaged in practices aimed to make it difficult to establish a presence in the market for new entrants. Consequently, new entry and security of supply are in danger in the EU.⁶⁹⁸

The Final Report found that many markets were still limited by either national or regional borders. These markets also tended to be highly concentrated as well as vertically integrated.⁶⁹⁹ This resulted in high prices. Another problem was the complexity of the pricing structure; consumers were not able to compare and shop for lower prices even in markets where they had a choice among suppliers.⁷⁰⁰ Even though there were two waves of Directives mandating liberalisation there was still no competitive European energy market. Most leading national energy firms did not even attempt to compete across the national borders. One notable exception was that in Austria prices seemed to be affected by the prices in Germany. Mergers were further singled out as a major concern and structural remedies were recommended as remedies. Structural remedies were also recommended as remedies for violation of antitrust provisions other than mergers. Also recommended was that the NRAs receive more authority to liberalise the energy markets and that their powers in general should be strengthened.⁷⁰¹

⁶⁹⁶ Goldberg/Bjornebye, Introduction and Comment in *Delvaux/Hunt/Talus (Eds.)*, EU Energy Law and Policy Issues (2012) 10.

⁶⁹⁷ Lowe, Effective unbundling of energy transmission networks: lessons from the Energy Sector Inquiry, in Competition Policy Newsletter, Number 1, Spring 2007, 23.

⁶⁹⁸ European Commission, DG Competition Report on Energy Sector Inquiry, 10 January 2007, SEC(2006) 1724, 7-8

⁶⁹⁹ Report on Energy Sector Inquiry 7-8.

⁷⁰⁰ Report on Energy Sector Inquiry 9.

⁷⁰¹ Farmer, The European experience with merger and deregulation in Carstensen/Farmer, Competition Policy and Merger Analysis in Deregulated and Newly Competitive Industries (2008) 192-193.

The Commission therefore reviewed the two waves of Directives so far and tried to aggressively enforce their provisions and consider new Directives. The Commission also concluded that effective competition law enforcement at both the national and the Commission level is necessary due to the highly concentrated markets.⁷⁰²

4. The Third Energy Package

The Commission proposed remedies based on regulation and competition law as part of a larger package of measures in the context of a new European Energy Policy.⁷⁰³ These remedies include more stringent regulatory unbundling measures, i.e. ownership unbundling (OU), Independent System Operator (ISO) and TSO, as well as preliminary assessments into actions of energy companies and structural merger remedies.

The Third Electricity and Gas Directives had to be implemented by 3 March 2011 and superseded the Second Package of Directives. The Third Energy Package is intended to address the gaps of the First and Second Energy Package of Directives.⁷⁰⁴

Hancher and Larouche summarised the Third Energy Package and its important implications to the point.⁷⁰⁵

Breakdown of the formalistic separation between the regulation of the network itself and other market and associated functions: The Third Electricity and Gas Directives extend the role and the powers of the NRAs to market supervision and specifically their powers are also aligned more closely to those of competition authorities. This point is of special relevance, since the EU telecommunications decisions above unfortunately showed what happened when NRAs took no regard of competition rules or interpreted them wrongly.

Provision of substantive rules and joint decision-making process on some cross-border issues: This includes access to the networks and tariffs. Especially access to networks is vital to achieve a competitive energy sector.

⁷⁰² Farmer, The European experience with merger and deregulation 192.

⁷⁰³ Wäktare/Gee, The Energy Sector Inquiry: conclusions and way forward, in Competition Policy Newsletter, Number 1, Spring 2007, 57.

⁷⁰⁴ Hancher/Larouche, The Coming of Age 755.

⁷⁰⁵ Hancher/Larouche, The Coming of Age 755-756.

Far-reaching unbundling and structural unbundling of TSOs from generation and supply: Ownership and management of transmission grids must be transferred to separate legal entities to separate them from generation and supply. Due to the national opposition of some Member States to full ownership unbundling two further “lighter” unbundling regimes are introduced too. That other unbundling regimes had to be introduced too highlights both an advantage and a disadvantage of the EU, namely that even though a competitive internal market with ideally identical rules and a level playing field is the goal of the EU, the national interests continue to play an important role.

Extensive harmonization for technical or non-economic regulation: A wide range of issues are harmonized, e.g. cross-border procedures, network codes, investment plans and collection and processing of market data.

Separation of national regulation from political control: Accordingly the NRAs must be independent from both the industry and political control. Therefore they need to be given resources and strict rules on appointment and dismissal are introduced.

Other commentators described the Third Energy Package as introducing

*“a shift in the balance of competences between the European, national and regional levels, so that, on certain issues at least, Member States have lost importance powers, as well as opportunities to proceed with further ‘inter-governmental’ and ad hoc arrangements at the regional energy market level.”*⁷⁰⁶

As examples these commentators mentioned the new unbundling regime, the national regulators’ new duties and roles and the creation of ACER. In my opinion these developments are necessary to achieve an internal and competitive energy market.

Importantly a new innovation is that NRAs must be independent of the industry and enjoy some independence from national governments. Furthermore only NRAs may participate in ACER; accordingly governments are in some way excluded from an important forum for policy-making.⁷⁰⁷ The question that follows is how far NRAs are the target of lobbyists and whether it would not be better to leave some powers to the governments in this regard.

⁷⁰⁶ Hancher/Salerno, Energy Policy after Lisbon 375.

⁷⁰⁷ Hancher/Salerno, Energy Policy after Lisbon 378.

For the purpose of this thesis the most important feature of the Third Energy Package is that it requires the separation of transmission systems and the transmission system operators, i.e. unbundling. Accordingly these options will be explained in detail. There are three options to choose from: ownership unbundling, Independent System Operator and Transmission System Operator. Since 3 March 2012 Member States must ensure that the unbundling regime is being adhered to.⁷⁰⁸

a. The Ownership Unbundling Model (OU)

i. Description

Ownership unbundling is the first choice of the Commission since ownership and the exercise of influence between network owners and distributors are separated completely.⁷⁰⁹ According to the preamble to the Third Energy Package of directives

“[...] only the removal of the incentive for vertically integrated undertakings to discriminate against competitors as regards network access and investment can ensure effective unbundling. Ownership unbundling, which implies the appointment of the network owner as the system operator and its independence from any supply and production interests, is clearly an effective and stable way to solve the inherent conflict of interests and to ensure security of supply.”⁷¹⁰

Article 9(1) of both the Third Electricity and Gas directives provides the following for OU:

“Member States shall ensure that [...]:

(a) each undertaking which owns a transmission system acts as a transmission system operator;

(b) the same person or persons are entitled neither:

(i) directly or indirectly to exercise control over an undertaking performing any of the functions of generation or supply, and directly or indirectly to exercise control or

⁷⁰⁸ Rose, Bellamy & Child: European Community Law of Competition - Second Cumulative Supplement (2012) 231, 235.

⁷⁰⁹ Johnston/Block, EU Energy Law 40 Recital 3.18.

⁷¹⁰ Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, para 11 (“Third Electricity Directive”) and Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, para 8 (“Third Gas Directive”).

exercise any right over a transmission system operator or over a transmission system; nor

(ii) directly or indirectly to exercise control over a transmission system operator or over a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of generation or supply [...].”⁷¹¹

Accordingly the same person may not exercise control over an undertaking which generates power or supplies power while at the same time exercising control or a right over a TSO or a transmission system.

Article 9(3) of both Directives clarifies that the requirements of Article 9(1)(b) apply even across the electricity and gas sectors. This serves to prevent any influence using linkages between the electricity and gas markets, *inter alia* because of the significant role gas plays in the generation of electricity.⁷¹²

In this regard the preamble to the Third Electricity Directive even states about ownership unbundling that it is to be seen as the following:

“[...] the most effective tool by which to promote infrastructure in a non-discriminatory way, fair access to the network for new entrants and transparency in the market. Under ownership unbundling, Member States should therefore be required to ensure that the same person or persons are not entitled to exercise control over a generation or supply undertaking and, at the same time, exercise control or any right over a transmission system operator or transmission system.”⁷¹³

Furthermore, an undertaking may exercise control or rights over another undertaking engaging in generation or supply, or an undertaking engaging in transmission; however, it may not do so over both at the same time.

Article 9(1) of both the Third Electricity and Gas directive further provides the following for OU:

“(c) the same person or persons are not entitled to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking, of a transmission system operator or a transmission system, and directly

⁷¹¹ Directive 2009/72/EC, Art. 9(1) and Directive 2009/73/EC, Art. 9(1).

⁷¹² *Johnston/Block*, EU Energy Law 41 Recital 3.21.

⁷¹³ Directive 2009/72/EC, para 11.

or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of generation or supply; and

(d) the same person is not entitled to be a member of the supervisory board, the administrative board or bodies legally representing the undertaking, of both an undertaking performing any of the functions of generation or supply and a transmission system operator or a transmission system.”⁷¹⁴

This is a prohibition of being member of the board of directors of the TSO and at the same time exercising function for generation or supply.

Member States are also obliged to ensure that neither staff nor commercially sensitive information by a TSO, which used to be a part of a vertically integrated undertaking, is transferred to undertakings engaging in generation and supply.⁷¹⁵

The vertically integrated undertaking shall not maintain control over or have influence in the TSO; therefore it is obliged to divest its controlling shares over that TSO.⁷¹⁶ Minority shareholdings are still possible, although they may not be used to control or influence the TSO.⁷¹⁷

Member States should have the option to implement OU by direct divestiture or by splitting shares, namely into shares of the network and the generation and supply undertaking.⁷¹⁸

Additional time should be granted too since OU sometimes requires the restructuring of undertakings.⁷¹⁹

Article 10 of both the Third Electricity and Gas Directives provides to the NRA the responsibility to approve and designate an undertaking owning a transmission system as TSO.⁷²⁰

⁷¹⁴ Directive 2009/72/EC, Article 9(1) and Directive 2009/73/EC, Article 9(1).

⁷¹⁵ *Johnston/Block*, EU Energy Law 42 Recital 3.26.

⁷¹⁶ *Johnston/Block*, EU Energy Law 42 Recital 3.27.

⁷¹⁷ *Johnston/Block*, EU Energy Law 42 Recital 3.28.

⁷¹⁸ *Johnston/Block*, EU Energy Law 42 Recital 3.29.

⁷¹⁹ *Johnston/Block*, EU Energy Law 42 Recital 3.30.

⁷²⁰ *Johnston/Block*, EU Energy Law 43 Recital 3.31.

As explained above ownership unbundling is the first choice of the Commission as ownership and the exercise of influence between network owners and distributors are separated completely.⁷²¹

ii. *Why Pursue Ownership Unbundling?*

As explained above the Second Package already provided for far-reaching unbundling provisions. Then why did the Commissions pursue the Third Energy Package which features full ownership unbundling? The key arguments in favour of ownership unbundling may be summarised as follows:

Promotion of competition: Competition will be promoted if discrimination against non-vertically integrated undertakings in a number of areas, e.g. prices, terms and conditions and access to information, is reduced. In turn this will encourage new entries to the market since the fear that the incumbent companies will exploit their power to the detriment of new competitors will be removed.⁷²²

Improvement of the NRAs' ability to perform their tasks: If greater transparency, especially regarding costs, in network and commercial businesses is achieved, the NRAs can perform their tasks more effectively.⁷²³ As described already it is important for NRAs to consider competition as part of their goals; otherwise an undesirable outcome as in *Deutsche Telekom* might follow; i.e. anticompetitive behaviour with the permission of the NRA.

Increase investment in transmission networks to reduce risk of government intervention: If there is more investment into the transmission networks there are numerous benefits, especially for interconnections, inter-Member State trade and market integration. This is important because if there is no ownership unbundling there are fewer incentives to invest into the whole systems instead of merely into the vertically integrated undertaking itself. It

⁷²¹ *Johnston/Block*, EU Energy Law 40 Recital 3.18.

⁷²² *Johnston/Block*, EU Energy Law 66 Recital 3.117 citing *Pollit*, The Arguments For and Against Ownership Unbundling of Energy Transmission Networks, in Energy Policy 36/2008, 704.

⁷²³ *Johnston/Block*, EU Energy Law 66 Recital 3.117 citing *Pollit*, Energy Policy 36/2008, 704.

follows that the risk of government intervention into the market and its structure are mitigated and by that a stabile regulatory regime is ensured.⁷²⁴

Other policies and priorities at national level: At the national level there may well be other reasons why ownership unbundling may or may not be pursued. Some countries may want to privatise unbundled assets, for example ownership unbundling of Distribution System Operators (DSO) in the Netherlands. There might be other countries striving to retain a clear role for TSOs or DSOs as public utilities thereby opposing unbundling or privatisation. Additionally, there may be Member States who fear that ownership unbundling may facilitate the takeover of domestic energy businesses.⁷²⁵

Practical considerations: There may as well be some practical considerations to be taken into account. An example is that it may prove difficult to raise the huge amounts of capital needed to be invested into the upgrading and expanding of transmission networks when the TSO does not have the assets of the vertically integrated undertaking and/or cannot develop revenue from related businesses like supply or even generation. Furthermore there are high costs of replacing relations within the vertically integrated undertaking itself with numerous complicated at arm's length contracts.⁷²⁶

iii. *Constitutional Dimensions*

A range of legal arguments has been raised by academics and practitioners to challenge ownership unbundling:

Free movement law: The free movement rules of the TFEU have been raised as potential objection against national measures which pursue full ownership unbundling. Those rules are directly effective and hierarchically superior to other Treaty rules under EU law. For example in the Netherlands three Dutch generating companies challenged full ownership unbundling of DSOs in court.⁷²⁷ In June 2010 the Court of Appeal (now General Court) ruled that the Dutch legislation was potentially justifiable, but in the end a disproportionate restriction upon the free movement of capital rules within the EU.

⁷²⁴ Johnston/Block, EU Energy Law 66 Recital 3.117 citing Pollit, Energy Policy 36/2008, 704.

⁷²⁵ Johnston/Block, EU Energy Law 66 Recital 3.118.

⁷²⁶ Johnston/Block, EU Energy Law 67 Recital 3.119.

⁷²⁷ CoJ 22 October 2013, Joined cases C-105/12 to C-107/12, *Staat der Nederlanden v Essent NV (C-105/12)*, *Essent Nederland BV (C-105/12)*, *Eneco Holding NV (C-106/12)* and *Delta NV (C-107/12)*.

Accordingly, full ownership unbundling for DSOs amounts to a restriction of capital movement since those engaged in business activities like generation, trade and supply are prevented from securing a substantial interest in a company engaged in distribution. The promotion of pure economic interest as justification was rejected by the Court of Appeal since on the one hand this is not allowed according to ECJ case law and on the other hand the Third Energy Package had addressed these concerns in a less restrictive manner than the Dutch rules.⁷²⁸

Obviously the free movement rules are an obstacle for those Member States wanting to achieve full ownership unbundling and are playing right into the hands of those Member States and undertakings that opt for less restrictive means of adopting the Third Energy Package. As the General Court recognised, the free movement rules are a hurdle not to be jumped over. Accordingly the Member States and the Commission have to ensure that the less strict alternatives to ownership unbundling do not result in or facilitate anticompetitive behaviour. Below I describe in detail how the Commission achieved its unbundling goals using competition tools; it seems only consequent to engage in the same tactic for undertakings opting for the ISO and ITO alternatives in case they engage in anticompetitive behaviour.

EU fundamental rights law: The rules developed under the European Convention for the protection of Human Rights and Fundamental Freedoms (ECHR) by the European Court of Human Rights (ECtHR) are of significance in the regard of ownership unbundling. The ECJ has developed extensive case law on the legislative competence of the EC and its relationship to fundamental rights. Also ECtHR's case law serves as inspiration for the ECJ and the General Court. Importantly the Member States are all signatories of the ECHR and must therefore comply with its rules under their national legal orders. The fundamental right which relates to the discussion on full ownership unbundling is the right to property as laid down in Article 1 of the First Protocol to the ECHR.⁷²⁹ Protocol 1 Article 1 of the European Convention on Human Rights states that “*every natural or legal person is*

⁷²⁸ *Johnston/Block*, EU Energy Law 67-68 Recital 3.121.

⁷²⁹ *Johnston/Block*, EU Energy Law 69 Recital 3.123.

*entitled to the peaceful enjoyment of his possessions [...].*⁷³⁰ However, according to Johnston and Block the proportionality concerns may well be satisfied if the current owners receive compensation in return selling transmission assets.⁷³¹

I do not believe that proportionality concerns will be satisfied that easily. First and foremost, as with the free movement rules, there are less restrictive alternatives to ownership unbundling. Secondly, it has to be determined what adequate compensation for selling transmission assets is. What if the undertaking in question does not find a buyer who can pay an adequate price? Who compensates that undertaking for selling at a price below value? Thirdly - and this is a point of relevance for all legal arguments raised to challenge ownership unbundling - court proceedings take a number of years, are costly and might have negative influences on the undertaking in question, e.g. it can lose value, stop investments for the time being and/or delay the adherence to the Third Energy Package.

National constitutional law: Even though arguments of national constitutional law are strictly a matter of national law it is important to note that they do exist. Such arguments have been raised by governments as well as commentators and usually were similar to those under the ECHR with regard to property rights and proportionality.⁷³²

Due to political pressure of some Member State the ISO and ITO options were included in the Third Energy Package too.

b. *The Independent System Operator Model (ISO)*

i. *Description*

The ISO option is an elaborated form of legal unbundling compared to the second energy package. The vertically integrated undertaking retains ownership of the network; however, the ISO is entrusted with the technical and commercial operation of the network. There are strict rules as to the autonomy and independence of the ISO.

⁷³⁰ European Convention on Human Rights, 35 via: http://www.echr.coe.int/Documents/Convention_ENG.pdf.

⁷³¹ Johnston/Block, EU Energy Law 69 Recital 3.123.

⁷³² Johnston/Block, EU Energy Law 69 Recital 3.124.

The Directives provide for this alternative to OU for Member States choosing not to introduce OU. But regarding this option the Commission said the following:

*"[...] this option must, however, provide the same guarantees regarding independence of action of the network in question and the same level of incentives on the network to invest in new infrastructure that may benefit competitors."*⁷³³

The ISO model is provided for in Articles 13 and 14 of the Electricity Directive and Articles 14 and 15 of the Gas Directive. Article 13 of the Electricity Directive and Article 14 of the Gas Directive state the following:

*"Where the transmission system belongs to a vertically integrated undertaking on 3 September 2009, Member States may decide not to apply Article 9(1) and designate an independent system operator upon a proposal from the transmission system owner."*⁷³⁴

It is necessary for the ISO to respect certain requirements and commitments to ensure that it can perform its tasks and ensure the independence of the network. These are laid out in Article 13 of the Electricity Directive and Article 14 of the Gas Directive. Especially the relationship between the network owner and the ISO regarding investments is key.⁷³⁵

Furthermore, the Member State may only choose the ISO model if the transmission system has been owned by a vertically integrated undertaking at the time when the Directive entered into force. The ISO must be legally, functionally and personally unbundled from the vertically integrated undertaking.⁷³⁶

Accordingly Article 14 of the Electricity Directive and Article 15 of the Gas Directive state the following:

"(1) A transmission system owner, where an independent system operator has been appointed, which is part of a vertically integrated undertaking shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to transmission.

(2) In order to ensure the independence of the transmission system owner referred to in paragraph 1, the following minimum criteria shall apply:

⁷³³ Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity, COM (2007) 528, 2007/0195/COD.

⁷³⁴ Article 13 of the Electricity Directive and Article 14 of the Gas Directive.

⁷³⁵ Johnston/Block, EU Energy Law 43-44 Recital 3.35.

⁷³⁶ Johnston/Block, EU Energy Law 44 Recital 3.36.

(a) persons responsible for the management of the transmission system owner shall not participate in company structures of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, distribution and supply of electricity;

(b) appropriate measures shall be taken to ensure that the professional interests of persons responsible for the management of the transmission system owner are taken into account in a manner that ensures that they are capable of acting independently; and

(c) the transmission system owner shall establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored. The compliance programme shall set out the specific obligations of employees to meet those objectives. An annual report, setting out the measures taken, shall be submitted by the person or body responsible for monitoring the compliance programme to the regulatory authority and shall be published.

3. The Commission may adopt Guidelines to ensure full and effective compliance of the transmission system owner with paragraph 2 of this Article. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 46(2).”⁷³⁷

Furthermore, a regulatory regime as well as permanent regulatory monitoring are both necessary to ensure that the ISO remains independent from the vertically integrated company.⁷³⁸

ii. Specific Duties of the NRAs

When a Member State chooses the ISO model the NRA is responsible to meet specific duties which are set out in Article 37(3) of the Electricity Directive (similar: Article 41(3) Gas Directive):

”3. In addition to the duties conferred upon it under paragraph 1 of this Article, when an independent system operator has been designated under Article 13, the regulatory authority shall:

(a) monitor the transmission system owner’s and the independent system operator’s compliance with their obligation under this Article, and issue penalties for non-compliance in accordance with paragraph 4(d);

⁷³⁷ Directive 2009/72/EC, Art. 14 and Directive 2009/73/EC, Art. 15.

⁷³⁸ Johnston/Block, EU Energy Law 45 Recital 3.38.

(b) monitor the relations and communications between the independent system operator and the transmission system owner so as to ensure compliance of the independent system operator with its obligations, and in particular approve contracts and act as a dispute settlement authority between the independent system operator and the transmission system owner in respect of any complaint submitted by either party pursuant to paragraph 11;

(c) without prejudice to the procedure under Article 13(2)(c), for the first ten-year network development plan, approve the investments planning and the multi-annual network development plan presented annually by the independent system operator;

(d) ensure that network access tariffs collected by the independent system operator include remuneration for the network owner or network owners, which provides for adequate remuneration of the network assets and of any new investments made therein, provided they are economically and efficiently incurred;

(e) have the powers to carry out inspections, including unannounced inspections, at the premises of transmission system owner and independent system operator; and

*(f) monitor the use of congestion charges collected by the independent system operator in accordance with Article 16(6) of Regulation (EC) No 714/2009.*⁷³⁹

The NRAs received specific regulatory competences due to these provisions. These competences are vital in overseeing the relationship between the ISO and the network owner.⁷⁴⁰ To meet the concerns of the Commission as described in the Sector Inquiry it is necessary that NRAs are made responsible to meet further duties for Member States choosing the less strict ISO model. The question that remains in practice is whether the NRA really receives enough money and personnel to conduct their tasks effectively. Especially in Member States that opt for the less strict models I believe it is possible that NRAs are not empowered well enough to conduct their tasks according to the Third Energy Package.

c. The Independent Transmission Operator Model (ITO)

i. Description

This option was introduced because some Member States, especially France and Germany, wanted to retain the possibility that ownership and network operation could

⁷³⁹ Directive 2009/72/EC, Art. 37(3).

⁷⁴⁰ Johnston/Block, EU Energy Law 46 Rectial 3.40.

remain within the same vertically integrated undertaking.⁷⁴¹ The ITO option is similar to the ISO option as the vertically integrated undertaking retains ownership of the network assets. However, there are less strict rules as to the autonomy and independence of the ITO as compared to the ISO.

The ITO is taking the operational decisions for the network and leases the network from the vertically integrated undertaking, i.e. the network owner. The Directives try to ensure that the ITO has autonomy and managerial independence from the network owner. Again, a Member State may only choose the ISO model if the transmission system has been owned by a vertically integrated undertaking at the time when the Directive entered into force.⁷⁴²

In Articles 17 to 23 (Chapter V) of the Electricity Directive and in Articles 17 to 23 (Chapter IV) of the Gas Directive rules aiming to preserve unbundling have been set out. The most important ones are the following:

- Assets, equipment, staff and the identity of the network operator:

*“Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission [...]”*⁷⁴³

- Activities, services and those systems which have to be carried out:

*“The transmission system operator shall not, in its corporate identity, communication, branding and premises, create confusion in respect of the separate identity of the vertically integrated undertaking or any part thereof.”*⁷⁴⁴

- Independence:

“(1) Without prejudice to the decisions of the Supervisory Body under Article 20, the transmission system operator shall have: (a) effective decision-making rights, independent from the vertically integrated undertaking, with respect to assets necessary to operate, maintain or develop the transmission system; and (b) the power to raise money on the capital market in particular through borrowing and capital increase. (2) The transmission system operator shall at all times act so as to ensure it

⁷⁴¹ Hancher/Salerno, Energy Policy after Lisbon 375-376.

⁷⁴² Johnston/Block, EU Energy Law 46 Recitals 3.41-3.43.

⁷⁴³ Directive 2009/72/EC, Art. 17(1).

⁷⁴⁴ Directive 2009/72/EC, Art. 17(4).

*has the resources it needs in order to carry out the activity of transmission properly and efficiently and develop and maintain an efficient, secure and economic transmission system.”*⁷⁴⁵

Further important rules are those on the independence of the staff and management of the TSO (Article 19 of the Electricity Directive), network development and powers to make investments (Article 22 of the Electricity Directive) and the cooling off period for managing personnel.⁷⁴⁶

ii. *Specific Duties of the NRAs*

As with the ISO model the NRA has a number of specific duties in regards to the ITO model. According to Article 17(1)(d) of the Electricity Directive it is necessary to safeguard the independence of the ITO:

*“without prejudice to the decisions of the Supervisory Body under Article 20, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate request from the transmission system operator.”*⁷⁴⁷

Furthermore, to ensure non-discrimination a compliance officer must be appointed:

*“The overall management structure and the corporate statutes of the transmission system operator shall ensure effective independence of the transmission system operator in compliance with this Chapter. The vertically integrated undertaking shall not determine, directly or indirectly, the competitive behaviour of the transmission system operator in relation to the day to day activities of the transmission system operator and management of the network, or in relation to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.”*⁷⁴⁸

The NRA also has the power to force the ITO to invest in the network in case the vertically integrated undertaking does not itself invest in the network.⁷⁴⁹

⁷⁴⁵ Directive 2009/72/EC, Art. 18(1) and (2).

⁷⁴⁶ Johnston/Block, EU Energy Law 47 Recital 3.48.

⁷⁴⁷ Directive 2009/72/EC, Art. 17(1)(d).

⁷⁴⁸ Directive 2009/72/EC, Art. 18(4).

⁷⁴⁹ Johnston/Block, EU Energy Law 48 Recital 3.53.

iii. *Rules Regarding the Independence of the ITO and Particular Issues*

In Article 17 of the Third Electricity Directive rules of independence on assets, equipment and staff are provided as follows:

“1. Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission, in particular:

(a) assets that are necessary for the activity of electricity transmission, including the transmission system, shall be owned by the transmission system operator;

(b) personnel, necessary for the activity of electricity transmission, including the performance of all corporate tasks, shall be employed by the transmission system operator;

(c) leasing of personnel and rendering of services, to and from any other parts of the vertically integrated undertaking shall be prohibited. A transmission system operator may, however, render services to the vertically integrated undertaking as long as:

(i) the provision of those services does not discriminate between system users, is available to all system users on the same terms and conditions and does not restrict, distort or prevent competition in generation or supply; and

(ii) the terms and conditions of the provision of those services are approved by the regulatory authority;

(d) without prejudice to the decisions of the Supervisory Body under Article 20, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate.”⁷⁵⁰

Accordingly the ITO has to be autonomous in financial, human and technical aspects and these resources have to be available for the management of the network.

iv. *Personnel*

Both directives require the independence of staff and management of the TSO; the necessary personnel for managing the TSO has to be employed directly by the TSO. Furthermore, the ITO's management structure has to be independent from that of the

⁷⁵⁰ Directive 2009/72/EC, Art. 17.

vertically independent undertaking.⁷⁵¹ Articles 19(3) of both Directives therefore provide the following:

*“No professional position or responsibility, interest or business relationship, directly or indirectly, with the vertically integrated undertaking or any part of it or its controlling shareholders other than the transmission system operator shall be exercised for a period of three years before the appointment of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are subject to this paragraph.”*⁷⁵²

Article 19 (8) of the Electricity and Article 19 (5) of the Gas directive further provide:

*“The persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are not subject to paragraph 3 shall have exercised no management or other relevant activity in the vertically integrated undertaking for a period of at least six months before their appointment.”*⁷⁵³

However, the question emerged whether these periods were to be applied retroactively before the date of entry into force of these Directives. Since neither the Directives themselves nor the Commission’s Interpretative Note on this topic give an answer to this question, it may well be the case that these rules apply to the period in time before the Directives entered into force.⁷⁵⁴

However, the draft of the Commission’s Interpretative Note mentioned an exemption from these rules for persons responsible for the network management itself:

*“A derogation to this rule relates to the TSO itself: the management of the TSI already in place before the setting up of the ITO can stay in function (Article 19 (3)) of the Electricity and Gas Directive.”*⁷⁵⁵

This means that those persons who were already named to be in charge of the management before the TSO was established may remain in their functions even if they worked at the vertically integrated company before.⁷⁵⁶

⁷⁵¹ Johnston/Block, EU Energy Law 50 Recitals 3.56-3.57.

