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The Coming of Age of EU Regulation of Network Industries and Services of General Economic Interest

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The coming of age of EU regulation of network industries and services of general economic interest

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Abstract

This paper is a contribution to the 2nd edition of Craig and de Búrca, *The Evolution of EU Law*. It highlights key trends in EU law in the last ten to fifteen years, as regards the regulation of network industries and of services of general economic interest (SGEIs) more generally. Our central claim is that over the relevant period of time, EU law has been – and still is – in the process of moving from one legal paradigm to another. The first paradigm is more traditional, static, formalistic and self-contained (mono-disciplinary). Its hallmark is the use of legal definitions and concepts to create categories in which phenomena are placed, by way of pigeonholing or labeling, and to which consequences are attached. It was more appropriate in earlier times when EU law was concerned with establishing market access and realizing the Internal Market. The second paradigm is more dynamic, integrative and inter-disciplinary. Its hallmark is the use of general guidelines and principles to assess specific situations in a wider sectoral setting, with progressive refinement, until the point where a conclusion can be reached and consequences attached. It leads to 'managed competition', where EU law integrates other objectives besides market access.

As for substantive law, EU electronic communications law, since 2002, presents the best – albeit not complete – example of the new paradigm, with its reliance on technological neutrality and economic analysis. EU energy law has not gone as far down that path. Interestingly, the ECJ judgment in *Altmark* can be seen as an attempt to steer the law concerning SGEIs away from formalism, towards the new paradigm. However, developments following *Altmark* show that the other institutions have not fully followed the ECJ.

As for institutions, EU electronic communications and energy law have followed a similar path, away from formalistic separations (i) between EU and Member State institutions, (ii) along national borders or (iii) between regulation and competition law. At the same time, the separation between the regulatory authority and the national legislative and executive powers has been strengthened. The policing of SGEIs under Article 106(2) TFEU would benefit from following a similar institutional path.

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A. Introduction and background

This paper highlights key trends in the evolution of EU law in the period since publication of the first edition as regards the regulation of network industries and of services of general economic interest (SGEIs) more generally. We cannot and will not claim to make an exhaustive chronicle of all developments; this would be tedious and would vastly exceed the scope of this contribution.

Our aim is rather to take a more theoretical and critical view of the evolving relationships between the EU institutions, the market and the national state, from our perspective as legal academics with an inter-

disciplinary approach and with practical experience. The focus is primarily on two network sectors which have been the subject of extensive regulation – electronic communications and energy – and on the application of Article 106 TFEU to those sectors of the economy where the tensions between Community, state and market have remained, to quote the recent Monti report, a ' persistent irritant' in the European public debate.[1]

Our central claim is that over the relevant period of time, EU regulation of network industries has been – and still is – in the process of moving from one legal paradigm to another. This not merely a shift from State to market or indeed from State to Community. The process is more complex. It can only be understood by analyzing both the substantive rules as well as the institutional architecture as these have evolved over the past two decades.

The first paradigm, which EU regulation is moving away from, is more traditional, static, formalistic and self-contained (mono-disciplinary). Its hallmark is the use of legal definitions and concepts to create categories in which phenomena are placed, by way of pigeonholing or labeling, and to which consequences are attached. The underlying problems – including jurisdictional and enforcement problems – are thereby avoided. More specifically, that paradigm can be observed most clearly in instances where the law introduces a separation between two categories, whether in substance (liberalized or reserved services) or in the institutions (EU or Member State powers).

The second paradigm, towards which EU regulation is progressing, is more dynamic, integrative and inter-disciplinary. Its hallmark is the use of general guidelines and principles (based on economic insights) to assess specific situations in a wider sectoral setting, with progressive refinement, until the point where a conclusion can be reached and consequences attached. In other words this paradigm is characterized not by separation, rather integration (in substance as well as institutionally). It is not mono-disciplinary or formalistic, but draws on other disciplines to inform regulatory choice as well to guide assessment of regulatory outcomes.

As this paper will seek to explain, an analysis of the regulation of network industries, both in substantive and institutional terms, suggests that in any event EU law is shifting between a traditional formalistic pigeonholing model and more integrative model which seeks to manage competition and not just to guarantee market access.

This in turn has generated a multi-layered institutional structure in which the interaction of Community and state is by no means hierarchical or even based on a gradual linear transfer of key powers. The substitution of state control of complex economic sectors with a centralized or 'one-stop' institutional structure based on far-reaching or maximum harmonization of ex ante regulation has not been the pattern of institutional reform in the network sectors.

[1] M. Monti, *A New Strategy for the single Market, at the Service of Europe's Economy and Society*, Report to the President of the European Commission, 9 May 2000 at p. 73.

This legal evolution is not taking place in a vacuum. Our contention is that legal formalism may be better suited to a single-minded pursuit of market opening and market access, that is to the initial task of building a single market, which drove EU policy in the 1990s. Given that the single market was all but absent in network industries, tensions were bound to arise as ambitious liberalization projects were undertaken. It would then have been appropriate to use a formalistic model to establish market opening and market access firmly amongst the legal categories and defuse tensions by turning them into classification exercises. Starting from the 2000s, however, market opening and access becomes settled as a central policy objective, and at the same time other policy objectives which had taken a backseat in the 1990s re-assert themselves. For instance, the need to keep the European economy competitive and innovative requires a constant stream of investment in upgrading not only electronic communications, but also energy and transport infrastructures. Environmental concerns – including sustainability and climate change – dictate that the energy and transport sectors be managed and operated differently. These changes lead to social concerns about access, inequality and exclusion as network industries and