⁷⁵² Directive 2009/72/EC, Art. 19(3) and Directive 2009/73/EC, Art. 19(3).

⁷⁵³ Directive 2009/72/EC, Art. 19(8) and Directive 2009/73/EC, Art. 19(5).

⁷⁵⁴ Johnston/Block, EU Energy Law 51 Recital 3.60.

⁷⁵⁵ Commission Staff Working Paper, Draft Interpretative Note on directive 2009/72/EC concerning common rules for the internal market in electricity and Directive 2009/73/EC concerning common rules for the internal market in natural gas; the unbundling regime (22 January 2010), 14.

⁷⁵⁶ Johnston/Block, EU Energy Law 51 Recital 3.62.

A further relevant feature of the independence of personnel is the question who may recruit the TSO personnel within the vertically integrated undertaking. In this regard Article 19(1) of the Electricity and Gas Directives provides as follows:

“Decisions regarding the appointment and renewal, working conditions including remuneration, and termination of the term of office of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator shall be taken by the Supervisory Body of the transmission system operator appointed in accordance with Article 20.”⁷⁵⁷

Article 19(4) furthermore provides as follows:

“The persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall have no other professional position or responsibility, interest or business relationship, directly or indirectly, with any other part of the vertically integrated undertaking or with its controlling shareholders.”⁷⁵⁸

This means that personnel responsible for management or members of the administrative body of the TSO may only be hired by the Supervisory Body of the TSO.

Article 17(1)(b) of both Directives provides for other personnel as follows:

“Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of electricity transmission, in particular:

(b) personnel, necessary for the activity of electricity transmission, including the performance of all corporate tasks, shall be employed by the transmission system operator;”⁷⁵⁹

According to Article 9(7) of the Electricity Directive the Member States shall ensure that persons who used to work at a TSO who used to be part of a vertically integrated company may not be transferred to undertakings which perform a function in generation or supply.

Article 17(1)(c) of both Directives prohibits the leasing of personnel *“to and from any other parts of the vertically integrated undertaking”⁷⁶⁰*. This means that personnel of the

⁷⁵⁷ Directive 2009/72/EC, Art. 19(1) and Directive 2009/73/EC, Art. 19(1).

⁷⁵⁸ Directive 2009/72/EC, Art. 19(4) and Directive 2009/73/EC, Art. 19(4).

⁷⁵⁹ Directive 2009/72/EC, Art. 17(1)(b) and Directive 2009/73/EC, Art. 17(1)(b).

⁷⁶⁰ Directive 2009/72/EC, Art. 17(1)(c) and Directive 2009/73/EC, Art. 17(1)(c).

manager of the grid system must not be engaged by another part of the vertically integrated company.

According to the Interpretative Note on Unbundling the ITO must employ a sufficient number of qualified employees:

“As regards corporate services, including legal services, accountancy and IT services, which are considered to constitute part of the activity of electricity or gas transmission as defined in Articles 12 and 17(2) Electricity Directive and Articles 13 and 17(2) Gas Directive, the ITO must employ a sufficient number of qualified staff members to handle day-to-day core activities. Only if the ITO has employed a sufficient number of staff members for day-to-day handling of these activities may it, in specific circumstances and by way of exception, conclude contracts with third-party service providers for legal, IT, or accountancy services. The same applies to specific services relating to, for example, the development and repair of the network. The ITO should employ a sufficient number of qualified staff members to handle day-to-day activities in this area, in order to be autonomous. Only if this condition is fulfilled can it, by way of exception, conclude contracts for services in this area with third-party service providers.”⁷⁶¹

The leasing of personnel is also addressed in this Interpretative Note on unbundling:

“A specific regime concerns the leasing of personnel and contracting of services between any part of the vertically integrated undertaking and the ITO. As the ITO should be autonomous and not dependent on other parts of the vertically integrated undertaking, leasing of personnel and contracting of services to the ITO by other parts of the vertically integrated undertaking, including by the DSO, are categorically prohibited (Article 17(1)(c) Electricity and Gas Directives).”⁷⁶²

“Furthermore, the ITO is not allowed to share IT systems or equipment, physical premises and security access systems with any other part of the vertically integrated undertaking. The ITO is also not allowed to use the same consultants or external contractors for IT systems or equipment, security access systems or auditing, in accordance with Article 17(5) and (6) Electricity and Gas Directives.”⁷⁶³

v. The “Supervisory Body” and the “Compliance Officer”

Articles 20 and 21 of the Directives provide that the TSO under the ITO model should have a “Supervisory Body” and a “compliance officer”. Article 20 in both Directives states as follows:

⁷⁶¹ Interpretative Note on directive 2009/72/EC, 16.

⁷⁶² Interpretative Note on directive 2009/72/EC, 17.

⁷⁶³ Interpretative Note on directive 2009/72/EC, 17.

“1. The transmission system operator shall have a Supervisory Body which shall be in charge of taking decisions which may have a significant impact on the value of the assets of the shareholders within the transmission system operator, in particular decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of the transmission system operator and the amount of dividends distributed to shareholders. The decisions falling under the remit of the Supervisory Body shall exclude those that are related to the day to day activities of the transmission system operator and management of the network, and to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.

2. The Supervisory Body shall be composed of members representing the vertically integrated undertaking, members representing third party shareholders and, where the relevant legislation of a Member State so provides, members representing other interested parties such as employees of the transmission system operator.”⁷⁶⁴

The Supervisory Body is one of the key elements of the ITO option and in charge of important decisions like the appointment of the management and all decisions which are capable of influencing the value of the ITO's assets. On the other hand the Supervisory Body does not have the power to intervene in decisions regarding the day-to-day business activities and the management of the network. Such decisions have to be notified to the National Regulatory Agency and when the latter does not raise objections within three weeks they become effective.⁷⁶⁵

The Supervisory Body is responsible for designating a compliance officer. In this regard Article 21 of both Directives provides as follows:

“1. Member States shall ensure that transmission system operators establish and implement a compliance programme which sets out the measures taken in order to ensure that discriminatory conduct is excluded, and ensure that the compliance with that programme is adequately monitored. The compliance programme shall set out the specific obligations of employees to meet those objectives. It shall be subject to approval by the regulatory authority. Without prejudice to the powers of the national regulator, compliance with the program shall be independently monitored by a compliance officer.

2. The compliance officer shall be appointed by the Supervisory Body, subject to the approval by the regulatory authority. The regulatory authority may refuse the approval of the compliance officer only for reasons of lack of independence or professional capacity. The compliance officer may be a natural or legal person. Article 19(2) to (8) shall apply to the compliance officer.

⁷⁶⁴ Directive 2009/72/EC, Art. 20 and Directive 2009/73/EC, Art. 20.

⁷⁶⁵ Johnston/Block, EU Energy Law 56 Recital 3.83.

3. *The compliance officer shall be in charge of:*

(a) monitoring the implementation of the compliance programme;

(b) elaborating an annual report, setting out the measures taken in order to implement the compliance programme and submitting it to the regulatory authority;

(c) reporting to the Supervisory Body and issuing recommendations on the compliance programme and its implementation;

(d) notifying the regulatory authority on any substantial breaches with regard to the implementation of the compliance programme; and

(e) reporting to the regulatory authority on any commercial and financial relations between the vertically integrated undertaking and the transmission system operator.

4. *The compliance officer shall submit the proposed decisions on the investment plan or on individual investments in the network to the regulatory authority. This shall occur at the latest when the management and/or the competent administrative body of the transmission system operator submits them to the Supervisory Body.*⁷⁶⁶

vi. *The Management of Combined Grids*

The possibility of a combined operator is referred to in Articles 29 and 26(2) on both Directives. By combined operator a single operator for the transmission and distribution networks is meant. Article 29 provides the following in this regard:

*“Article 26(1) shall not prevent the operation of a combined transmission and distribution system operator provided that operator complies with Articles 9(1), or 13 and 14, or Chapter V or falls under Article 44(2).”*⁷⁶⁷

However, the requirement in Article 26 of both Directives that the management of distribution and the management of transmission must be independent raises difficulties:

“2. In addition to the requirements under paragraph 1, where the distribution system operator is part of a vertically integrated undertaking, it shall be independent in terms of its organisation and decision-making from the other activities not related to distribution. In order to achieve this, the following minimum criteria shall apply:

(a) those persons responsible for the management of the distribution system operator must not participate in company structures of the integrated electricity undertaking

⁷⁶⁶ Directive 2009/72/EC, Art. 21 and Directive 2009/73/EC, Art. 21.

⁷⁶⁷ Directive 2009/72/EC, Art. 29 and Directive 2009/73/EC, Art. 29.

*responsible, directly or indirectly, for the day-to-day operation of the generation, transmission or supply of electricity.”*⁷⁶⁸

Articles 26 and 29 are worded ambiguously. Article 26 provides that the distribution system operator shall be independent as regards to organisation and decision-making from such activities which are not related to distribution. The same article also provides that the management personnel of the distribution system operator may not belong to those parts the vertically integrated undertaking that are responsible for the daily management of supply, transmission and production. However, Article 29 states that it is possible to create a combined transmission and distribution system operator.

The Commission’s Interpretative Note answers this ambiguity by stating that this issue has to be looked at on a case-by-case basis.⁷⁶⁹

A combined grid operator may be beneficial because it avoids the creation of a new undertaking. That way it may also be possible to avoid difficulties might arising from the transfer of licenses or agreements.⁷⁷⁰

vii. *Certification of the TSO*

According to the Third Energy Package a TSO is subject to prior certification by its NRA. The certification is believed to guarantee that the TSO unbundles its activities from production and/or supply. There are two types of procedures for obtaining the certificate.⁷⁷¹

The general procedure is laid down in Article 10 of both Directives:

“1. Before an undertaking is approved and designated as transmission system operator, it shall be certified according to the procedures laid down in paragraphs 4, 5 and 6 of this Article and in Article 3 of Regulation (EC) No 714/2009.

2. Undertakings which own a transmission system and which have been certified by the national regulatory authority as having complied with the requirements of Article 9, pursuant to the certification procedure below, shall be approved and designated as transmission system operators by Member States. The designation of transmission system operators shall be notified to the Commission and published in the Official Journal of the European Union.

⁷⁶⁸ Directive 2009/72/EC, Art. 26(2) and Directive 2009/73/EC, Art. 26(2).

⁷⁶⁹ Interpretative Note on directive 2009/72/EC, 26.

⁷⁷⁰ *Johnston/Block*, EU Energy Law 59 Recital 3.94.

⁷⁷¹ *Johnston/Block*, EU Energy Law 60 Recital 3.99.

3. *Transmission system operators shall notify to the regulatory authority any planned transaction which may require a reassessment of their compliance with the requirements of Article 9.*⁷⁷²

This means that the approval of the NRA may only be granted if the unbundling requirements of Article 9 of both Directives have been satisfied.

The second model of certification applies to TSOs controlled by a person from a non-EU Member State and is laid down in Article 11 of each Directive. This clause is sometimes referred to as the “Gazprom clause” and its rationale is found in Recital 25⁷⁷³ of the Electricity Directive and Recital 22⁷⁷⁴ of the Gas Directive.⁷⁷⁵ Article 11 of each

⁷⁷² Directive 2009/72/EC, Art. 10 and Directive 2009/73/EC, Art. 10.

⁷⁷³ Recital 25: „*The security of energy supply is an essential element of public security and is therefore inherently connected to the efficient functioning of the internal market in electricity and the integration of the isolated electricity markets of Member States. Electricity can reach the citizens of the Union only through the network. Functioning electricity markets and, in particular, the networks and other assets associated with electricity supply are essential for public security, for the competitiveness of the economy and for the well-being of the citizens of the Union. Persons from third countries should therefore be allowed to control a transmission system or a transmission system operator only if they comply with the requirements of effective separation that apply inside the Community. Without prejudice to the international obligations of the Community, the Community considers that the electricity transmission system sector is of high importance to the Community and therefore additional safeguards are necessary regarding the preservation of the security of supply of energy to the Community to avoid any threats to public order and public security in the Community and the welfare of the citizens of the Union. The security of supply of energy to the Community requires, in particular, an assessment of the independence of network operation, the level of the Community's and individual Member States' dependence on energy supply from third countries, and the treatment of both domestic and foreign trade and investment in energy in a particular third country. Security of supply should therefore be assessed in the light of the factual circumstances of each case as well as the rights and obligations arising under international law, in particular the international agreements between the Community and the third country concerned. Where appropriate the Commission is encouraged to submit recommendations to negotiate relevant agreements with third countries addressing the security of supply of energy to the Community or to include the necessary issues in other negotiations with those third countries.*”

⁷⁷⁴ Recital 22: “*The security of energy supply is an essential element of public security and is therefore inherently connected to the efficient functioning of the internal market in gas and the integration of the isolated gas markets of Member States. Gas can reach the citizens of the Union only through the network. Functioning open gas markets and, in particular, the networks and other assets associated with gas supply are essential for public security, for the competitiveness of the economy and for the well-being of the citizens of the Union. Persons from third countries should therefore only be allowed to control a transmission system or a transmission system operator if they comply with the requirements of effective separation that apply inside the Community. Without prejudice to the international obligations of the Community, the Community considers that the gas transmission system sector is of high importance to the Community and therefore additional safeguards are necessary regarding the preservation of the security of supply of energy to the Community to avoid any threats to public order and public security in the Community and the welfare of the citizens of the Union. The security of supply of energy to the Community requires, in particular, an assessment of the independence of network operation, the level of the Community's and individual Member States' dependence on energy supply from third countries, and the treatment of both domestic and foreign trade and investment in energy in a particular third country. Security of supply should therefore be assessed in the light of the factual circumstances of each case as well as the rights and obligations arising under international law, in particular the international agreements between the Community and the third country concerned. Where appropriate the Commission is encouraged to submit recommendations to negotiate*

Directive gives the national authority the power to overrule a decision of the NRA recognising that an undertaking wanting to acquire a TSO complies with the unbundling rules, if security of supply due to the granting of the certification is at risk. Commentators even suggest that the wording of Article 11 suggests that a Member States is entitled to put its own interests in security of supply above those of the Community. This is a deference on the principle of subsidiarity.⁷⁷⁶

As with the ISO option it is much harder to achieve the goals of the Third Energy Package where there is no effective ownership unbundling. Also the NRAs have even more responsibilities as with the ISO option. Therefore the same concerns as with the ISO option apply but stronger. Unfortunately it is not yet clear how well (or not) the ISO and ITO options contribute to the overall goal of a competitive internal energy market.

d. Unbundling Derogations

Estonia secured a temporary derogation from Articles 33(1)(b) and (c) of the Third Electricity Directive and thereby delayed the opening of the market until 1 January 2013.

Further, the Third Energy Package provides for the possibility of derogation for small isolated systems or markets in Article 44 (1) of the Third Electricity Directive and Article 49 (1) of the Gas Directive.

Small isolated systems are defined in Article 2(26) and Micro isolated systems are defined in Article 2(27) of the Third Electricity Directive:

“26. ‘small isolated system’ means any system with consumption of less than 3 000 GWh in the year 1996, where less than 5 % of annual consumption is obtained through interconnection with other systems;

27. ‘micro isolated system’ means any system with consumption less than 500 GWh in the year 1996, where there is no connection with other systems.”⁷⁷⁷

relevant agreements with third countries addressing the security of supply of energy to the Community or to include the necessary issues in other negotiations with those third countries.”

⁷⁷⁵ Hancher/Salerno, Energy Policy after Lisbon 377.

⁷⁷⁶ Hancher/Salerno, Energy Policy after Lisbon 377.

⁷⁷⁷ Directive 2009/72/EC, Art. 2(26)-2(27).

Due to their size and structure of electricity markets an automatic derogation from unbundling for Cyprus, Luxembourg and/or Malta was enshrined in Article 44(2) of the Third Electricity Directive. Article 7(3) of the Third Gas Directive regards “isolated systems forming gas islands”.

“3. Member States shall ensure, through the implementation of this Directive, that transmission system operators have one or more integrated system(s) at regional level covering two or more Member States for capacity allocation and for checking the security of the network.”⁷⁷⁸

This means that the Member States should foster on the one hand the integration of national markets and on the other hand the cooperation of the system operators on an EU and regional level. This aims to create an internal market. Isolated systems forming gas islands should be incorporated. Isolated and emergent gas markets are addressed in Article 49 of the Third Gas Directive.

e. Conclusion

Any of three possibilities could have been chosen by the Member States. The ISO and the ITO models are each a derogation from the principle of ownership unbundling. If ownership unbundling was chosen, it is not possible to divert back to the ITO option. Furthermore, the ISO and ITO models could have only been chosen if there were TSO still involving vertical ownership integration.⁷⁷⁹

A TSO that is structurally unbundled, i.e. the ownership unbundling option, will be subject to much less regulation than the ISO and ITO options. If the latter two options were chosen *ex ante* regulation would be intrusive and exacting⁷⁸⁰, which is not what liberalisation should be about.

In the end the OU option is certainly preferable to obtain a competitive and successful internal energy market. For the impact of the Third Energy Package on liberalisation see below.

⁷⁷⁸ Directive 2009/73/EC, Art. 7(3).

⁷⁷⁹ Johnston/Block, EU Energy Law 60 Recitals 3.95-3.97.

⁷⁸⁰ Hancher/Larouche, The Coming of Age 756.

5. Case Law

a. Introduction

An interesting feature is that the Commission used its wide range of legal instruments to make sure that they achieve their unbundling objective as part of their case law even before the implementation of the Third Energy Package. This exemplifies the EU approach of using both sector-specific regulation and competition law to achieve its competitive internal market goal. This strategy also shows how the legal arguments against ownership unbundling can be circumvented by making ownership unbundling a remedy.

The Commission therefore made use of Articles 7 and 9 of Regulation 1/2003⁷⁸¹ and the well-established structural remedies in the context of the ECMR. It seemed to be clear to the Commission that these rules had the potential to significantly contribute to market structure questions. Hereby the question of the appropriate remedy, i.e. behavioural or structural was central. In this thesis I will concentrate on the structural remedies since they are most effective to change the structure of an undertaking and thereby change the market structure too.

This dual application of *ex post* competition rules and legislative proposals in the Third Energy Package amounted to sometimes ironic outcomes. For example the German government tried to defend the legal status of German TSOs; however E.ON and RWE agreed to sell their grids to avoid competition law fines. The Commission's strategy was controversial and there were critics stating, for example, that the dual strategy showed the weakness of *ex ante* rules or that a *quasi-ex ante* approach was achieved through competition law. Furthermore the achievement of structural remedies through merely only partly public processes leading to commitments serves to create unpredictability and may damage the legitimacy of the dual application of competition rules and Third Energy Package rules. The latter especially by creating the impression that the legislative

⁷⁸¹ 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.

compromises the Member States made can be upset or circumvented by the Commission's application of competition rules.⁷⁸²

b. *Structural Remedies*

For the purpose of this thesis the Commission's use of structural remedies is central. There is no formal definition of structural remedies in the ECMR, the Notice on Remedies or in another part of EU jurisprudence.⁷⁸³

Structural remedies serve to change the structure of the respective undertaking by modifying the allocation of property rights. This can involve divestiture.⁷⁸⁴

*“Divestiture is the disposal or sale by an enterprise of a business, a package of assets or productive capacity, with the aim of creating or strengthening a source of competition [...] to restore or maintain competition in the relevant market.”*⁷⁸⁵

In contrast behavioural remedies set constraints on the firm's property rights, i.e. they change the behaviour of the firm.⁷⁸⁶

c. *Articles 7 and 9 of Regulation 1/2003*

Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in then Articles 81 and 82⁷⁸⁷ describes how the main EU antitrust articles may be implemented.

Article 7(1) of Regulation 1/2003 regards infringement decisions by the Commission. The Commission may order structural remedies in the context of infringement decisions, where there is no equally effective behavioural remedy or where an equally effective behavioural remedy would be more burdensome for the undertaking than the structural remedy:

⁷⁸² *Johnston/Block*, EU Energy Law 3.128 at 71-72.

⁷⁸³ *Went*, The acceptability of remedies under the EC Merger Regulation: structural versus behavioural, in European Competition Law Review 2006, 27(8), 455.

⁷⁸⁴ *Motta*, Competition Policy (2004) 265.

⁷⁸⁵ *Papan*, Structural v behavioural remedies in merger control: a case to case analysis, ECLR 2009, 37.

⁷⁸⁶ *Motta*, Competition Policy 266.

⁷⁸⁷ Now Articles 101 and 102 TFEU.

“1. Where the Commission, acting on a complaint or on its own initiative, finds that there is an infringement of Article 81 or of Article 82 of the Treaty, it may by decision require the undertakings and associations of undertakings concerned to bring such infringement to an end. For this purpose, it may impose on them any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. Structural remedies can only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy. If the Commission has a legitimate interest in doing so, it may also find that an infringement has been committed in the past.”⁷⁸⁸

Article 9(1) of Regulation 1/2003 regards voluntary commitments by undertakings. The Commission may make binding the commitments undertakings voluntarily offer to bring a Commission investigation to an end. Such commitments must eliminate the competition concerns expressed by the Commission:

“1. 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. Such a decision may be adopted for a specified period and shall conclude that there are no longer grounds for action by the Commission.”⁷⁸⁹

Such commitments may be behavioural, structural or both and the Commission has a wide discretion regarding the acceptance of those proposed commitments.⁷⁹⁰ According to the Commission’s memo on commitment decisions the Commission considers adopting a commitment decision for companies being investigated when they are willing to offer such commitments serving to remove the competition concerns the Commission has, when a fine would be an inappropriate remedy and where efficiency reasons justify that the Commission limits itself to making the proposed commitments binding.⁷⁹¹

“While the addressee of a commitment decision does not receive a prohibition decision, with the consequent negative publicity, for a violation of the antitrust rules,

⁷⁸⁸ Regulation 1/2003, Art. 7(1).

⁷⁸⁹ Regulation 1/2003, Art. 9(1).

⁷⁹⁰ Kerse/Khan, EC Antitrust Procedure⁵ (2005) 358 Recital 6-053.

⁷⁹¹ European Commission - MEMO/04/217 17/09/2004, Das neue Kartellverfahren nach Artikel 9 der Verordnung 1.,

neither does it get the Commission's blessing, the commitment decision being a substitute for a prohibition decision and not for an exemption decision."⁷⁹²

Especially the introduction of the commitment procedure in Article 9 and the significant increase in fines made competition laws an effective tool for market design. Such unilateral commitments turned into a standard measure of the tools the Commission had to restructure the energy market in the EU.⁷⁹³

According to *Alrosa* commitments should be suitable, necessary and proportional to deal with the competition problem in question. Otherwise they are not lawful.⁷⁹⁴ Accordingly the CFI (now General Court) limited the use of the commitment procedure and imposed restrictions on its use.⁷⁹⁵

i. *E.ON Commission Decision of 26 November 2008*⁷⁹⁶

The E.ON commitment decision is of central relevance since it was the very first commitment decision where the party being investigated by the Commission voluntarily offered merger-like structural commitments to prevent the Commission from launching proceedings.⁷⁹⁷

E.ON was one of major German energy companies being active in all parts of the energy sector, i.e. production, transportation, distribution and supply of electricity, gas and other energy sources. E.ON not only operated in Germany, but also in other Member States and non-EU countries.⁷⁹⁸

E.ON was being investigated for allegedly engaging in two sets of abusive practices. Firstly, the investigation concerned withholding available generation capacity for sale. By withholding such available generation E.ON was able to raise prices for electricity to the detriment of consumers. Allegedly E.ON also discouraged third parties from investing into

⁷⁹² Commitment decisions MEMO/04/217.

⁷⁹³ *Hancher/Larouche*, The Coming of Age 771.

⁷⁹⁴ ECJ 29 June 2010, C-441/07, *European Commission v Alrosa Company Ltd.*

⁷⁹⁵ *Van Den Bergh*, The Relationship between Sector Specific Regulation and Competition Law 196.

⁷⁹⁶ Commission Decision 26 November 2008, COMP/39.388- German Electricity Wholesale Market and COMP/39.389 – German Electricity Balancing Market.

⁷⁹⁷ *Piergiovanni*, Competition and regulation in the energy sector in Europe in the post-sector inquiry era, in *Competition Law International*, June 2009, 1 (7).

⁷⁹⁸ Commission Decision 26 November 2008, COMP/39.388 and COMP/39.389, para 3.

new generation capacity by presenting them with the possibility to participate in their own power plants and further offered long-term electricity supply contracts.⁷⁹⁹

Secondly, E.ON was being investigated for favouring its own production affiliates providing balancing services. This resulted in additional balancing costs incurred by the consumers. Moreover, E.ON even prevented generation producers from other Member States from selling their balancing electricity within E.ON's transmission grid.⁸⁰⁰

To address the competition concerns of the Commission E.ON offered a merger-like set of remedies. Firstly, regarding the Commission's concerns of withholding capacity E.ON took up to divest of around 5000 MW of generation capacity in Germany. This divestiture eliminated E.ON's ability to withdraw capacity. Secondly, E.ON committed to divest its transmission system business to address the Commission's concerns regarding the balancing markets.

Apart from the fact that this case is important since it was the first commitment decision in the energy sector including structural remedies, this case is central since it led to ownership unbundling of a large part of the electricity network in Germany.⁸⁰¹ In this regard it is necessary to note that critique by Energy Commissioner Piebalgs in 2007 regarding the level of liberalisation was directed especially to Germany.⁸⁰²

ii. *RWE Gas Foreclosure Commission Decision of 18 March 2009*⁸⁰³

This commitment decision concerned one of E.ON's competitors in Germany, RWE. This case is the second overall commitment decision where the Commission managed to obtain structural remedies as well as the second commitment decision regarding a German energy undertaking.

As mentioned above, RWE was a major player on the German energy market. Its main activities consisted of production and supply of electricity and gas.⁸⁰⁴

⁷⁹⁹ Piergiovanni, Competition Law International, June 2009, 6.

⁸⁰⁰ Piergiovanni, Competition Law International, June 2009, 7.

⁸⁰¹ Piergiovanni, Competition Law International, June 2009, 7.

⁸⁰² Müller-Terpitz/Weigl, Ownership-Unbundling – ein gemeinschaftsrechtlicher Irrweg? in Zeitschrift Europarecht 2009/3, 350.

⁸⁰³ Commission Decision 18 March 2009, COMP/39.402 – RWE Gas Foreclosure.

The Commission accused RWE of providing for unjustified obstacles for third parties regarding the access to natural gas transportation in Germany. RWE, as Transmission System Operator, allegedly charged too high prices to third parties wanting to gain access to its gas network. Additionally, the failure of RWE to release transportation capacity, the inflation of its network costs and the maintenance of artificial network fragmentation led the Commission to the conclusion that RWE's conduct created further barriers to entry into the market for regional wholesale gas supply, i.e. RWE's core grid area. According to the Commission such behaviour might constitute a violation of Article 102 TFEU.⁸⁰⁵

To address the competition concerns of the Commission RWE took up to divest its high-pressure gas transmission network in western German in May 2008. This gas transmission network offered a viable transport business for independent operators. The Commission started to market-test this commitment in December 2008 and adopted the commitment decision in March 2009.⁸⁰⁶

With this commitment decision ownership unbundling of an important part of the German high-pressure gas infrastructure was achieved. It took the Commission a whole year until it adopted the commitment decision whereas in the E.ON case (see above) it merely took them five months after initial presentation of the commitments to adopt the Article 9 decision. A reason might be the market test which was introduced in December 2008. Another reason might be that the E.ON commitments were more important for the introduction of even more competition into the German energy sector than the commitments RWE offered.

iii. *Gaz de France Commission Decision of 3 December 2009*⁸⁰⁷

In this case long-term reservations of transport capacity and under-investment in the French energy sector were at issue.

This case concerned GDF Suez and its vertically integrated entities. GDF Suez itself was one of the world's main energy suppliers operating on all levels of the electricity and

⁸⁰⁴ Commission Decision 18 March 2009, COMP/39.402, para 3.

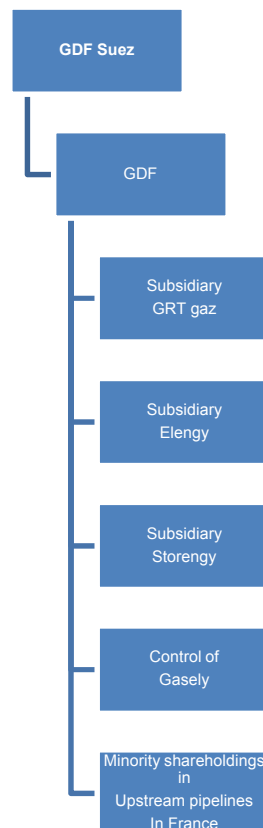
⁸⁰⁵ Piergiovanni, *Competition Law International*, June 2009, 7.

⁸⁰⁶ Piergiovanni, *Competition Law International*, June 2009, 7.

⁸⁰⁷ Commission Decision 3 December 2009, COMP/39.316 – *Gaz de France*.

natural gas sectors. GDF, a subsidiary of GDF Suez, was the vertically integrated incumbent in the French natural gas sector. GDF's subsidiary GRTgaz owned and operated the French gas transport network. Elengy, another subsidiary of GDF owned and operated the only two LNG terminals (in service) in France. Another subsidiary named Storengy owned most gas storage sites in France. GDF further controlled an energy trading company named Gasely. Furthermore, GDF owned minority shareholdings in upstream gas pipelines from France.⁸⁰⁸

The commitment decision states that GDF Suez might have abused Article 102 TFEU by foreclosing access to the gas import capacity in each of GRTgaz's balancing zones for a long period. Thereby GDF Suez restricted competition on the markets for the supply of gas in each of those balancing zones.⁸⁰⁹ Moreover, it was alleged that GDF had rejected third party proposals to co-finance the new LNG terminal it was building in return for capacity. Accordingly GDF did not explore the possibility of increasing capacity to facilitate access to the infrastructure for third parties.⁸¹⁰



⁸⁰⁸ Commission Decision 3 December 2009, COMP/39.316, para 3.

⁸⁰⁹ Commission Decision 3 December 2009, COMP/39.316, para 24.

⁸¹⁰ Commission Decision 3 December 2009, COMP/39.316, paras 32, 33.

Figure 8 - GDF Suez (figure by *Daniel*)

Release of capacity and limiting the reservation of capacity were the commitments agreed upon. GDF Suez committed to release long term capacities to third party firms at three entry points of the GRT gaz pipeline from 1 October 2010 until 30 September 2026 and respectively 30 September 2027 GDF Suez.⁸¹¹ GDF Suez also committed to release upstream transport capacities to third parties at various entry points from 1 October 2010 until 30 September 2027 and respectively 30 September 2025 and 30 September 2018.⁸¹² GDF releases capacities to third parties in both LNG terminals too.⁸¹³ GDF also proposed to limit reservations of capacity.⁸¹⁴

In this case the remedies agreed upon were quasi-structural which is to be regarded a contrast to the first three cases (see is above). GDF did not divest of shares or assets, but the access remedies served as quasi-structural remedies. In the *Verbund/EnergieAllianz* case (see chapter VIIIC.5.d.iv below) the energy undertakings concerned agreed to auction a certain amount of electricity to third parties each year to stimulate expansion of existing competitors and new entry. This commitment was “*intended to effect a structural change to the market*”⁸¹⁵.

iv. *EDF Commission Decision of 17 March 2010*⁸¹⁶

This case regarded foreclosure issues, therefore access remedies were accepted by the Commission.

EDF was the French incumbent electricity operator. EDF operated worldwide in a number of activities. At that time French law required that the state must at any time hold at least 70% in EDF’s share capital.⁸¹⁷ EDF had the majority shareholding in the energy

⁸¹¹ Commission Decision 3 December 2009, COMP/39.316, para 43.

⁸¹² Commission Decision 3 December 2009, COMP/39.316, para 44.

⁸¹³ Commission Decision 3 December 2009, COMP/39.316, para 45.

⁸¹⁴ Commission Decision 3 December 2009, COMP/39.316, paras 47, 48.

⁸¹⁵ Commission Decision 11 June 2003, 2004/271/EC declaring a concentration to be compatible with the common market and the EEA Agreement (COMP/M.2947 - Verbund/EnergieAllianz), para 162.

⁸¹⁶ Commission Decision 17 March 2010, COMP/39.386 – Long-term contracts France.

⁸¹⁷ Commission Decision 17 March 2010, COMP/39.386, para 4.

undertaking Électricité de Strasbourg which was the only company EDF owned that was also active in the retail supply market for electricity to large industrial consumers.⁸¹⁸

The Commission alleged that EDF might have breached Article 102 TFEU in the market for the supply of electricity to large industrial customers in France. Foreclosure concerns were raised since EDF concluded long-term exclusive purchasing agreements with large industrial consumers.⁸¹⁹

The commitments had to eliminate the foreclosure concerns of the Commission; therefore EDF committed to return a percentage of annually at least 60-65% of the electricity supplied to large industrial customers to the market either directly or through a buying group from 2010 onwards.⁸²⁰ Moreover behavioural remedies included new forms of supply contracts and ceasing resale restrictions.⁸²¹

This case is relevant since the structure of the electricity market was altered by returning electricity. The commitment decision paved the way for new entry and the strengthening rivals' positions. It has to be noted that the wording of the contracts and therefore the behaviour of EDF caused the problem in this case, not the structure of EDF itself. Nevertheless, a remedy bundle of quasi-structural and behavioural remedies was decided upon instead of only behavioural remedies regarding the contracts.

v. *Svenska Kraftnät*⁸²² *Commission Decision of 14 April 2010*

This commitment decision was the first one in the European energy sector where the Commission had not by itself started an investigation. Instead the Commission received a complaint from Dansk Energi (DaE), a commercial and professional organisation of Danish energy companies operating in Denmark about Svenska Kraftnät's (SvK) behaviour.⁸²³

SvK was the Swedish Transmission System Operator for the Swedish national electricity system. SvK was owned by the Swedish State SvK and responsible to maintain,

⁸¹⁸ Commission Decision 17 March 2010, COMP/39.386, para 6.

⁸¹⁹ Commission Decision 17 March 2010, COMP/39.386, para 2.

⁸²⁰ Commission Decision 17 March 2010, COMP/39.386, para 43.

⁸²¹ Commission Decision 17 March 2010, COMP/39.386, paras 45-46, 49.

⁸²² Commission Decision 14 April 2010, COMP/39.351 – Swedish Interconnectors.

⁸²³ Commission Decision 14 April 2010, COMP/39.351, paras 5, 6.

operate and develop the Swedish transmission grid for electricity. SvK was also responsible for the state-owned interconnectors with neighbouring countries. A board appointed by the state supervised SvK since it had no legal personality due to being a part of the Swedish state administration. According to then Swedish constitutional law the government was prohibited from exercising control of SvK's activities.⁸²⁴

According to the Commission SvK might have breached Article 102 TFEU by limiting capacity on the Swedish interconnectors when SvK anticipated internal congestion within the Swedish transmission system. SvK discriminated between different network users when limiting capacity. Furthermore, SvK was accused of artificially segmenting the market and preventing users (also industrial users) located outside of Sweden from obtaining the benefits of the internal market. This accusation stems from SvK treating requests for transmission for the purpose of consumption within Sweden differently from requests for transmission for the purpose of export. In this regard it is necessary to note that the ECJ in the *Tetra Pak*⁸²⁵ already stated that behaviour committed on one market having an effect on another market can be considered an abuse under Article 102 TFEU.⁸²⁶

To address the Commission's concerns SvK took up to subdivide the Swedish transmission system into two or more bidding zones as a structural remedy.⁸²⁷ Accordingly a new network infrastructure had to be build.⁸²⁸ This commitment removed the need to restrict available interconnector capacity due to internal congestion on the bottlenecks which were identified in the network in Sweden.⁸²⁹

In this case the competition problems were due to the market structure. Through the structural remedy in this case the company structure of SvK was altered which in turn served to alter the structure of the market too. One may say that SvK could have argued that it had only been carrying out the national policy objective of maintaining a single price

⁸²⁴ Commission Decision 14 April 2010, COMP/39.351, paras 3-4.

⁸²⁵ ECJ 14 November 1996, C-333/94 P, *Tetra Pak International SA v Commission of the European Communities*.

⁸²⁶ Commission Decision 14 April 2010, COMP/39.351, para 27.

⁸²⁷ Commission Decision 14 April 2010, COMP/39.351, para 47.

⁸²⁸ *Hancher/Larouche*, The Coming of Age 772.

⁸²⁹ Summary of the Commission Decision of 14 April 2010 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COMP/39.351 – Swedish Interconnectors), 2010/C 142/08, para 5.

throughout Sweden. However, Regulation No 1228/2003⁸³⁰ forbade such practices. These diverging rules may have made it possible to raise a challenge before the NRA. However, by relying on Article 102 TFEU the Commission was able to circumvent national level and directly managed to obtain far-reaching commitments.⁸³¹ As in the *Deutsche Telekom* case the EU antitrust rules applied to behaviour also covered by national sector-specific regulation. In this case however, that sector-specific regulation diverted from EU rules as opposed to the NRA interpreting the sector-specific regulation wrongly.

vi. *ENI – Commission Decision of 29 September 2010*⁸³²

This decision concerned the Italian natural gas market. A Statement of Objections was sent by the Commission in March 2009 to ENI setting out that ENI might be in breach of Article 102 TFEU. The investigation in this case was started by the Commission taking the initiative itself.⁸³³

At that time the ENI Spa group was controlled by the Italian state. Being engaged mainly in Italy ENI Spa was the predominant producer, importer and supplier of natural gas for both retail and wholesale markets.⁸³⁴

ENI was being investigated by the Commission on the Commission's initiative. Surprise inspections on ENI's premises were part of the investigation. Foremost ENI's transmission pipelines were at issue in the Statement of Objections. The pipelines served to import natural gas to Italy, namely from Austria (TAG pipeline) and Germany (TENP/Transitgas pipelines). The Commission alleged that ENI had engaged in capacity hoarding and strategic underinvestment. Such behaviour constituted a breach of Article 102 TFEU. Also this behaviour created a bottleneck on import capacity and therefore had negative impact on the security of supply of gas in Italy.⁸³⁵ The Commission stated that these abuses were a result of a conflict of interests for ENI. On the hand it had an incentive to make additional

⁸³⁰ Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.

⁸³¹ *Hancher/Larouche*, The Coming of Age 772

⁸³² Commission Decision 29 September 2010, COMP/39.315 - ENI.

⁸³³ European Commission - IP/10/1197 29/09/2010, Antitrust/ENI case: Commission opens up access to Italy's natural gas market.

⁸³⁴ European Commission - IP/10/1197 29/09/2010.

⁸³⁵ European Commission - MEMO/09/120 19/03/2009, Antitrust: Commission confirms sending Statement of Objections to ENI concerning the Italian gas market.

profits as the operator of the gas pipelines, but on the other hand ENI also had an incentive to earn additional profits from selling gas to its consumers through reducing access to that market for (potential) rivals.⁸³⁶

ENI took upon it to divest its shares in the three pipelines that raised the antitrust concerns of the Commission (TAG, TENP and Transilgas).⁸³⁷ Regarding TAG ENI would divest its shareholding to a company controlled by the Italian State. However, if within the agreed divestiture period no purchase agreement was signed the shares would have to be sold to a public or private purchaser approved by the Commission.⁸³⁸

These divestments resulted in ownership unbundling since the transmission pipelines would be divested of. Furthermore the increased opportunities for competitors to transport gas into Italy and to compete on the Italian market would inject more competition into the market thereby benefitting the consumers.⁸³⁹

vii. *CEZ – Commission Decision of 10 April 2013*⁸⁴⁰

This case concerns the Czech electricity market. The Commission opened its proceedings against ČEZ, a.s. (CEZ) on 11 July 2011. On 28 June 2012 the preliminary assessment was notified to CEZ, which submitted commitments to the Commission on 3 July 2012. On 6 March 2013 an amended commitment proposal was submitted by CEZ to the Commission. Shortly afterwards, i.e. on 10 April 2013, the Commission made its commitment decision.⁸⁴¹

CEZ was the incumbent dominant undertaking on the market for generation and wholesale supply of electricity in the Czech Republic.⁸⁴²

⁸³⁶ Commission welcomes ENI's structural remedies proposal to increase competition in the Italian gas market, Speech by Neelie Kroes 4 February 2010

⁸³⁷ Commission Decision 29 September 2010, COMP/39.315, para 88.

⁸³⁸ European Commission - IP/10/1197 29/09/2010.

⁸³⁹ European Commission - IP/10/1197 29/09/2010.

⁸⁴⁰ Commission Decision 10 April 2013, AT.39.727 - CEZ.

⁸⁴¹ Summary of Commission Decision of 10 April 2013 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case AT.39.727 - CEZ), paras 2-4 and 6.

⁸⁴² Summary of Commission Decision of 10 April 2013, AT.39.727 CEZ, para 7.

The Commission alleged that CEZ may have abused its dominant position in the generation and wholesale supply market for electricity in the Czech Republic by strategically preventing new market entry. Part of that strategy was making a potentially pre-emptive reservation in the electricity transmission system in the Czech Republic in January 2007.⁸⁴³ The potentially pre-emptive reservation resulted in the exhaustion of available transmission capacity which could have otherwise been used by competitors of CEZ. It follows that the competitors could have been prevented from access to the network for transmission.⁸⁴⁴

The remedy agreed upon was the divestment of a generation asset (about 800-1000 MW of its generation capacity) to a purchaser to be approved by the Commission. CEZ further had to agree not, for a period of 10 years, to acquire direct or indirect influence over the generation asset it divests of.⁸⁴⁵

This remedy was sufficient to tackle the competition concerns of the Commission since the transfer of generation capacity to a competitor represents (according to the Commission) a “*clear-cut solution to the identified competition concerns*”⁸⁴⁶. Also Almunia commented that the divestiture of significant generation capacity will make it possible for a new player to enter the electricity market in the Czech Republic and to compete with CEZ.⁸⁴⁷

d. *ECMR*

The parties to a merger have the possibility to offer voluntary remedies where the merger raises competition concerns; otherwise the merger might be prohibited.⁸⁴⁸ In the case of mergers structural remedies are called divestment commitments.

The Commission Notice on Remedies sets out the principles applicable to remedies. The Commission is responsible for showing that the merger would significantly impede

⁸⁴³ Summary of Commission Decision of 10 April 2013, AT.39.727 CEZ, para 8.

⁸⁴⁴ Summary of Commission Decision of 10 April 2013, AT.39.727 CEZ, para 10.

⁸⁴⁵ Summary of Commission Decision of 10 April 2013, AT.39.727 CEZ, paras 11-12.

⁸⁴⁶ Summary of Commission Decision of 10 April 2013, AT.39.727 CEZ, para 15.

⁸⁴⁷ European Commission - IP/13/320 10/04/2013, Antitrust: Commission accepts commitments from CEZ concerning Czech electricity market and makes them legally binding.

⁸⁴⁸ *Whish*, Competition Law 872.

effective competition. The merging parties need to show that their proposed remedies would serve to completely eliminate the Commission's competition concerns.⁸⁴⁹ It is important to note that the remedy in question should be capable of being implemented effectively and quickly.⁸⁵⁰ In case of the acquiring party being the existent dominant company the Commission must not require remedies removing such dominance as only remedies that return the situation to the *status quo ante* can be required.

In its Notice on Remedies the Commission stated that it prefers structural remedies to behavioural remedies.⁸⁵¹ This preference stems from their conclusion that creating the conditions for a new competitive entry or strengthening existing competitors via divestiture (apart from prohibition) are most effective to restore effective competition.⁸⁵² Nevertheless the type of remedy suitable to counter competition concerns will be decided upon on a case-by-case basis. Accordingly remedies other than structural remedies may be accepted by the Commission.⁸⁵³ It may also be the case that depending on the competition problems it is sometimes necessary to offer remedy packages comprising of a combination of structural and other remedies.⁸⁵⁴

i. *Neste/IVO – Commission Decision of 2 June 1998*⁸⁵⁵

This case concerned issues of vertical integration, namely vertically integrating Neste's dominant position in gas via Gasum with IVO's dominant position in production and sale of electricity.⁸⁵⁶

The Finnish state owned a majority shareholding of 83.17% in Neste, which was engaged in the oil, energy and chemical business sectors.⁸⁵⁷ Neste in turn owned the majority ownership of Gasum, the dominant natural gas supplier in Finland.⁸⁵⁸ The Finnish

⁸⁴⁹ European Commission IP/00/1525 21 December 2000, Notice on merger remedies: how and when to cure dominance problems, para 6.

⁸⁵⁰ European Commission IP/00/1525 21 December 2000, para 9.

⁸⁵¹ European Commission IP/00/1525 21 December 2000, para 15.

⁸⁵² European Commission IP/00/1525 21 December 2000, para 13.

⁸⁵³ European Commission IP/00/1525 21 December 2000, para 16.

⁸⁵⁴ Jones, EU Energy Law Volume II, EU Competition Law and Energy Markets² (2007) 498 Recital 4.366.

⁸⁵⁵ Commission Decision 2 June 1998 declaring a concentration to be compatible with the common market (Case No IV/M.931 - Neste/IVO).

⁸⁵⁶ Went, European Competition Law Review 2006 27/8, 469.

⁸⁵⁷ Commission Decision 2 June 1998, No IV/M.931, para 2.

⁸⁵⁸ Roggenkamp/Redgwell/Rønne/del Guayo (Eds.), Energy Law in Europe: National, EU and International Regulation² (2007) 281.

state also owned a majority shareholding of 95.6% in IVO which was the largest energy company in Finland and active on all level of the electricity sector.⁸⁵⁹

100% of shares of the holding company IVO-Neste were owned by the Finnish state too. The initial plan was that this holding company should acquire at first the shareholdings of the Finnish state in Neste and then its shareholdings in IVO. Moreover, IVO-Neste was supposed to acquire the remaining minority shares Neste in return for shares of its own company.⁸⁶⁰ The first part of the transaction was deemed reorganisation within the Finnish state. However, the second part constituted a concentration.⁸⁶¹

A number of competition concerns would have followed this proposed merger. Firstly, the concentration would have resulted in a *de facto* monopoly held by its subsidiary Gasum (75%) on the natural gas market. Secondly, the concentration would sell the electricity it generated to third parties leading to exerting at least significant influence over both the electricity and the natural gas market in Finland.⁸⁶²

IVO-Neste had to divest 50% of its Gasum shares to reduce their shares to 25%. Furthermore, the Finnish state was offered 24% of Gasum shares and the 26% were to be sold to independent competitors.

ii. *VEBA/VIAG – Commission Decision of 13 June 2000*⁸⁶³ and *RWE/VEW – German Bundeskartellamt of 4 July 2000*⁸⁶⁴

Simultaneous mergers in an oligopolistic market were at issue in these cases. The Commission investigated the VEBA/VIAG merger where the parties intended to create

⁸⁵⁹ Commission Decision 2 June 1998, No IV/M.931, para 3.

⁸⁶⁰ Roggenkamp/Hammer (Eds.), European Energy Law Report I (2004) 58.

⁸⁶¹ Roggenkamp/Hammer (Eds.), European Energy Law Report I 58.

⁸⁶² Roggenkamp/Redgwell/Rønne/del Guayo (Eds.), Energy Law in Europe 281.

⁸⁶³ Commission Decision 13 June 2000, 2001/519/EC on the compatibility of a concentration with the common market and with the EEA Agreement (Case COMP/M.1673 – VEBA/VIAG).

⁸⁶⁴ Bundeskartellamt, Bundeskartellamt gibt Fusion RWE/VEW mit Auflagen frei, 4 June 2000 via: http://www.bundeskartellamt.de/SharedDocs/Meldung/DE/Pressemitteilungen/2000/04_06_2000_RWE.html (accessed on 23 June 2014); summary in English language in *German Delegation to the Committee on Competition Law and Policy*, Annual Report on Competition Policy Developments in Germany, July 1999 – June 2000, Recitals 37-41 via: <http://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Taetigkeitsberichte/OECDAnnualReport2000.pdf> (accessed on 23 June 2014).

E.ON as a consequence of the concentration. The German Bundeskartellamt investigated the RWE/VEW merger.⁸⁶⁵

As a diversified group VEBA was engaged in a number of sectors. Its subsidiary PreussenElektra was active on all level in the electricity sector. Furthermore PreussenElektra, RWE and Bayernwerk jointly controlled VEAG.⁸⁶⁶ Similarly to VEBA the second party to the proposed merger, VIAG, was engaged in a number of sectors. It was also a conglomerate with international operations. Furthermore VIAG was engaged on all levels of the electricity industry via Bayernwerk.⁸⁶⁷

VEBA and VIAG planned to merge according to Article 2(1)(1) of the German Conversion Law (*Umwandlungsgesetz*). This constituted a merger in the legal sense.⁸⁶⁸ Also RWE and VEW wanted to merge.

According to the Commission a dominant duopoly would be created in the market.⁸⁶⁹ 80% of the market for electricity delivered from the interconnected grid in Germany would be under control of the duopoly.⁸⁷⁰

Moreover, certain characteristics in the market und in the structures of the undertakings concerned might lead in parallel behaviour. The undertakings at issue jointly operated large power stations and comparable cost structures. Furthermore there were numerous relationships between the two concentrations and there was a possibility of continuing to share customers along the former geographical monopolies.⁸⁷¹

⁸⁶⁵ Commission Decision 13 June 2000, 2001/519/EC (COMP/M.1673 – VEBA/VIAG).

⁸⁶⁶ Commission Decision 13 June 2000, COMP/M.1673, para 4.

⁸⁶⁷ Commission Decision 13 June 2000, COMP/M.1673, para 5.

⁸⁶⁸ Commission Decision 13 June 2000, COMP/M.1673) para 6.

⁸⁶⁹ *Went*, European Competition Law Review 2006 27/8, 471.

⁸⁷⁰ *Roggenkamp/Hammer (Eds.)*, European Energy Law Report I 59.

⁸⁷¹ *Roggenkamp/Hammer (Eds.)*, European Energy Law Report I 60.

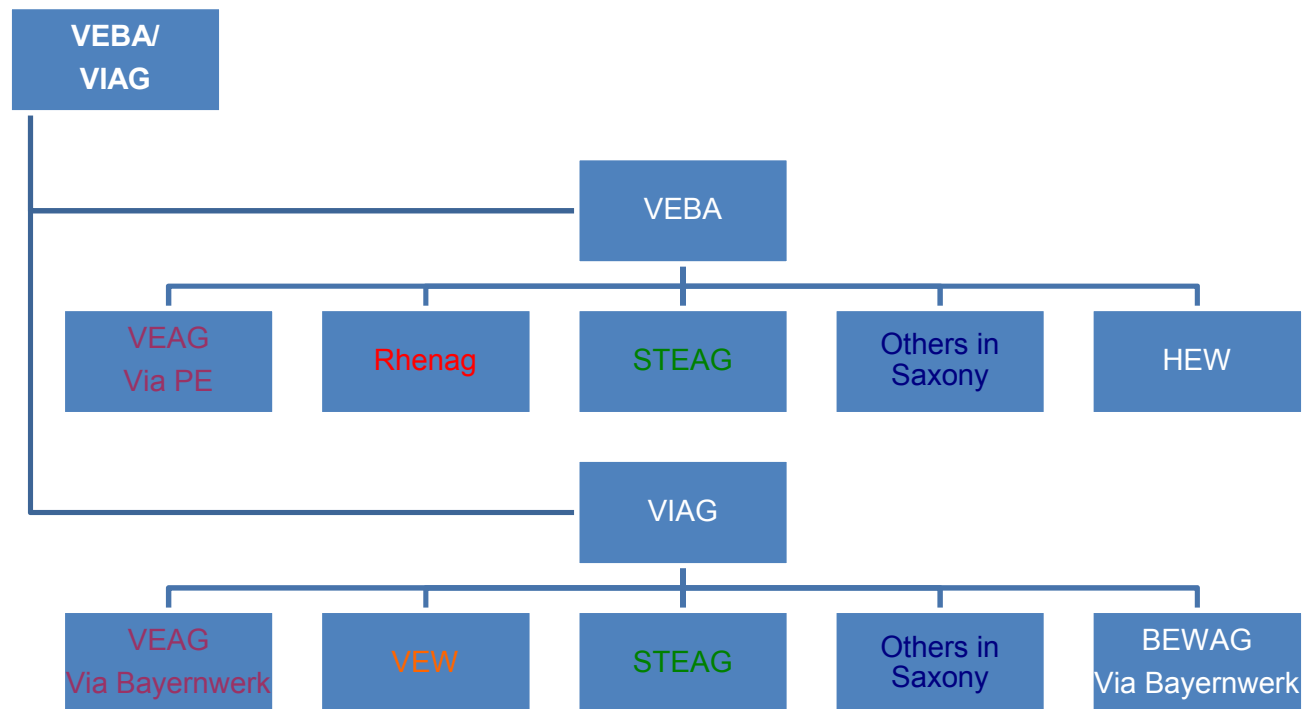


Figure 9 - The proposed VEBA/VIAG merger (figure by *Daniel*)

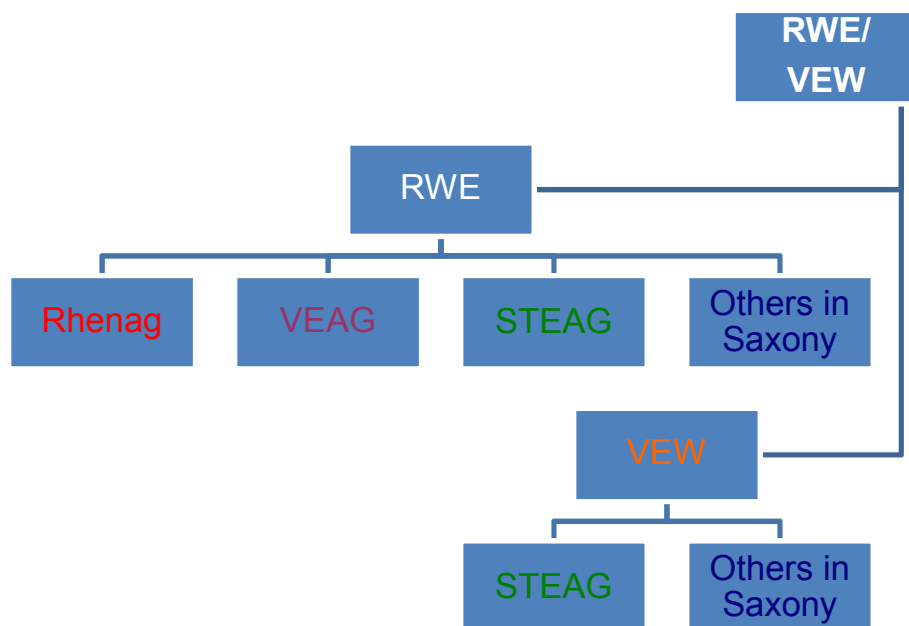


Figure 10 - The proposed RWE/VEW merger (figure by *Daniel*)

Firstly, it was agreed that VEBA and VIAG divest of their shareholdings in VEAG to remove their most important link with RWE. This served to remove the incentive to act in parallel behaviour. Moreover, as VEAG turned into an independent competitor competition in its traditional supply area was secured. Secondly, VIAG had to sell its shares in VEW and divest of the controlling shareholdings it possessed in BEWAG, to create an independent supplier of electricity at the interconnected level. Thirdly, VEBA had to sell its shares in Rhenag and divest its shareholding in HEW to create an independent supplier of electricity at the interconnected level too.

In energy merger cases collective dominance concerns are rather rare. To change the structure of the undertakings concerned is therefore necessary to effect a change in the market too. These mergers served as a good example for such structural remedies. Furthermore, sometimes divestiture is necessary to sever a link or some links with a competitor.

iii. *EdF/EnBW – Commission Decision of 7 February 2001*⁸⁷²

This proposed concentration raised competition concerns of adverse unilateral effects. Furthermore, it was necessary to safeguard a potential competitor of EdF in France.

EdF and Atel, a major player in the Swiss electricity market, enjoyed close commercial links (long term supply contracts). At that time Atel was one of seven transmission system operators (*Überlandwerke*) operating the transmission grid in Switzerland. Even though it was a minority shareholder, EdF was represented in Atel's board of directors.⁸⁷³

Energie Baden-Württemberg (EnBW) was engaged in electricity supply and transport in the Southwest of Germany as well as in electricity trading. EnBW held a controlling stake in Watt AG, which itself had controlling stakes in two of the seven *Überlandwerke* and in two other Electricity companies.⁸⁷⁴

⁸⁷² Commission Decision 7 February 2001 declaring a concentration to be compatible with the common market and the EEA Agreement (Case No COMP/M.1853 – EDF/EnBW).

⁸⁷³ Jones, EU Energy Law Volume II² 505 Recital 4.401.

⁸⁷⁴ Jones, EU Energy Law Volume II² 505 Recital 4.402.

EdF International (EdFI), EdF's subsidiary together with Zweckverband Oberschwäbische Elektrizitätswerke, an association of nine public districts in the Southwest of Germany planned to acquire joint control of EnBW.⁸⁷⁵

The Commission noted that the proposed concentration would have resulted in controlling over 50% of the interconnector capacity in Switzerland⁸⁷⁶ as well as the elimination of Watt AG as competitor. Moreover, by removing EnBW as competitor in the French market for electricity supply to eligible customers, EdF's at that time already dominant (90%) position in electricity would have been strengthened.⁸⁷⁷ The proposed concentration would have also strengthened EdF's revenge potential in Germany and EdF's position as pan-European supplier.⁸⁷⁸

According to the Commission Switzerland was a turntable for peak load for its own and other European utilities for seasonal and daily requirements. However, in 1999 80% of EdF's output was generated from nuclear power which is not suitable to satisfy peak load demand. In France electricity exports from Switzerland account mainly for peak load.⁸⁷⁹ French customers needed to be supplied with peak and base load. In case an energy undertaking in France cannot satisfy demand for one or both itself they need to make arrangements with other suppliers, especially Swiss suppliers. As a result of the proposed concentration EdF would have controlled a large part of the supply of peak load; accordingly such arrangement would be restricted.

Another important factor was that EGL, a potential competitor in France, would have been removed through the strengthening of EdF's already dominant position in that market.⁸⁸⁰

⁸⁷⁵ *Roggenkamp/Hammer (Eds.)*, European Energy Law Report I 61.

⁸⁷⁶ *Roggenkamp/Hammer (Eds.)*, European Energy Law Report I 62.

⁸⁷⁷ Went, European Competition Law Review 2006 27/8, 466.

⁸⁷⁸ *Roggenkamp/Hammer (Eds.)*, European Energy Law Report I 61.

⁸⁷⁹ *Jones*, EU Energy Law Volume II² 505-506 Recital 4.404.

⁸⁸⁰ *Jones*, EU Energy Law Volume II² 506 Recital 4.405.

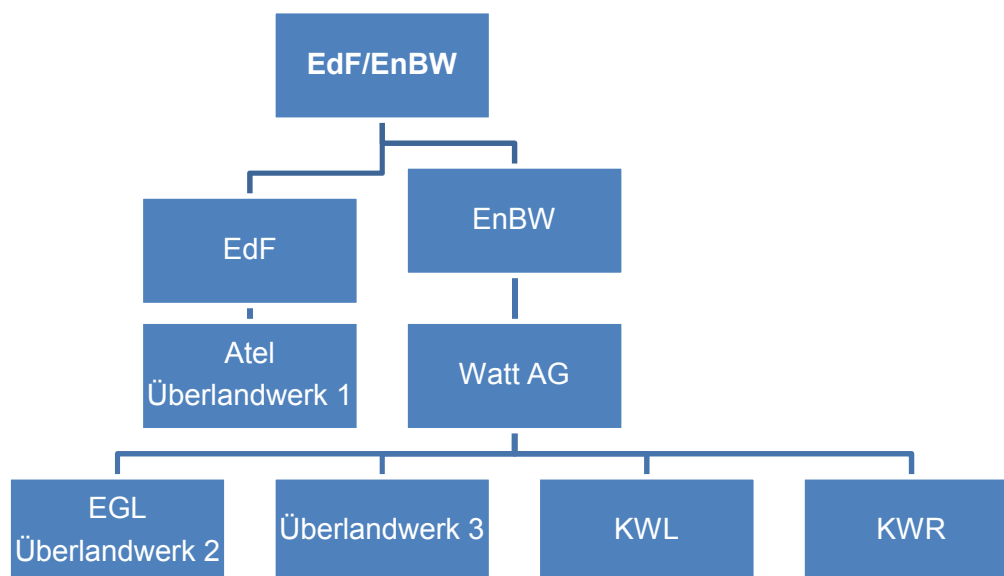


Figure 11 - The proposed EdF/EnBW merger (figure by *Daniel*)

As a structural remedy EnBW's had to divest of its stake in Watt AG to ensure the *status quo ante* in Switzerland was restored. This divestment affected on the EU countries (especially France) neighbouring Switzerland.⁸⁸¹ The divestment essentially removed structural links with EdF's competitor.

iv. *Verbund/Energie Allianz – Commission Decision of 11 June 2003*⁸⁸²

This is one of the cases where a merger was approved subject to structural remedies even before the Sector Inquiry leading to the Third Energy Package was published.

The energy undertaking Verbund was controlled by the Austrian state. EnergieAllianz was an alliance through joint ventures between various regional energy suppliers in Austria. Regional or local authorities held the majority shareholdings in these various energy suppliers.⁸⁸³ In the market for distribution to large customers in Austria Verbund and EnergieAllianz were the main competitors: Verbund (through APC, its distribution company) had a share of 5-15% and EnergieAllianz between 45-55%. Accordingly

⁸⁸¹ Jones, EU Energy Law Volume II² 506 Recital 4.407.

⁸⁸² Commission Decision 11 June 2003, 2004/271/EC (COMP/M.2947).

⁸⁸³ Roggenkamp/Hammer (Eds.), European Energy Law Report I 66.

together they would have had a market share of around 50-70% leaving the remaining rivals with a market share of less than 10% each.⁸⁸⁴

The parties to this proposed merger planned to combine their respective activities in trade and supply customers through two new joint ventures. This would have resulted in creating or strengthening a dominant position in the Austrian markets for supply of electricity to large consumers, small distributors and small customers.⁸⁸⁵ Moreover, an advantageous generation portfolio suitable for supplying balancing energy would have been a result of the proposed merger too. At that time there was a lack of available development sites and therefore new entrants would have not been able to enjoy similar advantages.⁸⁸⁶

Verbund committed to divest of its 55% majority shareholding in the distribution company APC. Behavioural remedies were agreed upon too.⁸⁸⁷

This case evidences that even before the Sector Inquiry structural remedies in energy merger cases were common to remedy competition concerns stemming from the market structure. It also shows that even at that time the Commission used its antitrust powers to inject competition into a market still being to a large part under sector-specific regulation and not yet liberalised completely.

v. *E.ON/MOL – Commission Decision of 21 December 2005*⁸⁸⁸

In this case the proposed merger between a dominant energy undertaking and another energy undertaking was at issue since anti-competitive vertical effects would have followed.⁸⁸⁹

⁸⁸⁴ Jones, EU Energy Law Volume II² 499-500 Recital 4.372.

⁸⁸⁵ Jones, EU Energy Law Volume II² 500 Recital 4.372.

⁸⁸⁶ Hammer/Roggenkamp (Eds.), European Energy Law Report III (2006) 32.

⁸⁸⁷ Jones, EU Energy Law Volume II² 499 Recital 4.371.

⁸⁸⁸ Commission Decision 21 December 2005 declaring a concentration compatible with the common market and the functioning of the EEA Agreement (Case COMP/M.3696 - E.ON/MOL), 2006/622/EC.

⁸⁸⁹ Hammer/Roggenkamp, European Energy Law Report III 37.

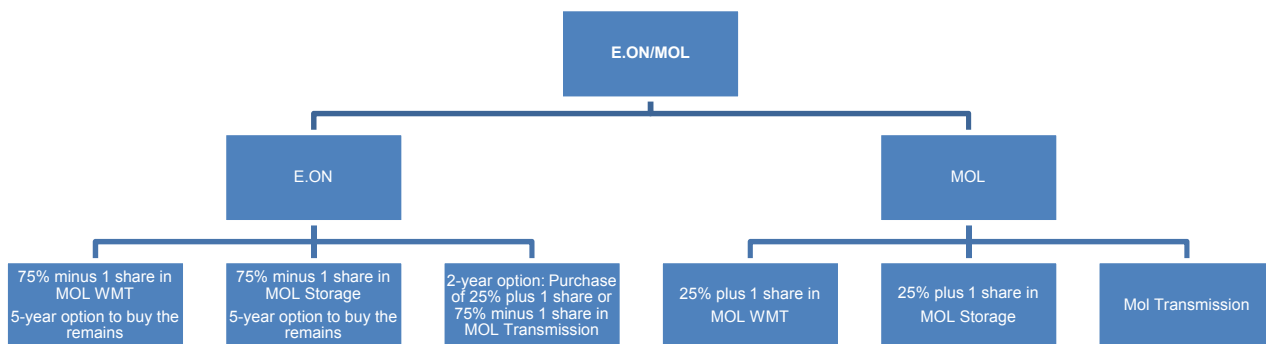


Figure 12 The proposed E.ON/MOL merger (figure by *Daniel*)

MOL was the Hungarian vertically integrated incumbent oil and gas company enjoying a monopoly over natural gas production, controlling most imports and owning all existing gas storage facilities in Hungary.

E.ON was one of the major integrated German energy supply companies. Being engaged in Hungary too E.ON owned two distribution companies and participated in a third one. In contrast to MOL, E.ON had a very strong market position in the retail supply of gas in Hungary.⁸⁹⁰

E.ON would have acquired the interest of 75% minus 1 share in two subsidiaries of MOL, MOL WMT (wholesale, marketing and trade) and MOL Storage. Additionally, E.ON and MOL agreed upon two put options: A five-year put option under which MOL could sell the remaining shares of MOL WMT and MOL Storage to E.ON and a two-year put option where MOL may require E.ON to buy either a 25% plus 1 share or 75% minus 1 share in MOL Transmission.⁸⁹¹ Accordingly, the proposed merger would have led to a

⁸⁹⁰ *Hammer/Roggenkamp*, European Energy Law Report III 44.

⁸⁹¹ *Jones*, EU Energy Law Volume II² 502.

fully vertically integrated company along supply chains for gas and electricity in Hungary.⁸⁹²

The Commission stated that MOL's remaining shares of its subsidiaries MOL WMT and MOL Storage and the put-option for shares in MOL Transmission would result in structural links between E.ON and MOL. Accordingly, MOL would have an incentive to discriminate against competitors of both companies for access to new gas storage facilities, gas transmission services and domestic gas.

A number of commitments were agreed upon in this case. Firstly, MOL's divestiture of its remaining interest in MOL WMT and MOL Storage within six months. These divestitures would dissolve structural links between the MOL E&P's gas production and its transmission by MOL transmission retained by MOL and the gas storage and wholesale activities which E.ON acquired. Secondly, it was agreed upon that for ten years and as long as E.ON still holds the majority shareholding in MOL WMT and MOL Storage, MOL won't directly or indirectly acquire minority stakes in its former subsidiaries. Thirdly, a remedy was agreed upon regarding the two-year put option: MOL had to undertake not to exercise the put option for 25% plus 1 share, while retaining the put option for the 75% minus 1 stake. Fourthly, for ten years as long as E.ON is majority shareholder of MOL WMT and MOL Storage, MOL must not sell such interest in MOL Transmission that would not result in E.ON acquiring either sole or joint control in MOL Transmission to E.ON or any of its affiliates.

This remedy package lead to ownership unbundling between E.ON gas wholesale and storage and MOL gas production and transmission. Furthermore, it was intended to remove incentives for MOL to favour MOL WMT for access to the transmission network and storage for access to new storage sites. It also served to ensure that any acquisition by E.ON of a share interest in MOL Transmission will be subject to merger control review.

⁸⁹² *Hammer/Roggenkamp*, European Energy Law Report III 44.

vi. *DONG/Elsam/Energi E2 – Commission Decision of 14 March 2006*⁸⁹³

The proposed conglomerate merger at hand raised competition concerns since the respective companies were dominant on the gas and the electricity markets in Denmark.⁸⁹⁴

DONG was the Danish state-owned gas incumbent active on all levels on the gas chain. Elsam and Energi E2 were the two major Danish electricity generation incumbents. At that time the Danish energy market was recognised as one of the most open and competitive in Europe.⁸⁹⁵

Initially it was agreed upon that DONG acquires Elsam, Energi E2, Københavns Energi Holding and Frederiksberg Elnet by purchasing shares and assets.⁸⁹⁶

However, the Commission raised a number of competition concerns. Firstly, effective competition on the Danish and Swedish gas wholesale/trading and gas storage/flexibility markets would have been significantly impeded. Furthermore, several gas supply markets would be affected as a consequence. Secondly, before the proposed merger was agreed upon, Energi E2 had considered entering the Danish gas wholesale/trading market. The concentration at hand would eliminate this potential entry to the market. Thirdly, the Commission was concerned as to the impact of the proposed concentration on the gas flexibility and storage market since it was possible for the electricity companies to operate their plants as virtual gas storages.⁸⁹⁷ Finally, vertical customer foreclosure was an issue, since integrating Elsam and Energi E2 would have removed them as two largest consumers of gas on the market.⁸⁹⁸

The competition concerns of the Commission were met with the commitment of DONG to divest the larger of its two gas storage facilities. Moreover, certain power plants were sold to the Swedish company Vattenfall.

⁸⁹³ Commission Decision 14 March 2006 declaring a concentration compatible with the common market and the functioning of the EEA Agreement (Case COMP/M.3868 – DONG/Elsam/Energi E2), 2007/353/EC.

⁸⁹⁴ *Hammer/Roggenkamp*, European Energy Law Report III 38.

⁸⁹⁵ *Hammer/Roggenkamp*, European Energy Law Report III 48.

⁸⁹⁶ Commission Decision 14 March 2006, COMP/M.3868, para 1.

⁸⁹⁷ *Hammer/Roggenkamp*, European Energy Law Report III 49.

⁸⁹⁸ *Hammer/Roggenkamp*, European Energy Law Report III 49.

These remedies are less far-reaching than one would think when reading the description of the case; however, DONG controlled “only” 80-85% of the gas wholesale market and most importantly the Danish state already required unbundling at the national level.⁸⁹⁹ Nevertheless, structural remedies were necessary, that proves that the unbundling measures of the Second Package of Energy Directives did not go far enough to inject competition in these markets.

vii. *Gaz de France/Suez – Commission Decision of 14 November 2006*⁹⁰⁰

This case concerned the Belgian gas market as the proposed conglomerate merger would have led to very high combined market shares in this market.⁹⁰¹

At that time Gaz de France (GDF) was engaged on all levels in the gas sector a, in electricity generation and retail and other energy services. GDF mainly operated France and Belgium but also all over Europe. GDF and another undertaking, Centrica in Belgium, had joint control over the second largest player in the Belgian energy market, SPE.⁹⁰²

Also Suez was active in both gas and electricity sectors and other sectors. Suez’ main subsidiaries were Electrabel for electricity and gas, Distrigaz for gas and Fluxys for gas infrastructure. Just like GDF Suez mainly operated in Belgium and France.⁹⁰³

GDF and Suez had originally agreed to merge via an exchange of shares.⁹⁰⁴

The Commission was concerned regarding a number of issues in the Belgian energy market. Firstly, GDF would be removed as the strongest competitor to the incumbent Distrigaz. This development in turn would lead to competition concerns regarding gas-to-gas fired power generators competing with Electrabel. Secondly, the high barriers to entry in the market would have strengthened the parties’ dominant position in the Belgian gas markets. Thirdly, together the parties to the proposed merger would have access to most

⁸⁹⁹ Commission Decision 14 March 2006, 2007/353/EC (COMP/M.3868), para 50.

⁹⁰⁰ Commission Decision 14 November 2006 declaring a concentration compatible with the common market and the functioning of the EEA Agreement (Case COMP/M.4180 – Gaz de France/Suez), 2007/194/EC.

⁹⁰¹ *Hammer/Roggenkamp*, European Energy Law Report III 50.

⁹⁰² *Bachour/Conte/Eberl/Martini/Paolicchi/Redondo/Van Haasteren/Wils*, *Gaz de France/Suez: Keeping energy markets in Belgium and France open and contestable through far-reaching remedies*, in Competition Policy Newsletter Number 1 Spring 2007, 83.

⁹⁰³ *Bachour et al.*, Competition Policy Newsletter Number 1 Spring 2007, 83.

⁹⁰⁴ Commission Decision 14 November 2006, COMP/M.4180, para 1.

gas imports into Belgium and hold almost all long-term import contracts. Fourthly, the control over the network operator Fluxys would result in privileged access to supply infrastructure and storage. Fifthly, there would have been an impact on the French market too as the competitive constraints by Distrigaz would be removed and this would have strengthened GDF's already dominant position in France. Similarly as to Belgium high barriers to entry regarding access to gas and infrastructure would have increased the horizontal effects of the proposed merger.

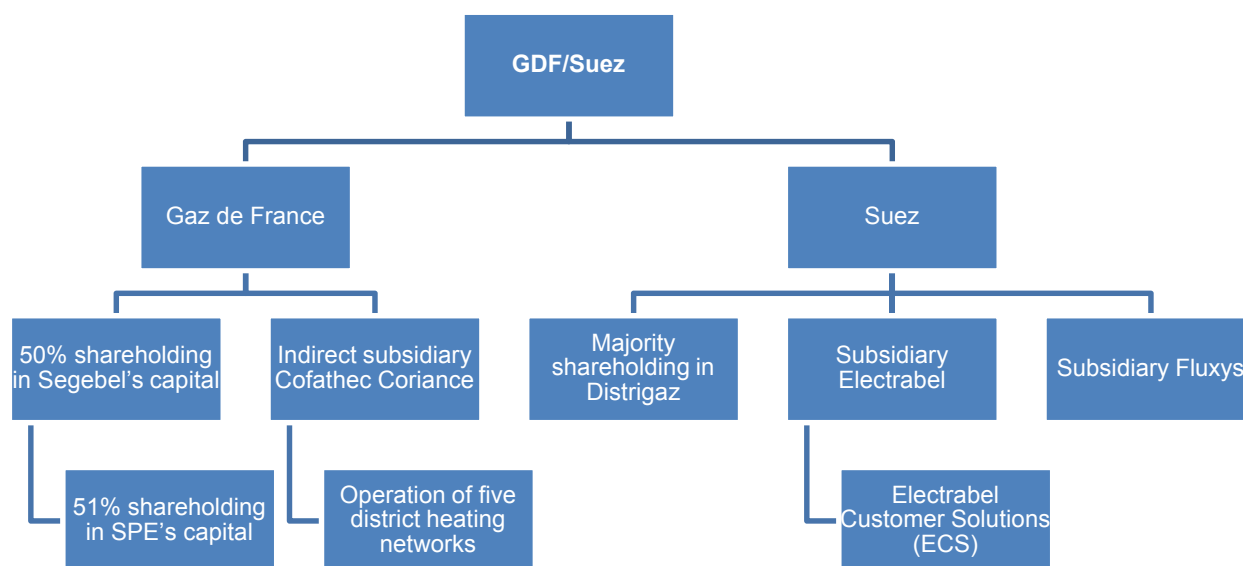


Figure 13 - The proposed GDF/Suez merger (figure by *Daniel*)

Extensive structural remedies were necessary to meet the number of competition concerns the Commission had raised. Firstly, Suez had to divest Distrigaz to a third party experienced in the energy sector⁹⁰⁵ to make sure that Distrigaz will be able to effectively compete with the GDF/Suez concentration. Regarding this remedy it has to be noted that prior to the divestiture the concentration concluded supply contracts with Distrigaz to cover parts of Electrabel's and ECS's needs. According to the Commission these contracts did not question the viability of Distrigaz since apart from the supply to Electrabel and

⁹⁰⁵ *Bachour et al.*, Competition Policy Newsletter Number 1 Spring 2007, 87.

ECS the volumes of gas available to Distrigaz would be enough to meet the increasing demand. Moreover, the amount of gas subject to the contracts would decrease over time. Secondly, the parties to the merger agreed at any time to transfer to Distrigaz, the Belgian storage capacity as well as the corresponding volumes being stored relating to any existing ECS public supply customer in Belgium which Distrigaz might acquire or by one of the resellers supplied by it.⁹⁰⁶ Thirdly, GDF undertook to give up its shareholding in Segebel, which held the majority of shares in SPE, at that time the second biggest player in the electricity and gas markets in Belgium. Fourthly, the parties to the merger had to give up Cofathec Coriance to remove the horizontal overlap between GDF and Suez in the French district heating market.

Essentially this package of remedies served to unbundle Suez since Distrigaz was divested of, i.e. the link between the main supplier of gas in Belgium and the Belgian gas network infrastructure.⁹⁰⁷

viii. *EDF/Segebel – Commission Decision of 12 November 2009*⁹⁰⁸

The Belgian electricity wholesale market was at issue in this case as the proposed concentration would have led to horizontal unilateral effects in that market.

EDF and its subsidiaries were active in both the electricity and gas markets. In the electricity sector these undertakings were engaged in generation, wholesale, trading and retail supply in France and other Member States. However, in the natural gas sector they are only active in the retail and wholesale markets. Importantly at that time EDF was the third largest operator in the Belgian electricity market, even though it had only limited presence. Therefore EDF planned to expand its presence in Belgium through investments in two CCGT⁹⁰⁹ generation capacity projects.⁹¹⁰

Segebel was owned by the British company Centrica and was essentially a Belgian holding company with a majority shareholding in SPE, its only asset. SPE was engaged in

⁹⁰⁶ Jones, EU Energy Law Volume II² 501 Recital 4.377.

⁹⁰⁷ Bachour *et al.*, Competition Policy Newsletter Number 1 Spring 2007, 83.

⁹⁰⁸ Commission Decision 12 November 2009, Non-opposition to a notified concentration (Case COMP/M.5549 - EDF/Segebel), 2010/C 57/05.

⁹⁰⁹ A CCGT is a combined cycle gas turbine plant, it generates electricity.

⁹¹⁰ Asbo/De Coninck/Hariton/Kecsma/Panayides/Van Haasteren, EDF/Segebel (SPE), More power to boost competition in Belgian energy markets, in Competition Policy Newsletter 2010-1.

both the electricity and the gas sector. In the former it was active in production, wholesale, trading and supply and in the latter it was active in supply. At that time SPE was even the second largest electricity generator in Belgium after the incumbent company GDF/Suez via Electrabel.⁹¹¹

The parties had agreed upon the acquisition of 100% of Segebel from Centrica by EDF.⁹¹²

In the Commission's opinion this proposed concentration gave rise to competition concerns in the Belgian electricity wholesale market even though the parties' current combined market shares in the Belgian electricity wholesale market were modest. The concentration would nevertheless have given rise to horizontal unilateral effects. Moreover, the merger would have significantly affected EDF's incentives to enter the Belgian electricity wholesale market via investing into two CCGT generation capacity projects. Accordingly the merger would have significantly affected future competition in the Belgian electricity wholesale market. The Commission also stated that the anti-competitive effects would have not been offset by E.ON's market entry by acquiring 1441 MW of existing generation capacity since no new generation capacity would be brought into the market.⁹¹³

To remedy the Commission's competition concerns EDF committed to immediately divest its assets in one of the two companies set up to implement the planned CCGT generation capacity projects. The other company not to be divested of immediately had to be invested into by a certain date (business secret) or divested.⁹¹⁴

What is interesting in this case that on the one hand there was a structural remedy with immediate effect and a second invest or divest remedy. The Commission stated that this remedy was adequate since EDF was not able to prevent or delay entry by rivals, as they had to decide what to do until a specific date. In contrast, before the commitments were agreed upon, EDF had only made a provisional decision to invest.⁹¹⁵ This remedy was

⁹¹¹ *Asbo et al.*, Competition Policy Newsletter 2010-1.

⁹¹² Commission Decision 12 November 2009, COMP/M.5549, para 4.

⁹¹³ *Asbo et al.*, Competition Policy Newsletter 2010-1.

⁹¹⁴ Commission Decision 12 November 2009, COMP/M.5549, para 211.

⁹¹⁵ Commission Decision 12 November 2009, COMP/M.5549, para 217.

inadequate to remedy the Commission's competition concerns since it brought uncertainty to the market and gave EDF a strategic advantage. Furthermore, they should not have gotten the chance to invest, since the concentration would only serve to create or strengthen its dominant position with more generation capacity. It would have been advisable to immediately divest of both companies. This case is a good example of structural remedies which do not go far enough to eliminate competition concerns and are therefore inappropriate to eliminate competition concerns.

ix. *Vattenfall/Nuon – Commission Decision of 22 June 2009*⁹¹⁶

This case concerned the merger of two energy companies active in electricity and gas markets in a number of Member States.⁹¹⁷

At that time Vattenfall, a Swedish company, was engaged on the following levels in the electricity sector: generation and wholesale supply, transmission, retail supply and financial trading of electricity. Vattenfall mainly operated in the Sweden, Germany, Finland, Denmark and Poland. It also had some minor presence in the gas sector.⁹¹⁸

Nuon Energy, a Dutch undertaking, was engaged on all levels of the energy chain. In contrast to Vattenfall it had more presence in the gas sector, namely in exploration, production and retail supply. Nuon Energy operated mainly in the Netherlands but also in Belgium and Germany.⁹¹⁹

Originally it was intended that Vattenfall acquires full control of Nuon Energy over a period of six years: Initially 49% of shares were to be acquired, after two and four years respectively this would have been followed by two tranches of 15%. The remaining 21% would have been acquired after six years. It was agreed upon that operational control would occur after the purchase of the first tranche.⁹²⁰

⁹¹⁶ Commission Decision 22 June 2009, Non-opposition to a notified concentration (Case COMP/M.5496 Vattenfall/Nuon Energy), 2009/C 212/05.

⁹¹⁷ *Lo Nardo/Godfried/Kovács*, The Vattenfall / Nuon Energy case – Upholding competition on electricity retail markets in Germany, in Competition Policy Newsletter 2009-3, 49.

⁹¹⁸ Commission Decision 22 June 2009, COMP/M.5496, para 2.

⁹¹⁹ Commission Decision 22 June 2009, COMP/M.5496, para 3.

⁹²⁰ *Lo Nardo/Godfried/Kovács*, Competition Policy Newsletter 2009-3, 49.

The Commission investigated the concentration and found that the only significant overlap between the merging parties was the retail sale of electricity to small customers in Berlin and Hamburg. In both cities their joint market shares amounted to 80-90%. Since Vattenfall and Nuon Energy concerned exerted competitive constraints on each other in these two cities, these would be eliminated after the merger.⁹²¹

To satisfy the competition concerns of the Commission the parties agreed on a structural remedy to remove future unilateral effects, namely to divest of Nuon Energy's subsidiary Nuon Deutschland GmbH, which operated in Hamburg, Berlin and Heinsberg.⁹²²

x. *RWE/Essent – Commission Decision of 23 June 2009*⁹²³

This concentration concerned rivals and raised unilateral issues as it would have eliminated a rival of RWE in Germany.

RWE was one of the major vertically integrated German energy companies and engaged in both the electricity and gas market. RWE was mainly active in Germany, but operated in the Netherlands with minor activities too.⁹²⁴

The Dutch energy company Essent acted in the Netherlands on all levels of the gas and electricity markets, apart from transport and distribution. Moreover, Essent owned a majority shareholding of 51% in Stadtwerke Bremen (swb). Swb was a local German energy utility engaged in generation as well as supply activities in the gas and electricity sector.⁹²⁵

The parties to the merger had agreed that RWE should acquire sole control (between 66% and 100%) of Essent through a private offer.⁹²⁶

In this case the Commission found that the concentration raised competition problems in the German due to swb. This was so as swb would be eliminated as independent player on

⁹²¹ *Lo Nardo/Godfried/Kovács*, Competition Policy Newsletter 2009-3, 51-52.

⁹²² *Lo Nardo/Godfried/Kovács*, Competition Policy Newsletter 2009-3, 52.

⁹²³ Commission Decision 23 June 2009, Non-opposition to a notified concentration (Case COMP/M.5467 - RWE/Essent), 2009/C 222/01.

⁹²⁴ *Driessen Reilly/Kecsmar/Redondo/Chauve/Kovács/Langus*, RWE/Essent: On the Borderline, in Competition Policy Newsletter Number 2009-3, 45.

⁹²⁵ *Driessen Reilly et al.*, Competition Policy Newsletter Number 2009-3, 45.

⁹²⁶ *Driessen Reilly et al.*, Competition Policy Newsletter Number 2009-3, 45.

the market as a result of the merger. Moreover swb had planned to develop generation capacity in the German electricity market, which suffered from high entry barriers anyways. Also in the German gas market competition concerns were present as the concentration would have resulted in horizontal and vertical relationships.⁹²⁷

Accordingly the parties to the potential merger agreed to divest of swb to make sure it remained an independent competitor or becomes a partner of a new entrant.⁹²⁸

In this case a behavioural remedy could not have dealt with that competition concern swb posed as effectively. Therefore the divestiture was necessary and appropriate.

xi. *GDF Suez/International Power – Commission Decision of 21 January 2011*⁹²⁹

This case raised competitive concerns regarding the Belgian electricity generation and wholesale market since the transaction, as originally notified, would have led to the reinforcement of GDF Suez' dominant position in the wholesale market in Belgium.⁹³⁰

As explained above GDF Suez is present across the entire energy chain in electricity as well as in gas. At the time the merger was notified in November 2010 the French government held a 39.9% capital share in GDF Suez. A further 51% were publicly held. International Power on the hand is an operator of power generation facilities with a capacity of then about 32,000 MW. It is operating internationally in Europe, North America, Australia, Asia and the Middle East.⁹³¹

The proposed transaction was to be implemented in two steps. GDF Suez wanted to first carry out an internal reorganisation to create a separate subgroup of subsidiaries which were supposed to then own most of the international energy assets of the GDF Suez group, located mainly outside of Europe. Electrabel, which is wholly owned by GDF Suez, was supposed to hold the subgroup. In a second step the shares of this subgroup were supposed to be transferred to International Power in return for the issuance of the shares of

⁹²⁷ *Driessen Reilly et al.*, Competition Policy Newsletter Number 2009-3, 45-47.

⁹²⁸ *Driessen Reilly et al.*, Competition Policy Newsletter Number 2009-3, 47-48.

⁹²⁹ Commission Decision 26 January 2011, Non-opposition to a notified concentration (Case COMP/M.5978 - GDF Suez/International Power), 2011/C 60/05. See also chapter VIII C 5 vii Gaz de France/Suez – Commission Decision of 14 November 2006.

⁹³⁰ Commission Decision 26 January 2011, COMP/M.5978, para 15.

⁹³¹ Commission Decision 26 January 2011, COMP/M.5978, paras 2-3.

International Power presenting 70% of that company's share capital. Accordingly GDF Suez would hold 70% of the share capital of a new International Power (itself enlarged by the GDF Suez shares) through Electrabel. GDF Suez would therefore be in sole control over International Power.⁹³²

As explained above competitive concerns regarding the Belgian electricity generation and wholesale market were raised. The Commission was of the opinion that the fact that International Power owned 33.3% of shares in T-Power in Belgium, which it also operated in, raised concerns. This was so since the proposed transaction would have given GDF Suez access to sensitive information as well as control and discretion over the T-Power plant. Thereby control and discretion over the operation of RWE Essent, the tollor of the T-Power plant and an entrant in the electricity market in Belgium and therefore a rival of GDF Suez, would be acquired by GDF Suez. Accordingly the transaction, as originally notified, would have led to a significant lessening of competition in the Belgian electricity markets.⁹³³

The remedies agreed upon were the divestment of all shares in T-Power held by International Power as well as all corresponding rights and obligations under any agreements signed between shareholders of T-Power. Furthermore the agreement entered into between T-Power and International Power for the operation and maintenance of the T-Power plant for the duration of the Tolling Agreement entered into between RWE Essent and T-Power had to be transferred.⁹³⁴

This structural remedy served to eliminate the competition concerns raised because of the co-shareholding in the power plant. The concerns were effectively remedied as broadly confirmed by the responses to the market investigation.⁹³⁵

6. Impact of Liberalisation

At the time of this thesis the report on the state of implementation of the internal energy market was not yet published.

⁹³² Commission Decision 26 January 2011, COMP/M.5978, paras 4-5.

⁹³³ Commission Decision 26 January 2011, COMP/M.5978, paras 117-118.

⁹³⁴ Commission Decision 26 January 2011, COMP/M.5978, para 121.

⁹³⁵ Commission Decision 26 January 2011, COMP/M.5978, para 141.

Nevertheless the Commission published a report on making the internal energy market work in 2012 which also describes the energy sector.⁹³⁶ The report describes major advances in recent years in the way the energy market works; nevertheless even more must be done to improve competition, integrate markets and respond to new challenges. It is essential to achieve full integration of Europe's energy networks and systems as well as opening up the energy markets. Especially necessary are furthermore investments into generation, transmission and distribution infrastructure and storage. Modernisation of existing energy systems is necessary too. The stimulation of fair competition is also mentioned as vital.⁹³⁷

Accordingly a deadline until 2014 was set to complete the internal energy market. By 2014 existing legislation needed to be fully implemented. At the time of the 2012 report the EU was not on track to meet its deadline since Member States were slow to adjust national legislation and create fully competitive markets. Importantly the need to move away from inward-looking and nationally inspired policies was mentioned as a goal. The Member States' slow implementation even threatens to unravel the progress made on the way to achieve an internal energy market.⁹³⁸

The report states that the generation in 2012 was still highly concentrated and in eight Member States more than 80% of power generation was still under control by the historic incumbent. Yet much has been achieved. More choice and flexibility for consumers have been accomplished. In 2012 at least fourteen electricity and/or gas companies were active in more than one Member State and there were more than three main electricity suppliers in twenty Member States. There was also more competitive pricing due to market opening, increased cross-border trade and market integration and stronger competition. Furthermore there were now more liquid and transparent wholesale markets due to improved market coupling. Finally there was more coordination and transparency in relations with third countries.⁹³⁹

⁹³⁶ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions 15 November 2013, COM(2012) 663, Making the internal energy market work.

⁹³⁷ COM(2012) 663, 2.

⁹³⁸ COM(2012) 663, 2-3.

⁹³⁹ COM(2012) 663, 3-5.

The report also mentions some areas where further benefits are expected soon. More power for consumers to control their energy costs or better control of consumption through smart technologies are two of those benefits. Also more competition through better access to transmission networks and more efficient use and development of grids are mentioned.⁹⁴⁰

What can be seen from this report is that important advances have been made; nevertheless there is still a long way to go until a competitive internal energy market is achieved. Since the EU is made up of 28 Member States it takes time to overcome national boundaries and therefore it is no wonder that the Third Energy Package, the use of Articles 7 and 9 of Regulation 1/2003 and the ECMR alone do not suffice to establish a competitive internal market. To accomplish an internal energy market it is also necessary to overcome national interests for the Member States to really achieve unity.

However, the fact that since 2010 only a single commitment decision with a structural remedy has been made and that the latest decision with a structural remedy according to the merger rules was made in 2011, indicates that the implementation of the Third Energy Package is a success so far.

⁹⁴⁰ COM(2012) 663, 5-6.

D. US approach in the Energy Sector

Especially in the energy sector the US faces a problem nearly unknown to the EU, i.e. governing an oligopolistic transportation network owned by both private and public undertakings. Furthermore historic market development resulted in highly concentrated local markets.⁹⁴¹ Accordingly deregulation was especially complicated to achieve in the US.

1. Electricity

Especially the generation of electricity can be subject to competition and has been the focus of most deregulatory actions in that sector. This industry is subject to a lot more vertical integration than the natural gas sector, as undertakings often possess their own generation, transmission and distribution systems. Furthermore, electricity cannot travel as far as natural gas without losing power, which highlights a territoriality issue. Unlike natural gas, electricity cannot be stored, which emphasises the ability to transmit electricity when it is needed.⁹⁴²

Even though throughout the world electricity power undertakings were typically vertically integrated, the US electricity industry was atypical in a number of ways. One of the most striking differences was the ownership structure. In the US the electricity power undertakings were primarily owned privately as opposed to state-owned outside the US. Another difference is that there were a very large number of electricity power undertakings. More than one hundred privately owned electricity power undertakings of varying sizes controlled the greater part of electricity resources in the US. As opposed to other countries horizontal integration was not as extensive in the US. Furthermore three synchronized networks compose the US electricity sector including some parts of Canada and Mexico: the Western Interconnection, the Eastern Interconnection and the Texas Interconnection. These networks were controlled by more 140 control areas, individual vertically integrated undertakings and groups of utilities. Accordingly complex operating protocols, bilateral agreements and multilateral agreements were necessary to facilitate

⁹⁴¹ *O'Neill*, Natural Gas Pipelines in Moss, Network Access, Regulation and Antitrust (2012) 113.

⁹⁴² *Aman*, Deregulation in the United States 296.

coordination between the transmission systems and trades of power as well as to minimise problems caused by free-riding. This decentralised structure of the electricity sector in the US caused an early development of wholesale markets. In the US nearly all retail consumers received electricity as a bundled product, i.e. generation, transmission, distribution and retail services, from the local monopolist acting as distributor. Prices were based on the average total cost of power generation by the distributor's own plants plus power purchased from third parties.⁹⁴³

a. *History of Regulation*

i. *Before the 1980s*

Most consumers were served by vertically integrated undertakings before the 1980s. These undertakings therefore performed all of the above described activities: generation, transmission, distribution and aggregation. Accordingly their services may be described as a bundled product. The undertakings in question usually rendered their services within an exclusive and specified local territory. Also many of the vertically integrated undertakings sold “bulk power”, i.e. generation and transmission, to wholesale customers. These wholesale customers themselves then distributed and aggregated. As for regulation, these undertakings were required under state law to serve at the retail level; a minority was obliged under a distinct federal law to transmit electricity for their competitors.⁹⁴⁴

In the 1970s the Congress wanted to reduce demand for fossil electricity sources and overcome reluctance to purchase from and/or sell power to so-called non-traditional facilities. This was influenced by the second Arab oil embargo around that time. New statutes were introduced, among them the Public Utility Regulatory Policies Act of 1978 (PURPA). This Act introduced wholesale sellers and thereby modified the market structure. Investors were now able to form or acquire “qualified facilities”, i.e. specialised generators. Such a specialised generator had to either be “small power producer” or a “cogenerator”. The “host utility”, i.e. the undertaking in whose service territory the “qualified facility” was located, could be compelled by the “qualified facility” to buy its

⁹⁴³ *Joskow*, Deregulation and Regulatory Reform in the U.S. Electric Power Sector in *Peltzman/Winston*, Deregulation of Network Industries - What's Next? (2000) 117-119.

⁹⁴⁴ *Hempling*, Regulating Public Utility Performance 72.

capacity and energy at a price equalling the “avoided cost”. Avoided cost was defined as *“the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source”*⁹⁴⁵. In case the host utility declined to buy it was obliged to transmit the output of the qualifying facility to a different, adjacent utility. Importantly, the qualifying utility could be any type of company, i.e. it was exempt from the requirement of “integrated public-utility system” of the Public Utility Holding Company Act (PUHCA). However, no more than 50 percent of the equity interest of a qualifying facility could be owned by a public utility or its holding company.⁹⁴⁶

ii. 1992

Congress passed the Energy Policy Act of 1992 (1992 Act) to inject some competition into the generation market since that act facilitated the development of non-utility generators. By amending PUHCA the 1992 Act allowed investors to create and/or acquire “exempt wholesale generators”. Just like the qualifying facility these “exempt wholesale generators” were exempt from the requirement of “integrated public-utility system”. Accordingly, generating companies had the opportunity to enter the wholesale markets anywhere which increased the number and types of competitors in the wholesale market. Unlike the “qualifying facility” the “exempt wholesale generator” had no right to compel a retail utility to buy its gas; however in contrast to the “qualifying facility” it could use any type of fuel.⁹⁴⁷

The 1992 Act further tried to encourage wholesale competition by allowing the Federal Energy Regulatory Commission (FERC), upon complaint, to order utilities owning transmission facilities to provide their services, i.e. transmission, to other undertakings on terms set by FERC.⁹⁴⁸ However, transmission is the key problem in this sector, since it is a natural monopoly⁹⁴⁹. This was also found by FERC after the introduction of the 1992 Act:

⁹⁴⁵ Conservation of Power and Water Resources, 18 C.F.R. §292,101(b)(6) (1978).

⁹⁴⁶ Hempling, Regulating Public Utility Performance 73-74.

⁹⁴⁷ Hempling, Regulating Public Utility Performance 74.

⁹⁴⁸ Hempling, Regulating Public Utility Performance 74.

⁹⁴⁹ Aman, Deregulation in the United States 296.

*”The ability to spend time and resources litigating the rates, terms and conditions of transmission access is not equivalent to an enforceable voluntary offer to provide comparable service under known rates, terms and conditions.”*⁹⁵⁰

Also only few prospective customers decided to file complaints, which was an unwieldy process. This weakness then led to Order No.888 in 1996.⁹⁵¹

iii. 1996

After recognising that the transmission facilities were bottlenecks, i.e. they were essential to competition, it was economically not possible to duplicate the transmission grids for competitors and they were controlled by the incumbent, FERC issued Order No.888.⁹⁵²

Order No. 888 FERC required nearly all transmission-owning public utilities to provide access to the transmission grid in exchange for a specific tariff. The role of ISOs is to provide that access through an independent decision-making process. Either by functional unbundling or divestiture the transmission facility must be transferred to ISO by the transmission-owning utility.⁹⁵³ Eligible customers included on the one hand wholesale power buyers and sellers and on the other hand buyers and sellers of retail power within states with authorised competition at retail level. As of April 2012 the District of Columbia and seventeen States allowed competition at the retail level.⁹⁵⁴

iv. *The California Power Crisis and Assembly Bill 1890*⁹⁵⁵

An interesting feature in electricity regulation is found in California. The California Power Crisis serves as an example where on the surface deregulation was attempted but actually badly designed sector-specific regulation created a market doomed to fail.

⁹⁵⁰ Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 61:92 Fed. Reg. 21540 (April 24, 1996).

⁹⁵¹ *Hempling*, Regulating Public Utility Performance 74. Order No.888, 75 FERC 61,080 (April 24, 1996) accessible via: <http://www.ferc.gov/legal/maj-ord-reg/land-docs/rm95-8-00w.txt>.

⁹⁵² *Hempling*, Regulating Public Utility Performance 74.

⁹⁵³ *Aman*, Deregulation in the United States 298-299.

⁹⁵⁴ *Hempling*, Regulating Public Utility Performance 75.

⁹⁵⁵ The Electric Utility Industry Restructuring Act, Assem. Bill 1890, 95-96, Reg. Sess, Ch. 854, 1996 Cal. Stat.

In 1996 the State legislature passed Assembly Bill 1890. Assembly Bill was intended to restructure the electricity industry in California so as to introduce competition. At first competition was only allowed for the wholesale power market. This meant that independent power producers were allowed to sell electricity to power distribution companies via a market run by the State. It was expected that this would result in lower prices since the power distribution companies were thought to buy from the cheapest producers.⁹⁵⁶

When taking a closer look at the Assembly Bill 1890 it becomes clear that this set of rules served rather to “re-regulate” than to deregulate. One set of regulatory laws was simply exchanged with another set of regulatory laws. After the passage of Assembly Bill 1890 the market was even more constrained than before.⁹⁵⁷

Even though the wholesale market was competitive the retail market still had fixed prices. So if the wholesale price rose above the retail price, the power distribution companies would have had to either sell at loss or not buying power to sell. However, the latter was no option since State law required them to sell electricity at a fixed price.⁹⁵⁸

A further problem was that the fixed retail prices were mandated to fall. This was based on the assumption that production costs would fall; however, the costs rose. Since the power distribution companies were by law forced to lower their prices they suffered high losses.⁹⁵⁹

Assembly Bill 1890 prohibited long-term contracts between power producers and power distributors. Since the power distribution companies could not enter into long-term contracts with power producers and therefore transfer the risk of rising costs to the latter, their losses could not be mitigated.⁹⁶⁰

Law obliged the distribution companies to sell most of their capacity to generate power. Had distributors owned production facilities too they could have made sure to have some

⁹⁵⁶ *Cole/Grossman*, Antitrust and Regulated Industries 384.

⁹⁵⁷ *Cole/Grossman*, Antitrust and Regulated Industries 384.

⁹⁵⁸ *Cole/Grossman*, Antitrust and Regulated Industries 384.

⁹⁵⁹ *Cole/Grossman*, Antitrust and Regulated Industries 384-385.

⁹⁶⁰ *Cole/Grossman*, Antitrust and Regulated Industries 385.

power in times of need. This was not the case. Accordingly the distributors participated in the market merely as buyers and not sellers.⁹⁶¹

A few years after the passing of Assembly Bill 1890 the State of California faced a higher demand due to the booming technology and arrival of many new residents. In 2000 gas supplies became tight; however, natural gas served as the main fuel for the most part of the generating companies in California. Accordingly the wholesale prices rose. Due to the retail price caps the distributing companies paid more for power than they earned. Consumers paid less than the market price electricity but were not told about the rising costs and the tightening demand on the market. They therefore did not get the chance to change their behaviour and conserve energy or lower their demand. There were also some power production facilities that engaged in specific schemes to lead the State authorities to believe that there was too much power in the market. That way they were paid to remove power. In reality there was not enough electricity in the systems and the distribution companies found it very difficult to meet the demand.⁹⁶²

These developments brought the distribution companies on the edge of bankruptcy and, to make it worse, power productions facilities feared that they would not get paid and sold less. Blackouts and a crisis throughout California followed in the late 2000s.⁹⁶³

In early 2001 the State of California started to undo the regulatory rules created in 1996. They capped the wholesale prices and increased the retail prices. They further decided not to go on with plans for retail competition and the State itself entered into long-term contracts. Since those contracts were made at the height of the crisis prices high above the long-term energy costs were agreed upon.⁹⁶⁴

One may describe the energy crisis in California as a failed attempt of deregulation. However, it was rather a failure of deregulation because contradictory legislation was introduced.

⁹⁶¹ *Cole/Grossman*, Antitrust and Regulated Industries 385.

⁹⁶² *Cole/Grossman*, Antitrust and Regulated Industries 385.

⁹⁶³ *Cole/Grossman*, Antitrust and Regulated Industries 385.

⁹⁶⁴ *Cole/Grossman*, Antitrust and Regulated Industries 385-386.

v. 1999

In 1999 FERC issued Order No. 2000⁹⁶⁵. This order served to encourage but not require utilities owning transmission grids to form and/or join “regional transmission organizations”. Such an organisation had to comply with Order No. 888. It had the obligation to control the transmissions systems of its members which made the “regional transmission organization” a public utility. Accordingly, it could serve multi-state regions. In California, New York and Texas however, they could only operate within the State boundaries.⁹⁶⁶

vi. 2005

In 2005 the Congress repealed the Public Utility Holding Company Act of 1935. This had the consequence that any type of undertaking may now own any type of utility asset and further perform any type of service function, in any location.⁹⁶⁷

vii. Today

Today competition at the wholesale level is possible anywhere and competition at the retail level is possible in certain States. Distribution remains a monopoly service since it has characteristics of a natural monopoly. This is similar to transmission where “regional transmission organizations” provide transmission services in their regions and in regions where they are not allowed to operate traditions utilities transmit electricity.⁹⁶⁸

Some States started a discussion as to whether some parts of the distribution service shall become subject to competition, for example metering.⁹⁶⁹

2. Natural Gas

In the US natural gas industry especially transportation and distribution were subject to monopoly power in the markets they served. Compared to the Electricity sector there is

⁹⁶⁵ Federal Energy Regulatory Commission, Order No.2000, 89 FERC ¶61,285 (December 20, 1999) accessible via: <http://www.ferc.gov/legal/maj-ord-reg/land-docs/RM99-2A.pdf>.

⁹⁶⁶ *Hempling*, Regulating Public Utility Performance 75.

⁹⁶⁷ *Hempling*, Regulating Public Utility Performance 75.

⁹⁶⁸ *Hempling*, Regulating Public Utility Performance 75.

⁹⁶⁹ *Hempling*, Regulating Public Utility Performance 76.

little vertical integration and the producers and interstate and local distributors are usually separate entities.

Nevertheless the US natural gas industry has some distinctive features. A uniform commodity is transmitted by displacement as opposed to discrete deliveries in other sectors like telecommunications. Furthermore natural gas networks are mostly privately owned and the market is oligopolistic as opposed to monopolistic. In the natural gas sector there is only little or no on-site storage and eminent domain is used to acquire land for the purposes of network expansion whereby an immediate public interest is created.⁹⁷⁰

a. *History of Regulation*

i. *Before the 1980s*

Before the 1980s the exploration and production companies sold the gas they had found and produced to large interstate pipelines. These pipelines transported the gas to the local markets, resold it on the wholesale level to local distribution companies and stored gas intended for future sales. Usually transportation and wholesale gas were sold as a bundled product by pipelines to the local distribution companies. Since the local distribution company often had only access to a single pipeline they had to buy their gas of that particular pipeline. Even though there was competition among producers for the sale of gas to pipelines there was little competition among pipelines for the sale and/or transport of gas. The local distribution companies operated within service territories defined by the state as state-franchised monopolies. Accordingly, they distributed and re-sold gas on the retail level; this was subject to state commission regulation.⁹⁷¹

The activities of the pipelines, namely transporting and wholesaling, were regulated under the Natural Gas Act of 1938 (1938 Act).⁹⁷² The Federal Power Commission (FPC) oversaw whether the pipelines adhered to the 1938 Act and certified the construction of

⁹⁷⁰ O'Neill, Natural Gas Pipelines 107.

⁹⁷¹ Hempling, Regulating Public Utility Performance 76.

⁹⁷² Natural Gas Act (NGA), 15 U.S.C. §717 et seq. (1938).

new pipelines. However, until 1954 the FPC did not have express jurisdiction to regulate producers' wellhead prices.⁹⁷³

In 1954 the Supreme Court issued the *Phillips*⁹⁷⁴ decision thereby interpreting the NGA so that the FPC was required to regulate wellhead prices. According to the decision producers selling gas to interstate pipelines were to be regarded as “natural gas companies” subject to the 1938 Act. As a consequence of this landmark decision the FPC experimented with a number pricing methods. These pricing methods led to the interstate markets being less attractive than intrastate markets from the viewpoint of the gas sellers. In the 1970s actual and anticipated gas shortages followed because of that. The congress was dissatisfied with the pricing methods of the FPC and therefore introduced the Natural Gas Policy Act of 1978 (1978 Act).⁹⁷⁵

This Act can be described as a major piece of legislation for deregulation in the US gas industry. Even though the 1978 Act injected competition into the sector, most of the deregulatory work was carried out by the Federal Energy Regulatory Commission (FERC). The NGPA firstly deregulated the wellhead price of a number of natural gas categories.⁹⁷⁶ To be more precise more than thirty classifications of gas were recognised in the 1978 Act; three of them involved production that would immediately sell gas at unregulated prices.⁹⁷⁷ Since then most deregulation has taken place through FERC.

ii. 1985

In 1985 FERC issued Order No. 436⁹⁷⁸ which provided for incentives to interstate pipelines to unbundle their services, i.e. their transportation and wholesale sales activities.⁹⁷⁹ Pipelines now had the opportunity to offer those services separately and customers had the chance to buy gas directly from the producer and hire the transport services of the pipeline. Order No. 436 further required pipelines to offer their

⁹⁷³ *Hempling*, Regulating Public Utility Performance 76.

⁹⁷⁴ *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

⁹⁷⁵ *Hempling*, Regulating Public Utility Performance 77. Natural Gas Policy Act of 1978, Pub L 95-621 (Nov. 9, 1978) accessible via: <http://www.gpo.gov/fdsys/pkg/STATUTE-92/pdf/STATUTE-92-Pg3350.pdf>.

⁹⁷⁶ *Aman*, Deregulation in the United States 291-296.

⁹⁷⁷ *MacAvoy*, The Natural Gas Market - Sixty Years of Regulation and Deregulation (2001) 15.

⁹⁷⁸ Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, 50 Fed. Reg. 42,805 (Oct. 18, 1985), 92 Stat. 3350.

⁹⁷⁹ *Hempling*, Regulating Public Utility Performance 77.

transportation services on a non-discriminatory basis. This was necessary since the pipelines were still able to offer their bundled service, i.e. sale at wholesale level and transportation.⁹⁸⁰

In 1988 FERC imposed Order No. 497⁹⁸¹ which included “Standards of Conduct” ensuring that pipelines were not allowed to provide to their affiliates superior access of information.⁹⁸²

Congress further passed the Natural Gas Wellhead Decontrol Act of 1989⁹⁸³ which served to remove price controls on wellhead sales from January 1993 onwards.⁹⁸⁴

iii. 1992

In contrast to Order No. 436, which was voluntary, the new Order No. 636 was mandatory.⁹⁸⁵ It was the most significant orders issued in the gas sector and broke up the traditional bundle of services which pipelines offered. Accordingly it unbundled sales, transportation and storage services.⁹⁸⁶

This order also prohibited for pipelines to sell bundled or unbundled gas. Upstream points of transportation services were exempt from that prohibition. In order to sell gas the pipeline undertakings had to create “marketing affiliates” operating independently from the business of the pipeline. Pipelines were also obliged to offer to their customers the following four services to match their needs: “no-notice” transportation services, access to storage, “capacity release” and the flexibility to choose receipt and delivery points.⁹⁸⁷

Customers receiving bundled services were given the right to switch to no-notice transportation services during the process of restructuring.⁹⁸⁸

⁹⁸⁰ *Hempling*, Regulating Public Utility Performance 77.

⁹⁸¹ Federal Energy Regulatory Commission, Order No. 497 (Jun 1, 1988) accessible via: <http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11625360>.

⁹⁸² *Hempling*, Regulating Public Utility Performance 77.

⁹⁸³ Natural Gas Wellhead Decontrol Act of 1989, Pub. L 101-60, 103 Stat. 157.

⁹⁸⁴ *MacAvoy*, The Natural Gas Market 16.

⁹⁸⁵ *Hempling*, Regulating Public Utility Performance 77. Federal Energy Regulatory Commission, Order No. 636 (April 8, 1992) accessible via: <http://www.ferc.gov/legal/maj-ord-reg/land-docs/rm91-11-000.txt>.

⁹⁸⁶ *Aman*, Deregulation in the United States 291-296.

⁹⁸⁷ *Hempling*, Regulating Public Utility Performance 78.

⁹⁸⁸ *Harrison/Morgan/Verkuil*, Regulation and Deregulation - Cases and Materials (2004) 147.

iv. 2000

In 2002 the market-oriented rules were further clarified by Order No. 637 and by 2002 the compliance process according to Order No. 637 was completed.⁹⁸⁹

v. 2005

FERC's authority to police the energy markets was strengthened by the EPA Act of 2005⁹⁹⁰ which served to increase criminal and civil penalties for NGA violations.⁹⁹¹

vi. Today

So far deregulation in the natural gas sector has been an economic and regulatory success.⁹⁹²

Wellhead gas prices are not regulated by federal laws. Interstate pipelines transport gas, but neither buy or resell gas; however, their marketing affiliates do so. Subject to the NGA FERC regulates the price of pipeline transportation. There are marketers and brokers in the industry. Marketers resell the gas they bought from the producers to local distribution companies or retail customers. They may be independent or affiliated with local distribution companies, pipelines or producers. They have to ability to re-bundle the sale of gas with transportation and storage. Brokers may also re-bundle; however, they cannot take ownership of gas or the capacity of the pipeline. Local distribution companies still have the ability to sell distribution and gas as a bundle. Furthermore, there are a number of States which allow the entry of competitors at retail level regarding the sale of gas. In these States the local distribution companies are obliged to deliver the gas consumers bought from marketers.⁹⁹³

3. Impact of Deregulation

As described above, all in all the deregulation of the electricity and gas markets has been a success. Nevertheless there are commentators arguing that the partial nature of

⁹⁸⁹ *O'Neill*, Natural Gas Pipelines 112.

⁹⁹⁰ Energy Policy Act of 2005, 42 U.S.C. §15801 et seq. (2005).

⁹⁹¹ *ABA*, Energy Antitrust Handbook (2009) 43.

⁹⁹² *Aman*, Deregulation in the United States 291-296.

⁹⁹³ *Hempling*, Regulating Public Utility Performance 78.

deregulation in the electricity sector is to be associated with lower levels of productive efficiency due to its complex environment for undertakings.⁹⁹⁴

One commentator suggests an interesting approach to regulation in the energy sector. In his opinion blending competition and cooperation would achieve the greatest benefit.⁹⁹⁵ A number of imperatives changed which is relevant for regulation:

“The first is focusing on regulating the network assets and services. Network assets have sunk natural monopoly characteristics. To the extent possible, create an ex ante approval process with a well-specific contract. A second imperative is not forcing network competition where cooperation is necessary for the network to work efficiently. A third is creating management incentives for the network that are compatible with policy objectives, for example protection of captive customers and efficient use. In other words, reward good management, not just capital investment. A fourth objective is avoiding tying non-network service that can be competitive to network services. It is an invitation to be mischievous and distort the market. Economies of scope arguments must be quantified and documented, not asserted. Fifth is focusing regulation on bad behaviour (while rewarding good behaviour) and establishing good institutions and incentives for competition to work. In other words, let players be rewarded for lower costs or higher quality. Finally, good governance structures for strong oligopoly markets are not well understood. Command-and-control, cost-of-service regulation is fading quickly in many markets. Laissez-faire approaches create more opportunity for behavior with negative effects on other players and society as a whole. A middle ground is evolving.”⁹⁹⁶

Establishing robust institutions allowing for changes in the conditions of the market and more decentralized decision-making is where regulation should turn to in the opinion of this commentator. Such market-based regulation is still missing and deregulation is only one option to achieve a competitive market.⁹⁹⁷

“Competitive market forces will substitute for many activities that were traditionally heavily regulated. However, this can only be effective if regulation is replaced by institutions that foster effective competition. To allow the market to continue to develop, regulation must ensure that the market is fair and open to all who can benefit from it. Such openness in markets runs counter to the understanding and interests of many parties accustomed to a regulated monopoly model of the industry.”⁹⁹⁸

⁹⁹⁴ Delmas/Russo/Montes-Sancho/Tokat, Deregulation, efficiency and environmental performance: evidence from the electric utility industry in Ménard/Ghertman (Eds.), Regulation, Deregulation, Reregulation – Institutional Perspectives (2009) 170 (173-175).

⁹⁹⁵ O'Neill, Natural Gas Pipelines 117.

⁹⁹⁶ O'Neill, Natural Gas Pipelines 117.

⁹⁹⁷ O'Neill, Natural Gas Pipelines 117-118.

⁹⁹⁸ O'Neill, Natural Gas Pipelines 118.

Even though this approach seems interesting it nevertheless is essentially arguing for more regulation and the establishment of even more regulatory agencies. With regard to the Capture Theory this does not seem constructive to me. In the US it would be better to aim for even more effective *ex-post* regulation, i.e. more emphasis on competition rules.

IX Comparison

A. Introduction

In this last chapter all the threads of the preceding chapters shall come together. I have started with explaining what regulated networks or network industries are, why they are so central for any society and what the economic theories behind them for regulating such network industries are.

Secondly, I set out how regulated networks in the EU are treated thereby highlighting the EU policy of complimentary use of sector-specific regulation and competition law. Moreover the two leading cases exemplifying this EU policy and underlining the differences in treatment to the US were mentioned and analysed in detail.

Thirdly, I did the same with regulated networks in the US, setting out the ever evolving US approach, the origins of the antitrust rules and the respective case law. As with the chapter on the EU, I set out the two leading cases exemplifying the US policy today in detail. Moreover I included the *Actavis* case, which even though it regards patents, may serve as an indication of a change of the US policy towards the relationship between sector-specific regulation and antitrust law.

Fourthly, both the EU and the US efforts of liberalisation of these regulated networks were set out to offer a full picture of the changed role of regulated networks in both sets of judicial systems.

Lastly, I chose to dedicate a chapter to the energy sector. This vital sector is in my opinion the best example of the EU policy of complimentary use of sector-specific regulation and competition law due to the extensive use of both to achieve the goal of an internal energy market that is competitive. Moreover the US energy sector is interesting as it shows how deregulation rules are implemented successfully as well as how reregulation or badly designed sector-specific regulation creates undesirable outcomes.

In this last chapter I will trace the differences I laid out so far back to their roots, i.e. I will explain where they come from. This will make it possible to compare the two

diverging approaches having regard to their different origins. Finally, I will set out which approach is preferable in my opinion and/or whether one approach is really preferable to the other having regard to the different judicial systems.

B. Diverging Case Law

The two main cases highlighting the differences between the US and the EU approach are *Trinko* and *Deutsche Telekom*. Interestingly the Supreme Court and Commission decisions were published within months in 2003-2004.⁹⁹⁹

In both cases the initial situation was similar: there was co-existence of regulation and competition and competition was not excluded by regulation. From that common starting point the cases went in the opposite direction.¹⁰⁰⁰

In the *Trinko* case the US Supreme Court clearly wanted to avoid the simultaneous application of both sets of rules. It seems that the US Supreme Court assumed that sector-specific regulatory regimes are so complete that they also perform an antitrust function. Since they couldn't use the implied immunity doctrine, the majority argued that § 2 of the Sherman Antitrust Act did not apply to the facts of the case and that the Telecommunications Act 1996 did not offer a basis to introduce a new exception to the rule that there is no duty to deal with competitors for dominant undertakings. This resulted in the inapplicability of antitrust rules where sector-specific regulation has the behaviour at issue covered.

In contrast the Commission (upheld by the General Court and the Court of Justice later on) applied competition rules, even though regulation had already been applied in the *Deutsche Telekom* case.

The question now is what the explanation for the different outcomes of these similar cases is.

⁹⁹⁹ Larouche, Contrasting legal solutions 78.

¹⁰⁰⁰ Larouche, Contrasting legal solutions 81.

1. Case-Specific Explanations

In the *Trinko* case a desirable outcome was produced by the FCC; however, in the *Deutsche Telekom* case the regulatory authority did not tackle the problem at issue well. But that difference alone cannot account for the different outcomes as there are good arguments why the margin squeeze test used by the Commission was not correct (e.g. artificially splitting monthly subscription from call rates).¹⁰⁰¹ It must be noted that also in the *Telefónica* case the regulatory authority did not produce a desirable outcome.

Also regulatory immunity (as in *Trinko*, *Credit Suisse* or *Linkline*) would have not been appropriate in *Deutsche Telekom* and *Telefónica* since in both cases the regulators were no effective steward of the antitrust function.¹⁰⁰²

Another difference may be that *Trinko* has precedential value as a Supreme Court decision whereas *Deutsche Telekom* may be viewed as an aberration not having the same value as the former. In the *Deutsche Telekom* case the defendant was somehow punished for the wrongs of the German authorities. The margin squeeze was only made possible because of low retail tariffs which had remained low since Germany had breached its obligations under Directive 90/388 to undertake tariff rebalancing ahead of 1998's liberalisation of the telecommunications sector. One may argue that an infringement procedure against Germany would have been more appropriate than a competition case against Deutsche Telekom. Nevertheless this in itself does not turn the *Deutsche Telekom* case into a peculiarity.¹⁰⁰³ The *Telefónica* case proves that *Deutsche Telekom* is a precedent of the same value as an US Supreme Court case. Furthermore, both leading EU cases were upheld by the Court of Justice.

Furthermore in the abovementioned EU cases the decisions were made on factual records in which clear abuse of dominance was found by the Commission. In contrast in the abovementioned US cases no factual evidence was taken since they were decided on motions to dismiss and the Supreme Court perceived that it was unlikely that significant anticompetitive harm occurred. Accordingly there might be a difference in cases where

¹⁰⁰¹ *Larouche*, Contrasting legal solutions 82.

¹⁰⁰² *Brunell*, Antitrust Law Journal 2012, 308.

¹⁰⁰³ *Larouche*, Contrasting legal solutions 82-83.

courts are confronted with clear evidence of anticompetitive behaviour and others where they doubt that serious competitive harm occurred.¹⁰⁰⁴

Nevertheless that standard for immunity under EU law is narrower than in the US. Under the Sherman Antitrust Act it was never required for implied immunity to take effect that an antitrust violation is to be compelled by regulation.¹⁰⁰⁵

From the case-specific explanations the argument that in the EU cases the NRAs were no effective steward of the antitrust function is the most convincing for the difference between the EU and the US approaches. However, can that alone explain the differing positions? I do not think so since the case law in the EU and the US before 2003/04 does not suggest so. In the EU it has always been the case that both sets of rules apply. In the US however, the case law moved from a traditional approach, where antitrust rules were essentially inapplicable in a regulated market to an approach of implied immunity. The regulatory authorities did not play a vital role in the formation of this case law.

2. Other Explanations

a. *Substance of Competition Law*

European competition law has a wide applicability and covers most major regulatory issues. Accordingly there is a substantive overlap between the two sets of rules in the EU which might explain why there is greater willingness in the EU to apply competition law for behaviour already covered by sector-specific regulation. However, this is not such a stark contrast to the *Trinko* decision where the majority indeed admitted that the presence of regulation might influence how competition law is to be interpreted. This may lead to a situation where competition rules apply in addition to regulatory rules. Accordingly differences in the coverage of competition do not explain the different outcomes in the *Trinko* and *Deutsche Telekom* cases.¹⁰⁰⁶

¹⁰⁰⁴ Brunell, Antitrust Law Journal 2012, 309.

¹⁰⁰⁵ Brunell, Antitrust Law Journal 2012, 309.

¹⁰⁰⁶ Larouche, Contrasting legal solutions 83.

b. Differing Conceptions of the Purposes of Dominant Firm Regulation

Most commonly the divergence between the two approaches to price squeezes have been traced to the differing conceptions of the purposes of dominant firm regulation in the EU and the US. This in turn resulted in different approaches to “refusal to supply” and the intersection of antitrust rules with sector-specific regulation.¹⁰⁰⁷

The EU is attracted to preserving an “equality of opportunity” for smaller undertakings to be able to compete against the dominant rivals. Commentators suggest that this focus does not translate into an exclusionary purpose or into consumer detriment.¹⁰⁰⁸ In this regard the *amici curiae* brief in the *Linkline* appeal from the Ninth Circuit Court of Appeals by a group of US antitrust professors and scholars headed by Bork and Sidak is interesting:

*“The alternative to consumer-welfare maximization is the view that antitrust law is simply one more tool of industrial policy, and thus its application may permissibly compromise consumer welfare to advance the welfare of competitors. Other nations evidently consider this normative proposition to be appropriate, if recent developments in the European Union are a valid indication. More than ever before, the United States and Europe appear to be at fork in the road over whether the law of monopolization exists to protect consumers or to ensure that a specified number of firms will profitably populate a market.”*¹⁰⁰⁹

They further state the following in their *amici curiae*:

“[...] the experience with price-squeeze cases brought by national competition authorities in Europe under Article 82 of the Treaty of Rome reveals the economic and factual complexity of correctly implementing the imputation analysis in an antitrust case. It becomes necessary to hypothesize what an efficient competitor would be and then determine whether the defendant’s wholesale and retail prices permit the efficient competitor to earn some level of profit deemed to be sufficient. This kind of analysis, however, merely underscores (1) that the primary concern in price-squeeze cases is not consumers, but competitors, and (2) that, in the American setting, the requisite analysis more resembles the work of a public utilities commission than that of a federal judge presiding over an antitrust case. By definition, the judge’s job as de facto rate regulator never ends because external forces will compel wholesale and retail prices to change over time, such that a given profit margin may shrink to

¹⁰⁰⁷ Hay/McMahon, The Diverging Approach to Price Squeezes in the United States and Europe, in *Journal of Competition Law & Economics*, 8(2) 2012, 259 (261).

¹⁰⁰⁸ Hay/McMahon, *Journal of Competition Law & Economics*, 8(2) 2012, 262.

¹⁰⁰⁹ Brief of Amici Curiae Professors and Scholars in Law and Economics in support of the Petitioners at 5, *Pac. Bell Tel. Co. v. Linkline Communications*, 555 U.S. 438 (2009) (No. 07-512), 2007 4132899, 4.

*jeopardize the survival of competitors. The perverse outcome is that price-squeeze litigation becomes a kind of enduring cost-of-service regulation that taxes the resources of a single district judge.*¹⁰¹⁰

Commentators suggest that due to the difficulty of imputing costs to vertically integrated telecommunications undertakings in markets subject to network effects where often the services are offered in a bundle, disadvantages may follow. This is so since requiring the incumbent in such a market to be mindful in its pricing decisions to avoid potential liability may impose unreasonable transaction costs which in turn may result in higher prices, the protection of inefficient rivals and obstacles to innovation and growth.¹⁰¹¹

i. *Equality of Opportunity*

In the *Deutsche Telekom* decision the ECJ (now Court of Justice) stated that undistorted competition between Deutsche Telekom and its rivals may only be guaranteed if “equality of opportunity” was secured between them.¹⁰¹² The question that follows is whether this may be regarded as a useful antitrust standard? Especially in markets which are highly regulated and where it is not easy to isolate costs, this may cause false positives and distort competition. The term equality of opportunity also lacks meaning in cases where the dominant firm is vertically integrated and the competitor a rival in the downstream market wanting access to the network. Also the concept of equality of opportunity is difficult to apply when the dominant firm is subject to sector-specific regulation and its competitors are not, e.g. unbundling, non-discriminatory access and universal services.¹⁰¹³

One can see that in the EU the totality of the competitive process is safeguarded as opposed to the US where the goals are efficient outcome and total welfare. The ECJ in *Deutsche Telekom* emphasised that Article 102 refers not only to practices causing consumer harm but also to practices having a detrimental effect on competition.¹⁰¹⁴ In contrast in the US under §2 of the Sherman Antitrust Act there is no duty to aid competitors. However, in EU antitrust case law the special responsibility of a dominant

¹⁰¹⁰ Brief of Amici Curiae Professors and Scholars in Law and Economics in support of the Petitioners at 5, *Pac. Bell Tel. Co. v. Linkline Communications*, 555 U.S. 438 (2009), 6-7.

¹⁰¹¹ *Hay/McMahon*, Journal of Competition Law & Economics, 8(2) 2012, 273.

¹⁰¹² CFI 10 April 2008, T-271/03, para 198 (see above chapter IVD.1 The *Deutsche Telekom* Case).

¹⁰¹³ *Hay/McMahon*, Journal of Competition Law & Economics, 8(2) 2012, 276.

¹⁰¹⁴ CFI 10 April 2008, C-280/08 P, para 176.

undertaking is emphasised.¹⁰¹⁵ This is evidenced by the focus in the EU to preserve rivalry and prevent foreclosure. This policy may be traced to the institutional and political history of the EU which prioritises market integration by setting out that competition in the internal market shall not be distorted. The EU fosters short-term competitive rivalry as, in its opinion, the best way to secure long-term investment incentives. In contrast the US goal is to promote economic efficiency as a way to promote consumer welfare.¹⁰¹⁶

It is therefore relevant to establish whether consumer detriment always is the consequence of a distortion of competition and a reduction of the equality of opportunity. This was so in *Deutsche Telekom* according to the ECJ.¹⁰¹⁷

The special responsibility doctrine for dominant undertakings in the EU highlights the difference in thinking in the US and the EU regarding the existence of dominant firms. This is related to protecting the competitive structure of the market. A responsibility or duty is placed upon private undertakings which is normally associated with public law duties. This suggests that dominant undertakings in certain situation should employ self-restraint.¹⁰¹⁸

Not only consumers and competitors are protected by EC competition law, but also trading partners. Since the functioning of competitive structures in the internal market is protected by EU competition law,¹⁰¹⁹ one may argue all relevant economic operators to the anticompetitive behaviour in question are to be protected.

However, the differing conceptions of the purposes of dominant firm regulation are not the reason for the differing approach but rather a factor to take account of when ruling in antitrust cases.

¹⁰¹⁵ Commission Decision 4 July 2007, COMP/38.784, para 278. In the corresponding footnote 238 the Commission referred to the judgment of the ECJ 9 November 1983, Case 322/81, para 57.

¹⁰¹⁶ *Hay/McMahon*, Journal of Competition Law & Economics, 8(2) 2012, 277-278.

¹⁰¹⁷ *Hay/McMahon*, Journal of Competition Law & Economics, 8(2) 2012, 278.

¹⁰¹⁸ *Szyszczak*, Fordham International Law Journal, 2010, 1755.

¹⁰¹⁹ *Azizi*, The Limits of Judicial Review concerning Abuses of a Dominant Position: Principles and Specific Application to the Communications Technology Sector, in Loyola Law and Technology Annual, 2009-2010, 149 (157).

c. *Regulatory Policy and Economics*

In the *Trinko* case the US Supreme Court discusses two rationales for keeping competition rules out of the realm of sector-specific regulation. The first one is the risk of false positives, i.e. competition rules intervening in a situation where these rules should rather not intervene. The second one is that courts applying competition rules are not in the position to exert the kind of control needed to implement regulatory types of obligations. Accordingly competition does not add value and is ineffective.¹⁰²⁰

Dogan and Lemley convincingly showed that the rationales and the criteria the court used to explain why sector-specific rules trump antitrust rules are actually not conclusive.

i. *Relative Expertise*

Even though it is true that antitrust courts are generalist courts and that regulators specialise in the particular industry the former still have two significant advantages over agencies.¹⁰²¹

Firstly, antitrust courts and regulatory agencies promote different things. For the former economic efficiency is the first and foremost objective to be achieved. Most antitrust scholars will agree that in past thirty years antitrust has been moved in the right direction by the courts, i.e. enhancing economic efficiency. Economic efficiency through competition is often not even intended by regulation. Legislators often have goals other than competition when establishing agencies. Indeed eliminating competition may be one of their goals in the respective industry. In the pharmaceutical sector an example may be that regulators care more about the safety or efficacy of a drug than about competition. When an agency is tasked to achieve goals other than competition it is indeed likely to ignore anticompetitive threats in the industry as long as they do not compromise their core mission. Also agencies tasked with goals including competition may not make it a priority due to a number of conflicting priorities.¹⁰²² Take the *Credit Suisse* case for example: Justice Breyer expressly pointed out that the SEC's goal is to improve market information

¹⁰²⁰ Larouche, Contrasting legal solutions 83-84.

¹⁰²¹ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 692.

¹⁰²² Lemley/Dogan, Texas Law Review, 87/4 March 2009, 696-698.

and considers competition among other objectives when setting regulation.¹⁰²³ It follows that an agency viewing competition as a secondary goal is less likely to establish rules and enforce them to encourage competition in an optimal way.¹⁰²⁴ In the EU cases *Deutsche Telekom* and *Telefónica* the NRAs put their goals, which were specific to the telecommunications sector, before the competition goals they should have adhered to too. Accordingly they did not take account of or interpreted the competition rules wrongly. This resulted in years of anticompetitive behaviour by the defendants which had negative effects on the consumers, the competitors and the defendants themselves as they had to pay high fines in the end. Moreover it were the undertakings concerned that had to pay high fines whereas the respective NRAs were not held accountable.

Finally, “*agencies are famously subject to ‘capture’ by the industries they are supposed to regulate*”.¹⁰²⁵ There are different forms of capture; the most obvious form is bribing or giving personal benefits. Another form is the already discussed Public Choice Theory¹⁰²⁶. So-called soft capture is another form of capture and may be described by lobbying.¹⁰²⁷ Here it is important to note that lobbying has a much longer tradition in the US than in the EU and is therefore more developed in the US. Since it may sometimes be difficult to acquire information on market conditions regulators may rely on lobbyists hired by companies to provide them with information.

*”Even if there are competing sources of information, interested parties can and do hire former employees, colleagues, or friends of the regulator to serve as lobbyists, and it is natural human instinct to trust those people more than strangers. And regulators tend to come from the industries they regulate, which may mean that they start out seeing things from industry’s perspective.”*¹⁰²⁸

In contrast the danger of being captured is much less likely with judges since antitrust courts’ goal is to achieve economic efficiency. Furthermore they handle cases in industries

¹⁰²³ *Credit Suisse Securities (USA), LLC v. Billing*, 127 S.Ct. 2383, 2396 (2007).

¹⁰²⁴ *Lemley/Dogan*, Texas Law Review, 87/4 March 2009, 698.

¹⁰²⁵ *Lemley/Dogan*, Texas Law Review, 87/4 March 2009, 698.

¹⁰²⁶ See chapter IIIA.2.e The Public Choice Theory.

¹⁰²⁷ *Lemley/Dogan*, Texas Law Review, 87/4 March 2009, 698-699.

¹⁰²⁸ *Lemley/Dogan*, Texas Law Review, 87/4 March 2009, 699.

they have no direct financial interest in and do not act to benefit their “agency”. Furthermore, both sides are represented in court proceedings.¹⁰²⁹

In this regard it is important to note what Areeda and Hovenkamp wrote about this issue:

*“[...] it often turn[s] out that the principal beneficiaries of industry regulation were the regulated firms themselves, which were shielded from competition and guaranteed profit margins.”*¹⁰³⁰

Also in the EU the danger of capture is high. Accordingly I argued above in the chapter on energy and the Third Energy Package that it may not be that advantageous to shift too much power from the government to the NRAs.

Accordingly it is wrong by courts to assume that competition is achieved only by regulators merely because they have more knowledge about the industry they regulate than courts.¹⁰³¹ Rather regulators should take account of antitrust rules and if a regulated company engages in anticompetitive behaviour the institution that is more capable of remedying the specific anticompetitive behaviour in question, i.e. the regulator or the court, should deal with the respective anticompetitive behaviour.

ii. *False Positives and False Negatives*

The risk of false positives, i.e. there being no antitrust violations but courts nevertheless finding them, outweighs the risk of false negatives according to the courts in the relevant decisions. Dogan and Lemley argue that this concern may have had some force in the past but not anymore.¹⁰³²

Recent history of antitrust decisions proves that it gets harder and harder for plaintiffs to win cases.¹⁰³³ Furthermore antitrust enforcement by the courts has changed dramatically as follows:

¹⁰²⁹ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 699-700.

¹⁰³⁰ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 700 citing *Areeda & Hovenkamp*, Antitrust Law (3d ed. 2006) at ¶241b2, at 293.

¹⁰³¹ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 700.

¹⁰³² Lemley/Dogan, Texas Law Review, 87/4 March 2009, 700.

¹⁰³³ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 700.

*”Courts in the last three decades have dismantled every per se rule applied to vertical conduct, limited the per se rule in horizontal conspiracies in a variety of ways, made it harder for plaintiffs to infer conspiracies, all but eliminated predatory-pricing claims, and substantially restricted the role of monopolization cases. Win rates for antitrust plaintiffs in at least one industry hover below 15%, and court rules make it harder and harder for antitrust plaintiffs to show standing to sue to enforce the laws that remain.”*¹⁰³⁴

*“The Antitrust Division, tasked with enforcing the antitrust laws, permits mergers to monopolize and seems to spend as much time arguing in favour of antitrust defendants as it does suing them.”*¹⁰³⁵

In my opinion *Linkline* is even stricter than *Trinko* and shows how the US approach shifts from implied immunity to immunity only. As described above it is also getting harder and harder for plaintiffs to win antitrust cases. These two developments may act as deterrence for plaintiffs to sue companies for damages according to the antitrust rules. One wonders whether these developments are on purpose to achieve that anticompetitive behaviour by a regulated network is dealt with by the regulator only and not by the courts. As will be described in detail below I believe that the complementary use of both sets of rules is more advantageous for the market and the consumers. We will have to hope, wait and see whether and how *Actavis* changes the current US situation.

An issue with regulated networks is whether there is something about their regulatory environment that makes them especially susceptible to false positives. In the *Credit Suisse* and *Trinko* cases this is true. In the former the behaviour at issue covered conduct forbidden by the SEC but hard to distinguish from allowed conduct. In *Trinko* the behaviour at issue was exactly the kind of conduct antitrust laws are directed at; accordingly mistaken condemnations may be too costly and likely chill business behaviour being actually legitimate.¹⁰³⁶

Dogan and Lemley rightly argue that there should be less concern about false positives since regulators can protect certain behaviour from antitrust scrutiny if they want to.

¹⁰³⁴ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 700 -701.

¹⁰³⁵ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 702.

¹⁰³⁶ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 703.

Furthermore in regulated industries the costs of false negatives is likely to be greater than the risk of false positives.¹⁰³⁷

In the US part of the devaluation of antitrust is attributable to fear of the US Supreme Court of sometimes considerable disadvantages of antitrust litigation, e.g. overdeterrence from private antitrust actions decided by generalist (i.e. non-expert) courts. In the EU such concerns are inapplicable since private rights of antitrust action are underdeveloped compared to the US. Cases in the EU are typically brought by competition authorities or the Commission.¹⁰³⁸

Accordingly the difference in the enforcement of private rights in antitrust action may seem to be a convincing reason why in the US there is the fear of disadvantages of antitrust litigation. Nevertheless in my opinion this is not convincing enough to make anticompetitive behaviour by regulated networks immune from antitrust rules in cases where that behaviour is covered by sector-specific rules. This is so because it seems like a pervasion of the judicial system to me to immunise certain behaviour from antitrust rules for fear that antitrust proceedings may be taken as a reason for the enforcement of private rights of antitrust action. It is the task of the courts to rule on allegedly unlawful behaviour and not doing so for the fear that there will be more court proceedings is not in line with the judicial system of a democratic country. If overdeterrence from private antitrust actions is viewed as dangerous then the rules on private actions have to be changed to take account of that or the courts simply deal with private actions in an appropriate way (as is their task anyways).

iii. *Duplication of Effort*

The US courts in *Trinko* and *Linkline* held that the value of antitrust enforcement is reduced since the regulatory agency can itself perform the function of protecting the market from anticompetitive behaviour. If they can really do so than this argument is

¹⁰³⁷ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 703.

¹⁰³⁸ Brunell, Antitrust Law Journal 2012, 312.

strong; however, in practice they will most of the times not be as effective guardians of a competitive market since they do not provide for as effective mechanisms as necessary.¹⁰³⁹

In the EU however, the Commission and national competition authorities enforce competition and even though they might not be as well-equipped as regulators they are still better equipped than courts in terms of resources and expertise. They can therefore handle situations where the two sets of rules intersect.¹⁰⁴⁰

d. *Legal and Constitutional Factors*

i. *Hierarchy of the Norms*

For Larouche the most convincing explanation for the different outcome in the *Trinko* and *Deutsche Telekom* cases lies at the constitutional level and involves the hierarchy of the norms.¹⁰⁴¹

In the US the Sherman Antitrust Act is a federal statute, even though it has some quasi-constitutional status. It follows that it can be affected by other federal statutes and can be interpreted by courts. The implied immunity doctrine, for example, is an interpretation in situations where there is extensive sector-specific regulation.¹⁰⁴²

In contrast competition law in the EU is enshrined in the EC Treaty and is therefore part of primary EU law. The ECJ (now Court of Justice) has never allowed that an industry is to be exempt from competition law. Legislation adopted on the basis of the EC Treaty by institutions of the Community is regarded as secondary EU law and can therefore not set aside primary EU law. Sector-specific regulation is also regarded as secondary EU law. Additionally, ECJ case-law cannot set aside primary EU law.¹⁰⁴³

¹⁰³⁹ *Lemley/Dogan*, Texas Law Review, 87/4 March 2009, 703-704.

¹⁰⁴⁰ *Larouche*, Contrasting legal solutions 84.

¹⁰⁴¹ *Larouche*, Contrasting legal solutions 84-85.

¹⁰⁴² *Larouche*, Contrasting legal solutions 85.

¹⁰⁴³ *Larouche*, Contrasting legal solutions 85.

In the *Deutsche Telekom* case the Commission (and also the CFI and the ECJ) emphasised that all actions of the German regulator are under competition scrutiny. Thereby the superior position of competition law in the EU was acknowledged.¹⁰⁴⁴

This is certainly a convincing explanation as the EU competition rules are part of primary EU law and sector-specific regulation - being merely secondary EU law - cannot set aside competition rules. However in the US the antitrust rules may be affected by other federal statutes, e.g. sector-specific regulation. Accordingly in the EU competition rules cannot be set aside by sector-specific regulation whereas in the US they can be set aside by sector-specific regulation.

ii. *Competition law as de facto regulation in the EU*

Commentators also suggest that in some circumstances competition law in the EU is applied not *ex post* to prevent abuses but rather as a form of *de facto* regulation in liberalised markets.¹⁰⁴⁵ The example they provide is the *TeliaSonera* case.¹⁰⁴⁶ It was alleged that this undertaking charged the prices to its wholesale access services to competitors and its broadband ADSL internet services to consumers at prices which did not cover the incremental costs the undertaking had incurred in providing the end user services. Unlike *Deutsche Telekom* and *Telefónica*, the wholesale and retail services of TeliaSonera were not subject to sector-specific regulation. The ECJ held that it is enough if there is reduced profitability or it is made more difficult for the undertakings concerned to trade on the market to constitute that the margin squeeze was capable of having an anticompetitive effect on the market.¹⁰⁴⁷

This approach is based on equality of opportunity and broadens the scope for margin squeeze liability in unregulated markets. However, describing competition law as a form of *de facto* regulation goes a bit too far in my opinion. If this would be true then also other rules, e.g. environmental laws, would have to be counted as *de facto* regulation. In the *TeliaSonera* case a margin squeeze was found; this was a typical EU competition law issue

¹⁰⁴⁴ Larouche, Contrasting legal solutions 85.

¹⁰⁴⁵ Hay/McMahon, *Journal of Competition Law & Economics*, 8(2) 2012, 282.

¹⁰⁴⁶ CoJ 17 February 2011, C-52/09, *Konkurrensverket v TeliaSonera Sverige AB*.

¹⁰⁴⁷ CoJ 17 February 2011, C-52/09, para 74.

where the Commission had to take action. The competition rules were applied within their boundaries and may not be described as *de facto* regulation.

iii. *Other Issues*

The US approach in *Trinko*, i.e. the diminished role for antitrust in regulated industries, is not easily transferable to the EU due to its historical and institutional context. In the US utility assets have traditionally been privately owned and the bottleneck issue in vertically integrated industries is actually considered a matter exclusive to regulation. In the EU, such utilities were traditionally owned by the state. Also supremacy of EU Community law and the duties imposed on the Member States differ from the US situation where the application of two federal statutes (Sherman Antitrust Act, Telecommunications Act of 1996) was at issue in the *Trinko* case. Harmonization in the EU and the liberalisation framework are in danger to be jeopardised by national interests.¹⁰⁴⁸ These issues are in my opinion certainly reasons for arriving at differing approaches but they can be solved. Nowadays liberalisation has come far; accordingly many former state owned undertakings are now privately owned. Also a solution for the conflict of norms in the US can be found through legal instruments.

Another difference is that different authorities apply regulatory and antitrust procedures at different levels. In the US there are state, inter-state and federal levels, whereas in the EU there are national and EU levels. This may lead to conflicting interpretations and/or inconsistencies.¹⁰⁴⁹ Furthermore there are procedural differences since in the US antitrust litigation is brought in civil courts whereas in the EU they rather follow an administrative procedure.¹⁰⁵⁰

In the US the courts weigh interests between what can be achieved under the regulatory framework and a costs-based evaluation of potential antitrust intervention. In *Trinko* the court considered the regulatory framework as effective steward of the antitrust function. In *Linkline* no attention was given to the regulatory framework since it was held that there was no antitrust duty to deal. Accordingly one could say that a claim regarding a regulated

¹⁰⁴⁸ Hay/McMahon, *Journal of Competition Law & Economics*, 8(2) 2012, 294-295.

¹⁰⁴⁹ Cavaleri, *Vanderbilt Journal of Transnational Law*, October 2010, 1110-1111.

¹⁰⁵⁰ Cavaleri, *Vanderbilt Journal of Transnational Law*, October 2010, 1119.

industry should first be brought to the regulatory authority and then only to a civil court when alleging that the antitrust function is not adequately protected under regulation.¹⁰⁵¹

A further difference is that in the EU there is no need to show that the abuse of a dominant position has a concrete effect since the notion of abuse is an objective concept. In the US, however, actual harm to consumers is required. One commentator describes this as the US position reflecting a preference for competition over the regulation of market performance by the government. In contrast Europeans seem less sceptic to the government as a regulator but rather they are more sceptical to private undertakings as servants of the public interest.¹⁰⁵²

Wood describes the US as distinct by tradition, resources, global economic power and military power. This distinctiveness is reflected in the antitrust laws; accordingly a global, unified approach is doomed to fail.¹⁰⁵³ I do not share his opinion and believe that in the future in an even more globalised world where business links between the EU and the US will become even stronger some kind of approach needs to be found to establish a level playing field without loopholes.

3. Implications

Refusal to supply is the most notable area of exclusionary abuse where there is a stark contrast between the EU and the US.¹⁰⁵⁴

A number of implications follow from this diverging approach. So-called “regulatory holidays” are worth less in the EU than in the US. In the EU only the threat of regulatory intervention is removed whereas competition law remains applicable. Another implication is that sector-specific tasks are left to the Member States to be carried out under respective national law. Competition law is primarily enforced by the Commission. This may give an impulse to economic regulation since competition law may indirectly discipline Member States in their application of sector-specific rules. A further implication may be that in the

¹⁰⁵¹ *Cavaleri*, Vanderbilt Journal of Transnational Law, October 2010, 1111-1113.

¹⁰⁵² *Cavaleri*, Vanderbilt Journal of Transnational Law, October 2010, 1116.

¹⁰⁵³ *Wood*, The U.S. Antitrust Laws in a Global Context, in Columbia Business Law Review 2004, 265 (279).

¹⁰⁵⁴ *Sher*, Abuse of dominance in the EU: the evolving law and practice, in PLC Cross-border Competition Handbook 2010:1, 9.

US regulated firms are comforted by the knowledge that antitrust rules do not apply to them and therefore they can concentrate on managing their relationship with the regulator. In the EU, however, dominant firms know about their special responsibility and have to respect both sets of rules. Additionally regulation in the EU may best be viewed as complementing competition law which could be described as economic regulation. Lastly from a dynamic perspective the EU approach is more advantageous. Regulation may only be necessary where competition law does not yet achieve the policy objectives and in a liberalised market there will be less regulation over time.¹⁰⁵⁵

Regulatory gaming is also a noteworthy implication which is why Dogan and Lemley criticise the US development in antitrust and regulation policy.¹⁰⁵⁶ They understand regulatory gaming “*as private behaviour that harnesses procompetitive or neutral regulations and uses them for exclusionary purposes*”.¹⁰⁵⁷ In their view antitrust courts have indeed included regulated industries in their purview. However, there was a change in the role of antitrust in the policy for regulated industries. A number of US Supreme Court decision, especially *Credit Suisse* and *Trinko*, have changed the relationship between sector-specific regulation and antitrust thereby placing the latter in a subordinate relationship. Even though some of these decisions may be justified on their specific facts they nevertheless caused courts and commentators to conclude that government regulation repeals antitrust rules.¹⁰⁵⁸

This is an unfortunate development since antitrust courts have better resources than regulators to deal with antitrust issues and can therefore achieve more efficient outcomes. According to Dogan and Lemley history taught us that reliance on regulation without considering and/or making use of antitrust rules would cause gaps in enforcement which competitors may exploit to the disadvantage of consumers. Ironically regulation actually existing to promote competition may create gaming opportunities for market participants. Regulatory gaming undermines one the one hand the regulatory system and on the other hand the complementary relationship between antitrust and regulatory rules. Dogan and Lemley argue that the risk of regulatory gaming is an example of why antitrust oversight of

¹⁰⁵⁵ Larouche, Contrasting legal solutions, 86-88.

¹⁰⁵⁶ Lemley/Dogan, Texas Law Review, 87/4 March 2009.

¹⁰⁵⁷ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 687.

¹⁰⁵⁸ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 685-686.

regulated sectors is indeed necessary. An example is product hopping in the pharmaceutical sector, i.e. changes in the respective drug's formulation by the branded company to prevent generic substitutes instead of making the drug more efficient. It is an antitrust question whether acts of regulatory gaming harm competition and not merely one interpreting agency regulations or statutes.¹⁰⁵⁹

A potential conflict between the two sets of rules has long been recognised by the US courts and in cases where government itself decided upon an anticompetitive end, antitrust rules were not applied. This has two reasons; worries regarding the relationship between federal and state relations and worries regarding the relationship between the administrative and the judiciary. This is still the rule today: deliberate actions by state which affect or destroy competition in the market are not regarded as antitrust violations. However, a similar immunity was not applied for private actions in regulated sectors.¹⁰⁶⁰ In *Silver v. New York Stock Exchange*¹⁰⁶¹ it was held that the antitrust rules were not pre-empted through the Securities Exchange Act even though the antitrust issue in this case, i.e. the membership in the stock exchange, was covered by the SEC rules.

*"[...] repeal [of the antitrust laws] is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary."*¹⁰⁶²

Trinko, *Credit Suisse* and *Linkline* clearly changed the traditional co-existence of the two sets of rules. This is cause for concern since both regimes are "*economic responses to market failures*". Judged by economic criteria "*virtually all*" economists, according to Dogan and Lemley, would agree that market competition overseen by antitrust rules is superior to sector-specific regulation. Also the criteria used by the US Supreme Court in the three cases above are no reason why regulation should be preferred to antitrust rules.¹⁰⁶³

¹⁰⁵⁹ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 686-688.

¹⁰⁶⁰ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 690-692.

¹⁰⁶¹ *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).

¹⁰⁶² *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963).

¹⁰⁶³ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 692.

Dogan and Lemley argue that “*antitrust courts are correct to defer to regulatory decisions themselves*”¹⁰⁶⁴. Antitrust rules must coexist with other laws and not trump them and if regulators are given control over a specific decision by law then this decision shall not be second-guessed by antitrust law.¹⁰⁶⁵

They are also of the opinion that regulatory gaming shall not be actionable if one’s viewpoint to persuade the regulators of their opinion is genuine and if the anticompetitive effects stem from the regulators’ actions and not from private actions. They shall be two exceptions to that suggestion, i.e. it only applies where the government is the relevant actor creating the rules and actively implementing them and secondly no false statements material to the decision-making process were made to the regulator.¹⁰⁶⁶

Finally “*antitrust law should not defer either to regulatory silence or to private action in the shadow of a regulatory structure*”¹⁰⁶⁷. This means that regulatory omissions are insufficient to pre-empt the antitrust rules.

Regulatory gaming is in my opinion a risk that always comes up when there are two (conflicting) sets of legal rules that may apply to the behaviour in question. Accordingly the risk of regulatory gaming regarding sector-specific rules and competition is clearly given. In this situation I too believe that competition in the market overseen by antitrust rules is superior to sector-specific regulation. However, if regulators are given control over a specific decision Dogan and Lemley argue that this decision shall not be second-guessed by antitrust law. In my opinion a decision shall not be second-guessed by antitrust law if account was taken of antitrust law before deciding. Furthermore I share Dogan and Lemley’s opinion that regulatory gaming shall not be actionable if one’s viewpoint to persuade the regulators of their opinion is genuine and if the anticompetitive effects stem from the regulators’ actions and not from private actions. However, the question is how this can be applied in practice. Whether anticompetitive behaviour of an undertaking due to the regulators’ action can really immunise the undertaking from liability is questionable. In the EU we have seen that the actions of the NRA were not seen as excuse but only as a

¹⁰⁶⁴ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 706.

¹⁰⁶⁵ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 706.

¹⁰⁶⁶ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 707.

¹⁰⁶⁷ Lemley/Dogan, Texas Law Review, 87/4 March 2009, 708.

reason to cut the fine by ten per cent. This was so since the undertakings in question should have known that their behaviour was anticompetitive; the same applies in my opinion to businesses in the US. It is in their responsibility not to take advantage of decisions of the regulatory authority but rather apply them in a way as not to engage in anticompetitive behaviour. Also, and I believe this is an important issue in practice, what happens with the damages (in the US even triple damages)? If anticompetitive behaviour is attributed to the fault of the regulator the damages the state or the consumers can receive will be much less than damages that the undertaking itself would have to pay.

In essence the US Supreme Court's expansion of regulatory immunity is a rather surprising development in an era of deregulation since it has long been thought that deregulation entails greater scope for antitrust laws in regulated industries. It is ironic that Europe, having a traditionally more hospitable attitude toward regulatory control than the US, has used antitrust as tool of liberalisation and deregulation while the US is currently moving towards displacing the antitrust rules in favour of regulatory remedies.¹⁰⁶⁸

In the US part of the devaluation of antitrust is attributable to fear of the Supreme Court of sometimes considerable disadvantages of antitrust litigation, e.g. overdeterrence from private antitrust actions decided by generalist (i.e. non-expert) courts. In the EU such concerns are inapplicable since private rights of antitrust action are underdeveloped compared to the US. Cases in the EU are typically brought by competition authorities or the Commission.¹⁰⁶⁹

In sum the US concerns over false positives resulting from private antitrust enforcement and a greater faith in regulators to perform the antitrust function are at least questionable. A strong presumption against implied immunity is important to ensure that both anticompetitive conduct in regulated industries is deterred and that deregulation is facilitated.¹⁰⁷⁰

¹⁰⁶⁸ Brunell, *Antitrust Law Journal* 2012, 280.

¹⁰⁶⁹ Brunell, *Antitrust Law Journal* 2012, 312.

¹⁰⁷⁰ Brunell, *Antitrust Law Journal* 2012, 312.

C. Other Relevant Differences

1. Deregulation

There are a number of differences between deregulation in the EU and the US. Firstly, deregulation is the result of a conscious economic policy choice which was adopted from the outset of the EU. Secondly, deregulation encompassed many industries in the EU. Thirdly, issues of federalism are more acute in the EU and the US. This is so because the EU is encompassed of 28 sovereign Member States. Accordingly it is not so easy for Brussels to impose liberalisation, i.e. market competition, on them and at the same time limit state aids, i.e. market protectionism. Finally, the relevant functions for achieving competition are bundled in DG Comp apart from state aid in the transportation sector.¹⁰⁷¹

Several conclusions may be drawn from these differences which also provide for contrasts between the experiences of deregulation in the EU and the US.

In the DG Comp there is essentially a bundle of antitrust enforcement and regulatory authority at the supra-national level. DG Comp is responsible for enforcing competition law, investigating and directing national liberalisation and enforcing the state aid rules. Additionally the individual Member States are also responsible for antitrust enforcement in some instances, deregulation and eliminating unlawful state aid. In contrast the American model is more fragmented. There is no single supra-national entity responsible for enforcement, deregulation and reduction of government protection. The EU approach is advantageous in that a central authority is able to develop and enforce a consistent competition policy to promote their competitive goals. However, there is a danger that one or the other issue will be neglected. Furthermore the complexity of the EU structure and organisation increases the likelihood that the liberalisation goals will not be achieved evenly in all sectors. Even though DG Comp is responsible for competition in the EU there are also other DGs responsible for other parts of the economy and sectors, e.g. DG Energy and Transport, which oversees these sectors. DG for the Internal Market and Services is responsible for the single European market.¹⁰⁷²

¹⁰⁷¹ *Farmer*, The European experience 180.

¹⁰⁷² *Farmer*, The European experience 181.

In the EU in some industries liberalisation has proceed more quickly and successfully than in others. For example the energy and financial sector industries in the EU may be liberalised but not yet fully competitive. Railroads remained highly regulated. Transportation and airlines were liberalised successfully.¹⁰⁷³

Barriers to EU-wide competition partly depend on the peculiarities of each industry sector. Some geographic markets are still national and cross-border competition is also an issue of relevance in this regard. However, e.g. these considerations do not really apply to the telecommunications sector but especially to the financial service sector.¹⁰⁷⁴

2. Mergers

Also regarding mergers the EU and US approaches are fundamentally different. The EU as an independent political entity is a recent phenomenon and the legislative history which underlies the founding documents reflects competition law theories differing in important points from US justifications. Also compared to US's history of nearly a century of merger control under the Clayton Act, the EU's merger legislation is relatively recent. In 1989 the first European merger regulation was adopted and amended in 2004. Furthermore, the EU is still evolving and thereby imperfectly mirroring the US federal system.¹⁰⁷⁵

3. Different Goals

One should not forget that the EU is a post-World War II creation motivated by different concerns than the founding of the US.¹⁰⁷⁶ Furthermore as explained in the foregoing chapters the EU goal is to achieve an internal market, consumer welfare and competitor welfare. In the US the current goal of antitrust law is to achieve consumer welfare only.

¹⁰⁷³ *Farmer*, The European experience 181.

¹⁰⁷⁴ *Farmer*, The European experience 181-182.

¹⁰⁷⁵ *Farmer*, The European experience 183.

¹⁰⁷⁶ *Farmer*, The European experience 184.

D. The Commission's Opinion

In a number of speeches Joaquín Almunia, former Vice President of the European Commission responsible for Competition Policy, said that competition policy and regulatory action go hand in hand to achieve a Single Market. Preserving the integrity of the Single Market is an objective of competition control.¹⁰⁷⁷ In another speech he described competition policy as a crucial factor in the overriding goal of building a Single Market. This has also been affirmed by the European Court of Justice.¹⁰⁷⁸

Almunia described the EU's work with former monopolists in telecommunications and energy markets as good illustration of the objectives of competition law.¹⁰⁷⁹ In that regard he described the breadth of competition law policy as follows:

*“Any attempt made by companies or governments to partition the Single Market or create unequal conditions in it becomes priority for the EU competition authority as a matter of course.”*¹⁰⁸⁰

In another speech he stated that the EU central competition authority together with the national competition authorities is responsible for preserving *“a level-playing field for every company that does business in the European Union”*¹⁰⁸¹. He also emphasised that the actions of EU competition policy shall benefit consumers but also create better conditions for any company intending to do business in the EU. Furthermore, he added that

¹⁰⁷⁷ Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, European and global perspectives for competition policy, (Speech at the IBA 9th Competition Mid-Year Conference, Sydney 21 March 2013) http://europa.eu/rapid/press-release_SPEECH-13-250_en.htm (accessed 10 October 2014); Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, Improving Europe's competitiveness in the global economy, The Future of Europe (Speech 17 January 2012, Brussels) http://europa.eu/rapid/press-release_SPEECH-12-11_en.htm (accessed 10 October 2014).

¹⁰⁷⁸ Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, Perspective from the European Commission: Competition as a tool for sustainable recovery (Speech at the 6th Annual Global Antitrust Enforcement Symposium, Georgetown Law/ Washington DC 19 September 2012) http://europa.eu/rapid/press-release_SPEECH-12-620_en.htm (accessed on 10 October 2014).

¹⁰⁷⁹ Almunia, European and global perspectives for competition policy, Speech at the IBA 9th Competition Mid-Year Conference, Sydney 21 March 2013.

¹⁰⁸⁰ Almunia, European and global perspectives for competition policy, Speech at the IBA 9th Competition Mid-Year Conference, Sydney 21 March 2013.

¹⁰⁸¹ Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, Time for the Single market to come of age (Speech at the ANZSOG & EABC Competition Policy Conference & Lunch, Melbourne 20 March 2013) http://europa.eu/rapid/press-release_SPEECH-13-243_en.htm (accessed on 10 October 2014).

a well regulated market economy is the best system to achieve prosperity and social development.¹⁰⁸²

In September 2013 Almunia gave a speech in New York where he described similarities and differences between EU and US competition law (policy). He stated that there is a similar understanding on unilateral-conduct enforcement in the EU and US. In his opinion both legal systems share the view that it is primarily about fighting against foreclosure as well as the exclusion of competitive undertakings by dominant ones. Furthermore there is agreement on the fundamental objective of competition laws, i.e. ensuring consumer welfare having regard to price, quality, innovation and choice. Finally, in both systems an analysis based on economic effects is crucial.¹⁰⁸³

He continued by stating that some aspects of the EU's abuse of dominance action are specific to the EU. Importantly he described that the differences stem from the fact that *"establishing a single European market is the wider object within which EU competition policy is enforced"*¹⁰⁸⁴. The competition rules in the EU are designed to tear down and prevent trade barriers within the EU raised by anti-competitive practices. He also mentioned that the EC Treaty does not confine the notion of abuse to specific behaviour; accordingly the Commission can employ Article 102 to a variety of practices that endanger competition.¹⁰⁸⁵

*"Sometimes this allows us to intervene in cases not covered by US law."*¹⁰⁸⁶

He further explained that the notion of abuse in the EU covers not only exclusionary practices (e.g. refusal to deal) but also exploitative practices, e.g. unfair or excessive

¹⁰⁸² Almunia, Time for the Single market to come of age, Speech at the ANZSOG & EABC Competition Policy Conference & Lunch, Melbourne 20 March 2013.

¹⁰⁸³ Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, Abuse of dominance: a view from the EU (Speech held at the Fordham's Competition Law Institute Annual Conference/New York 27 September 2013) http://europa.eu/rapid/press-release_SPEECH-13-758_en.htm (accessed on 10 October 2014).

¹⁰⁸⁴ Almunia, Abuse of dominance, Speech held at the Fordham's Competition Law Institute Annual Conference/New York 27 September 2013.

¹⁰⁸⁵ Almunia, Abuse of dominance, Speech held at the Fordham's Competition Law Institute Annual Conference/New York 27 September 2013.

¹⁰⁸⁶ Almunia, Abuse of dominance, Speech held at the Fordham's Competition Law Institute Annual Conference/New York 27 September 2013.

pricing. Therefore the EU can act directly against dominant firms overcharging for their services or products.¹⁰⁸⁷

He continued by stating that Article 102 applies to both state-controlled and private companies alike. This makes it possible to intervene where the dominant undertaking in question is controlled by a state. He further described that in newly liberalised markets, e.g. telecoms and energy, many incumbents tried to leverage their remaining monopoly power to adopt exclusionary practices to delay entry of new competitors.

Almunia further explained that the different economic and legal contexts in which US and EU competition law were established, the different institutional settings and finally the different legal traditions explain the development of US antitrust enforcement and of EU competition enforcement. He takes specific regard of margin squeeze and explains that in the EU this is a standalone abuse whereas in the US it is not considered an independent form of abuse. Referring to the *Linkline* Supreme Court judgment Almunia says that margin squeeze can be pursued in the US, but only as a regulatory duty to deal or as predatory pricing. The other difference between EU and US competition law in unilateral conduct cases is refusal to deal. Almunia states that the different treatment of these two kinds of abuse is less of problem today due to increased reliance in Europe on economic analysis of the effects of the alleged infringement on the market.¹⁰⁸⁸

In another speech Almunia said that network industries need stricter competition scrutiny than other industries to improve their pan-European integration as well as the general level of compliance with competition law. Special attention is also needed because of the reliance of a large proportion of the overall economic activity on them.¹⁰⁸⁹

All of this ties in very well with the EU and US judgments I have described in this thesis and the academic discussion around these issues. It also shows that the EU is aware (and I believe the US is aware, too) of the differences but does not see the diverging

¹⁰⁸⁷ Almunia, Abuse of dominance, Speech held at the Fordham's Competition Law Institute Annual Conference/New York 27 September 2013.

¹⁰⁸⁸ Almunia, Abuse of dominance, Speech held at the Fordham's Competition Law Institute Annual Conference/New York 27 September 2013.

¹⁰⁸⁹ Almunia, Perspective from the European Commission, Speech at the 6th Annual Global Antitrust Enforcement Symposium, Georgetown Law/ Washington DC 19 September 2012.

approaches as a problem big enough to change the EU position. Rather the diverging approaches are rooted in the different judicial systems and conceptions and therefore are specific to the EU and US and shall remain so. In my opinion judicial systems should remain dynamic which is essentially the case with legal regimes putting much emphasis on case law, e.g. the US. Accordingly, a change in the legal conception of an issue should surely be considered if that change can result in a more efficient outcome.

E. Which Approach is Preferable?

In my opinion there are a number of criteria which should be taken regard of when analysing whether a specific legal approach is advantageous or preferable to another. Firstly, the legal rules should be clear and not contradictory. Secondly, it should be possible to reach the policy goals set with the respective legal approach. Thirdly, effective and efficient enforcement is vital. Finally, legal certainty is necessary.

In the EU the complementary use of sector-specific regulation and competition, i.e. *ex ante* and *ex post* rules, makes it clear to the undertakings concerned that they have to obey both sets of rules. However, as seen in both the *Deutsche Telekom* and the *Telefónica* decisions contradictory rules or rather the application of sector-specific rules by NRAs having no regard to competition rules pose a significant problem in this regard. This problem has its roots on the one hand due to the fact that the EU is comprised of 28 Member States which implemented sector-specific rules differently and on the other hand due to the fact that NRAs and national competition authorities and the Commission pursue different goals as explained above. Accordingly dominant undertakings are always required to question the decisions of the respective NRAs and analyse them having regard to the EU competition rules. One may argue that this is a burden than stems from the special responsibility of dominant undertakings which in regulated industries usually derive their dominance from being the former national incumbents. Nevertheless the proportionality of this burden has to be questioned. Another relevant issue in this regard is who should be answerable when the NRA makes decisions inconsistent with competition rules? In the cases I mentioned above the Commission turned to the undertakings concerned instead of the respective Member States. In my opinion this was not only possible due to the discretion the Commission has, but also because it must have been clear

to the respective undertakings that the NRAs did not take regard to competition rules when making their decisions. Wouldn't it be preferable if NRAs do take regard of competition rules thereby aligning themselves with the national competition authorities? This could be a solution to the problems posed above. If decisions made by the NRA which were aligned with the national competition authority before turn out to be in breach with competition law than the Commission would have to turn to the Member State and not the undertaking concerned. Another option would be that undertakings ask the National Competition Authority for approval before implementing the decisions of the NRA in case they are not sure or have doubts about their compliance with competition rules. This is surely a burden on the National Competition Authority as it requires much more resources and there always remains the danger of action by the Commission against the respective Member States. However, if the undertakings can choose to ask the National Competition Authority for approval and do not do so the Commission could rightly turn to the respective undertakings if it considers that competition rules were not adhered to. It could also be an option that the undertakings pay a certain fee to the National Competition Authority to cover the costs for the assessment. On the other hand undertakings obey more sets of rules apart from sector-specific regulation and competition law, e.g. environmental or tax laws. It is normal for undertakings to take regard of all legal rules they are confronted with in their daily business. Accordingly it should not be too much to ask for if they themselves take all measures necessary to obey all kinds of rules that are applicable to them even if some seem contradictory on the surface.

In this regard the new CNMC in Spain is of relevance as it is an alternative to distinct authorities coming to diverging decision. This development shows that Spain rightly realised that an NRA not taking regard of competition law and not being an effective steward of the antitrust function is the weakest link in the chain. However, merging the respective authorities is not the solution to the question how to avoid diverging decisions. With this single powerful authority with only ten chamber members altogether there is the danger of politicization; but independence from government is vital for the achievement of the respective goals. It would be better if the respective authorities merely cooperate with each other or take account of each others goals and rules instead of forming a single authority with rather general knowledge.

In the US on the other hand the recent decisions in *Trinko* and *Linkline* made it clear that antitrust rules are in a subordinate relationship to sector-specific regulation. This caused courts and commentators to conclude that government regulation repeals antitrust rules. Even though both cases regarded a rather specific kind of abuse, namely margin squeeze, the US Supreme Court unfortunately made general statements about the relationship of sector-specific regulation and antitrust law. On the one hand this is advantageous since it serves for clear rules; however, as explained above, companies can now engage in regulatory gaming which is an unfortunate consequence of the above described decisions.

Accordingly even though the US rules seem to be clearer this is no way is preferable to the situation in the EU where undertakings are under more constraints that force them to obey all sets of rules regardless of who enforces them. This is so since in the EU both *ex ante* and *ex post* rules apply whereas the current position in the US is that merely *ex ante* rules apply. In this regard it is nevertheless necessary to take the US NRAs as a model since they are certainly better equipped to deal with behaviour falling under sector-specific regulation while at the same being in breach of competition rules.

As explained above the policy goals in EU competition law are somewhat different to those of US antitrust law. In the EU the goal is to reach a competitive internal market, consumer welfare and competitor welfare. In the US it seems like the current sole goal is consumer welfare even though at the time of the *Alcoa* decision competitor welfare was a policy goal too.

The complementary use of sector-specific regulation and competition law and the formers instruments is in my opinion the best way to reach the EU goals. Since the EU has 28 Member States it is a challenge to harmonize the laws for regulated industries between them so as to achieve a level playing field where competition can thrive. Accordingly it is necessary to use all possible means for the EU to reach its goal. The energy sector is a very good example since the Commission realised that sector-specific regulation did not go far enough and was too slow to achieve an internal energy market; accordingly early on the competition instruments of the ECMR and Articles 7 and 9 of Regulation 1/2003 were used to change the structure of the energy undertakings thereby changing the market structure and infusing competition into the markets. Even though a perfectly competitive

internal energy market has not yet been achieved the results since the late 1990s, i.e. less than two decades, are remarkable when taking regard of the fact that the EU is comprised of 28 Member States with both different history of regulation these sectors as well as different legal systems in use.

In the US however the goals of antitrust law seem to be changing over time. Currently it is consumer welfare only. I do not see how this goal can be reached when no regard is taken of competitors. When monopolies or dominant undertakings have only very limited duties to deal than competitors have a hard time to enter and stay in the market. If there is less competition prices will rise and output will decline; accordingly I do believe that consumer welfare can only be achieved if there is competition in the market. Competition can only be achieved if potential competitors get access to necessary or essential facilities. Once they are in the market then I believe the companies with the best products, services and prices will thrive and the other undertakings will be forced out of the market. Accordingly the market is able to regulate itself; however, one has to give potential rivals the chance to enter and prove themselves.

It follows that the current EU policy on the complementary use of sector-specific regulation and competition law is better suited to reach its policy goals as opposed to the US policy which does not take regard of the effects of competitor welfare due to limiting the duties to deal and interpreting the antitrust rules too narrowly.

As to effective and efficient enforcement a number of issues play a role in this regard. To enforce sector-specific regulation first and foremost NRAs are necessary which are equipped properly to enforce these rules effectively and efficiently. They need effective enforcement powers conferred on to them, enough resources and personnel and independency from the undertakings subject to them. The same applies to national competition authorities and courts.

In the EU the *Deutsche Telekom* and *Telefónica* cases made it clear that there is still a lot of room for improvement of the NRAs. In the US on the other hand the NRAs seem to handle cases such as the margin squeeze cases at issue in this thesis much better. However, as Dogan and Lemley remarked, capture is a risk with NRAs.

National competition authorities played actually no or only limited roles in the relevant cases which is rather extraordinary. In the EU the Commission and the Courts decided upon the cases thereby relying on factual records which clearly showed abuse of dominance in both cases. In the US the courts did not even really look into the cases as they merely decided upon motions to dismiss and the US Supreme Court perceived that it was unlikely that significant anticompetitive harm occurred.

In both the EU and the US the anticompetitive behaviour at issue was enforced; however, by different means. In the US the rather strong NRA fined the undertakings and asked for other remedies too. However, the anticompetitive behaviour at issue, i.e. margin squeeze was not recognised by the courts which was surely disadvantageous for the market and in turn for consumers. In the EU, however, the NRAs interpreted the competition rules wrongly (or rather not at all) and therefore the Commission and the EU Courts had to remedy the margin squeezes. Even though the NRAs and national competition authorities need to be strengthened, in the end the anticompetitive behaviour was better dealt with in the EU than in the US and this is what counts. This proves that the EU's complementary use of *ex ante* and *ex post* rules is better suited to tackle the competition problems regulated networks pose than merely using *ex ante* rules as in the US.

Legal certainty and the predictability of decisions by national authorities and national courts and in case of the EU also by EU institutions to a certain extent are necessary for undertakings to conduct their business and plan ahead.

In the EU both Deutsche Telekom and Telefónica criticised the Commission's decisions because in their opinion they lacked legal certainty since they were liable for breaching antitrust rules even though their behaviour was found to be in line with sector-specific regulation. Rightly the EU courts held that it is established case law that undertakings have to abide by both sector-specific rules and competition law. As explained above it is certainly unfortunate if the NRAs do not take regard of competition law when making decisions, however, it can be expected of (dominant) undertakings to behave in a way to obey the competition rules and not to take advantage of national sector-specific rules or decisions by NRA which may not be compatible with competition rules. Taking this into regard the EU policy of the complementary use of sector-specific regulation and competition law certainly does not lack legal certainty.

In the US I already explained that companies may now feel that they are exempt from antitrust rules when their behaviour is covered by sector-specific regulation. Certainly this serves for legal certainty; however, one should not forget that US case law is ever evolving and *Actavis* might be the milestone that changes the current US policy making it more similar to EU policy. Furthermore, as described above, some courts merely follow *Trinko* and *Linkline* in limited situations. It follows that in the US companies are only provided with legal certainty in certain situations, especially in those which are similar to the above described cases.

From what I have described the EU approach is preferable to the US approach in a number of ways. Nevertheless the EU approach is more than capable of improvement.

From an US viewpoint one commentator is of the opinion that the US is at crossroads moving from too much relaxation of regulatory oversight in some sectors to too much poorly designed reregulation in some sectors. This is due to mindless discussion based on ideology about the role of government in the economy instead of clear theoretical and empirical analysis of market and regulatory imperfections. Such discussion may be described as a regulation versus deregulation debate. It is better to analyse the specific market in question and then identify which set of rules may improve market conditions in the case at hand. Thereby one has to account of the specific attributes of the particular industry at issue as well as the products, undertakings and consumers.¹⁰⁹⁰

This is exactly the EU approach where the behaviour and the market are analysed to identify whether sector-specific regulation or competition law is better to deal with the respective behaviour.

However, due to the emphasis on deregulation in the EU in the past twenty years governments may feel that they should reduce the regulatory burden, i.e. sector-specific regulation since competition rules may preserve market competition well enough. This raises critique from commentators in the area of media markets which may well also fit

¹⁰⁹⁰ Joskow, Deregulation: Where Do We Go from Here (2009) 5-7.

with other regulated markets, i.e. regulatory solutions to perceived problems of the market may be inadequate to the specific facts of the case and miss the underlying issues.¹⁰⁹¹

I do not believe that this is the case as sector-specific regulation will always be necessary to regulate markets since each market has distinct aspects of different importance which need to be taken account of. Furthermore, competition law is no solution for all perceived problems in a market. It can be seen from extensive case law that competition law cases are analysed fact-specifically taking into account the specificities of the market in question, the undertakings and the consumers.

Nevertheless due to their special characteristics regulated networks are in my opinion - after having spent hundreds of hours on researching economic theories, policy issues and case law - best dealt with the complementary use of both sector-specific regulation and competition rules.

¹⁰⁹¹ *Feintuck/Varney*, Regulating Media Markets: The Need for Subsidiarity and Clarity of Principle in *Birkinshaw/Varney*, *The European Union Legal Order after Lisbon* (2010) 156-157.

X Conclusion

The doctoral thesis illustrated the differences between the EU and the US approaches regarding the treatment of regulated networks in competition law and compared them having special regard to case law as well as to the energy sector.

The chapter on the energy sector served to illustrate the EU policy of complimentary use of sector-specific regulation and competition law due to the extensive use of both to achieve the goal of an internal energy market that is competitive. Moreover the US energy sector shows how deregulation rules are implemented successfully as well as how reregulation or badly designed sector-specific regulation creates undesirable outcomes.

In sum I came to the following conclusions:

There are a number of possible reasons why differing decisions were made in *Trinko* and *Deutsche Telekom* even though in both cases the initial situation was similar: there was co-existence of regulation and competition and competition was not excluded by regulation. Some reasons are more convincing than others.

The most convincing reasons relate to regulatory policy, the historical and institutional context of the EU and the US and the hierarchy of norms.

In the *Trinko* case the US Supreme Court discussed two rationales for keeping competition rules out of the realm of sector-specific regulation: the risk of false positives and that courts applying competition rules are not in the position to exert the kind of control needed to implement regulatory types of obligations. Accordingly competition does not add value and is ineffective. In the EU the Commission and national competition authorities enforce competition and even though they might not be as well-equipped as regulators they are still better equipped than courts in terms of resources and expertise. They can therefore handle situations where the two sets of rules intersect. In regard to this reason I came to the conclusion that in reality these two rationales are no convincing reasons to keep competition rules out of the realm of sector-specific regulation.

Moreover, the US approach in *Trinko*, i.e. the diminished role for antitrust in regulated industries, is not easily transferable to the EU due to its historical and institutional context.

In the US utility assets have traditionally been privately owned and the bottleneck issue in vertically integrated industries is actually considered a matter exclusive to regulation. In the EU, such utilities were traditionally owned by the state. Also supremacy of EU Community law and the duties imposed on the Member States differ from the US situation where the application of two federal statutes (Sherman Antitrust Act, Telecommunications Act of 1996) was at issue in the *Trinko* case.

In my opinion the best and most convincing explanation is the hierarchy of norms since in the EU competition rules are part of primary EU law and sector-specific regulation - being merely secondary EU law - cannot set aside competition rules. However, in the US the antitrust rules may be affected by other federal statutes, e.g. sector-specific regulation. Accordingly in the EU competition rules cannot be set aside by sector-specific regulation, whereas in the US they can be set aside by sector-specific regulation.

The differing approaches lead to regulatory holidays being worth less in the EU than in the US. Also in the EU competition law may indirectly discipline Member States in their application of sector-specific rules; thereby giving an impulse to economic regulation. In the US regulated firms are comforted by the knowledge that antitrust rules do not apply to them and therefore they can concentrate on managing their relationship with the regulator. In the EU, however, dominant firms know about their special responsibility and have to respect both sets of rules. Finally, regulatory gaming is also an implication of the US approach.

To compare the differing approaches a number of criteria, which are relevant to determine whether a specific legal approach is advantageous or preferable to another, were taken into account.

Firstly, the legal rules should be clear and not contradictory. Even though the US rules seem to be clearer this is no way is preferable to the situation in the EU where undertakings are under more constraints that force them to obey all sets of rules regardless of who enforces them.

Secondly, it should be possible to reach the policy goals set with the respective legal approach. The current EU policy on the complementary use of sector-specific regulation

and competition law is better suited to reach its policy goals as opposed to the US policy which does not take regard of the effects of competitor welfare due to limiting the duties to deal and interpreting the antitrust rules too narrowly.

Thirdly, effective and efficient enforcement is vital. In both the EU and the US the anticompetitive behaviour at issue was enforced; however, by different means. Even though the NRAs and national competition authorities need to be strengthened in the EU, in the end the anticompetitive behaviour was better dealt with in the EU than in the US and this is what counts.

Finally, legal certainty is necessary. In the US companies may now feel that they are exempt from antitrust rules when their behaviour is covered by sector-specific regulation. This serves for legal certainty; however, one should not forget that US case law is ever evolving and *Actavis* might be the milestone that changes the current US policy making it more similar to EU policy. Moreover, some courts merely follow *Trinko* and *Linkline* in limited situations. It follows that in the US companies are only provided with legal certainty in certain situations, especially in those which are similar to the above described cases. Accordingly legal certainty in the EU is higher as undertakings know that both sets of rules apply to them.

In the end based on the above mentioned arguments I came to the conclusion that the EU approach is preferable to the US approach even though it should be improved.

Nevertheless one should not forget that we live in a globalised world with strong business links between the EU and the US and that therefore it would be best if the EU and the US choose an uniform approach that takes regard of the fact that a lot of and in the future even more of the dominant regulated networks in the EU and the US (will) operate in both judicial sets.

Accordingly the real question is not so much which approach is preferable but rather how the EU and the US can arrive at approaches that suit their policy goals, are not contradictory and take regard to the world becoming more and more globalised.

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B. List of Abbreviations

1992 Act	Energy Policy Act of 1992
1996 Act	Telecommunications Act of 1996
ABA	American Bar Association
ACER	Agency for the Co-ordination of Energy Regulators
ALCOA	Aluminium Company of America
AMC	Antitrust Modernization Commission
BEREC	Body of European Regulators for Electronic Communications
BGH	Bundesgerichtshof
CAB	Civil Aeronautics Board
CDGAE	Comisión Delegada del Gobierno para Asuntos Económicos
CEZ	ČEZ, a.s.
CFI	Court of First Instance (now General Court)
C.F.R.	Code of Federal Regulations
CLEC	Competitive Local Exchange Company
CMT	Comisión del Mercado de las Telecomunicaciones
CNMC	Comisión National de los Mercados y la Competencia
CoJ	European Court of Justice (now Court of Justice)
DC	Market Demand Curve
Deutsche Telekom	Deutsche Telekom AG
DG Comp	Directorate-General for Competition
DG Energy and Transport	Directorate-General for Energy and Transport
DG Internal Market and Services	Directorate-General for the Internal Market and Services
DOJ	Department of Justice
DSL	Digital Subscriber Line
DSO	Distribution System Operator
EC	European Community
ECHR	European Convention for the Protection of Human Rights and Fundamental Freedoms
ECJ	Court of Justice of the European Union
ECMR	European Community Merger Regulation
ECSC	European Coal and Steel Community
ECtHR	European Court of Human Rights
EdFI	EdF International
EnBW	Energie Baden-Württemberg
eresMas	Eresmas Interactive S.A.
ERGEG	European Regulators Group for Electricity and Gas
ERG	European Regulators Group for Electronic Communications Networks and Services
EU	European Union
FCC	Federal Communications Commission

FDA	Food and Drug Administration
Fed. Reg.	Federal Regulations
FERC	Federal Energy Regulatory Commission
FPC	Federal Power Commission
	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)
Framework Directive	
FTC	Federal Trade Commission
Hatch-Waxman Act	Drug Price Competition and Patent Term Restoration Act of 1984
ICT	Informations and Communications Technology
ILEC	Local Incumbent Monopolist Telephone Company
ISO	Independent System Operator
ISP	Internet Service Provider
LATAs	Local Exchange and Transport Areas
LEC	local exchange carrier
LNG	Liquefied Natural Gas
LRAC	Long Run Average Cost Curve
LRMC	Long Run Marginal Cost
MC	Marginal Cost
Microsoft	Microsoft Corporation
MR	Marginal Revenue
NGA	Natural Gas Act of 1938
NGPA	Natural Gas Policy Act of 1978
NRA	National Regulatory Authority
ONP	Open Network Provision
OSS	Operations Support System
OU	Ownership Unbundling
P	Price
P comp	Equilibrium Price
P mon	Monopoly Price
Par	Par Pharmaceutical
PSC	Public Service Commission
PUHCA	Public Utility Holding Company Act
PURPA	Public Utility Regulatory Policies Act of 1978
Q	Quantity
RBOCs	Regional Bell Operating Companies
RegTP	Regulierungsbehörde für Telekommunikation und Post
SC	Market Supply Curve
SEC	Security Exchange Commission
SMP	Significant Market Power
Solvay	Solvay Pharmaceutical
SvK	Svenska Kraftnät
Swb	Stadtwerke Bremen
TDATA	Telefónica Data de España, S.A.U
Telefonica	Telefónica S.A.

TERRA	Terra Networks España S.A.
TESAU	Telefónica de España, S.A.U
TFEU	Treaty for the Functioning of the European Union
TSO	Transmission System Operator
UNEs	Unbundled Network Elements
US	United States
Verizon	Verizon Communications Inc.
Wanadoo	Wanadoo Espana S.L.

XIII Annex

Abstract

Diese Doktorarbeit analysiert und vergleicht die juristische Situation in der EU und der USA hinsichtlich der Beziehung zwischen regulierten Netzwerken und Wettbewerbsrecht.

In einem generellen Kapitel über regulierte Netzwerke bzw. Netzwerkindustrien ist ausgeführt, worum es sich bei diesen Begriffen handelt und was die ökonomischen und rechtspolitischen Theorien sind, weswegen diese bis zu einem gewissen Grad reguliert werden müssen.

Die verschiedenen Ansätze hinsichtlich der Hierarchie der Anwendung von sektorspezifischen Regeln und Wettbewerbsregeln in der EU und der USA sind am besten in der EU Entscheidung zum *Deutsche Telekom* Fall und der *Trinko* Entscheidung des US Obersten Gerichtshofes erkennbar. Diese verschiedenen Ansätze sind daher für diese Doktorarbeit von zentraler Bedeutung.

In der Europäischen Union werden Wettbewerbsrecht und sektorspezifische Regeln nebeneinander angewendet. Der Europäische Gerichtshof hat im *Deutsche Telekom* Fall ausgesprochen, dass *ex post* Wettbewerbsregeln auch bei Existenz von *ex ante* sektorspezifischen Regeln anwendbar sind, außer wenn das System der sektorspezifischen Regeln dem dominanten Unternehmen keinen Spielraum lässt, der eine unabhängige Preisgestaltung erlaubt. Im *Telefónica* Fall wurde dieser Ansatz bestätigt.

In den USA hat der Oberste Gerichtshof im Urteil zum *Trinko* Fall festgehalten, dass es keinen Platz für wettbewerbsrechtliche Rechtsbehelfe gibt, wenn sektorspezifische Regeln anwendbar sind. Das kürzlich ergangene *Linkline* Urteil des Obersten Gerichtshofes hat diesen Ansatz sogar noch erweitert, indem klargestellt wurde, dass die Verpflichtung mit einem Wettbewerber zu handeln, wenn durch ein anderes Instrument als eine wettbewerbsrechtliche Anordnung auferlegt, wettbewerbsrechtliche Maßnahmen

ausschließt. Jedoch könnte der *Activas* Fall eine beginnende Änderung dieser Politik einläuten.

In weiterer Folge wird die Organisation von Netzwerkindustrien, die in der Europäischen Union und den USA in den letzten drei Jahrzehnten signifikante Änderungen durchgemacht haben, diskutiert. Die meisten dieser Netzwerkindustrien haben sich von vertikal integrierten Monopolen zu liberalisierten Unternehmen gewandelt. Zwei Kapitel über die Liberalisierungsanstrengungen in der EU und den USA veranschaulichen die geänderten Rollen der regulierten Netzwerke sowie die verschiedenen Ausgangspositionen für die Liberalisierung in der EU und den USA.

Im Kapitel über den Energiesektor werden die Liberalisierungsanstrengungen der EU und den USA im Detail dargestellt. Außerdem wird die EU Politik der komplementären Nutzung von sektorspezifischen Regeln und Wettbewerbsrecht, um das Ziel eines kompetitiven internen Energiemarktes zu erreichen, beschrieben. In den USA zeigt der Energiesektor wie Entregulierungsregeln erfolgreich umgesetzt wurden sowie das Reregulierung oder schlecht entworfene sektorspezifische Regeln zu unerwünschten Ergebnissen führen können.

Im letzten Kapitel werden die Unterschiede der zwei verschiedenen Ansätze zurück zu ihren Wurzeln verfolgt. Es folgt ein direkter Vergleich, der sich auf Kriterien bezieht, die meiner Meinung nach nötig sind, um eine erfolgreiche Rechtspolitik zu gewährleisten.

Das Ziel dieser Doktorarbeit ist eine Diskussion anzuregen, ob eine der beiden Rechtspolitiken zu bevorzugen ist und/oder ob die EU und die USA darauf abzielen sollten, einen globalen Ansatz zum Thema wettbewerbsrechtliche Behandlung von Netzwerkindustrien zu entwickeln, der Rücksicht auf die verschiedenen Jurisdiktionen nimmt.

Abstract

This thesis analyses and compares the legal situation in the EU and the US regarding the relationship between regulated networks and competition law.

In a general chapter on regulated industries or network industries it is set out what they are and what the economic and policy theories on why they need to be regulated to a certain extent are.

The different approaches regarding the hierarchy in the application of sector-specific regulation and competition law in the EU and the US are best evidenced by the EU decision in the *Deutsche Telekom* and the US Supreme Court decision in *Trinko*. These differing approaches are accordingly central to the thesis.

In the European Union competition law operates side by side with regulation. The Court of Justice stated in the *Deutsche Telekom* case that *ex post* competition rules will continue to apply despite the existence of *ex ante* sector-specific regulation, unless the system of sector-specific regulation confers upon the dominant firm no margin of freedom in which to pursue an independent pricing policy. This approach was followed in *Telefónica*.

In the United States the Supreme Court judgment in the *Trinko* case concluded that there was no room for antitrust remedies when sector-specific regulation was in place. The recent judgment of the Supreme Court in the *LinkLine* case takes that thinking one step further by clarifying that an obligation to deal, if imposed by an instrument other than an antitrust order, rules out the role of an antitrust action as regards that element of the offence. However, the *Actavis* case might indicate a change of this policy.

Next the organisation of network industries in the European Union and the United States has undergone significant changes in the past three decades. Most of these network industries moved from vertically integrated monopolies to liberalisation. Two chapters on the liberalisation efforts in the EU and the US follow to offer a full picture of the changed role of regulated networks as well as the different starting positions for liberalisation in the EU and the US.

In a chapter on the energy sector the liberalisation efforts in both jurisdictions are set out in detail. Furthermore, the EU policy of complimentary use of sector-specific regulation and competition law due to the extensive use of both to achieve the goal of an internal energy market that is competitive is described in detail. In the US energy sector is interesting to see how deregulation rules are implemented successfully as well as how reregulation or badly designed sector-specific regulation creates undesirable outcomes.

In the final chapter the differences between the two approaches are traced back to their roots. This is followed by a direct comparison having regard to a number of criteria that in my opinion are necessary for a successful legal policy.

The aim of this doctoral thesis is to stimulate the discussion as to whether one approach is preferable to the other and/or whether the EU and the US should aim to develop a global approach on the issue of the antitrust treatment of regulated network industries, taking account of their different legal systems.

NICOLE DANIEL, LL.B. LL.M.

Juristische Arbeitserfahrung

Seit 09/2010	Associate , DLA Piper Weiss-Tessbach (Rechtsanwaltskanzlei), Wien Abteilung: Litigation & Regulatory
07/2009 2 Wochen	Praktikum , Pritchard Englefield (Rechtsanwaltskanzlei), London
07/2008 1 Monat	Praktikum , Olswang (Rechtsanwaltskanzlei), Berlin
07/2007 1 Monat	Praktikum , Rechtsabteilung der BAWAG, Wien

Ausbildung

Seit 10/2012	Fellow , Stanford University, Transatlantic Technology Law Forum (TTLF) • Forschungsaufenthalt Stanford University im Oktober/November 2013 • TTLF Newsletter: Veröffentlichung von Artikeln in den Bereichen Wettbewerbsrecht und geistiges Eigentum in der EU und den USA
Seit 09/2011	Doktoratsstudium der Rechtswissenschaften , Universität Wien Dissertation: The Treatment of Regulated Networks in European and US Antitrust Law, having special regard to the Energy Sector • SE European and International Business and Technology Law Seminar • SE Europäisches Recht und jüdische Tradition - die Juden als Minderheit in der europäischen Rechtsgeschichte • Ergänzungsprüfung aus Zivilrecht • Ergänzungsprüfung aus Verfassungsrecht • VO Juristische Methodenlehre • KU System und wissenschaftliche Methode: Spinozas Ethik • Diverse anerkannte Fächer
09/2009 - 09/2010	LLM in Competition Law , King's College London • Competition Law and Regulated Network Industries • Economics of Competition Law • EC State Aid & State Regulation Law • Dissertation in EC Competition Law mit Prof. Richard Whish als Betreuer: Do Energy Cases under the Antitrust Rules require Structural Remedies?
07/2008	Mediator Zertifikat , Tulane Law School und Humboldt Universität Berlin

	International Summer School: Alternative Dispute Resolution
09/2005 - 06/2009	LLB in Law with German Law , King's College London <u>Jahr 4:</u> Competition Law, International Trade Law, Jurisprudence, Copyright & Designs, Patents & Breach of Confidence <u>Jahr 3: Auslandsjahr and der Humboldt Universität Berlin</u> Juristische Zeitgeschichte, Bürgerliches Recht - Grundkurs I und Grundkurs II, Öffentliches Recht -Grundkurs III, Seminar zum deutschen und europäischen Wirtschaftsrecht, Kommunikations- und Führungstraining <u>Jahr 2:</u> Tort Law, Land Law, Trust Law, German Law <u>Jahr 1:</u> Contract Law, Criminal Law, European Law, Public Law, German Law
1997 - 2005	Gymnasium , Zwi Perez Chajes Schule, Wien

Publikationen

Seit 2012	TTLF Newsletter: Veröffentlichung von Artikeln in den Bereichen Wettbewerbsrecht und geistiges Eigentum in der EU und den USA
Seit 2012	www.concurrences.com : Veröffentlichung von Artikeln in den Bereichen Wettbewerbsrecht und geistiges Eigentum in der EU und den USA

Auszeichnungen

2007/08	Auszeichnung als Jahrgangsbeste im Law with German Law Studium
2008	Stipendium für www.e-fellows.net für talentierte Studenten in Deutschland
2006/07	Auszeichnung als Jahrgangsbeste im Law with German Law Studium
1997-2005	Matura sowie jedes einzelne Jahr am Gymnasium mit Auszeichnung bestanden

Fertigkeiten

MS Office	Fortgeschritten, 5-jähriger Computerunterricht am Gymnasium
Sprachen	Deutsch (Muttersprache)
	Englisch, Ungarisch (Fließend)
	Hebräisch, Latein (Basiswissen)

Interessen

Sport	Fitnesscenter, Wandern, Schwimmen
Sonstiges	Lesen, Museen besuchen, Kochen, Malen, Reisen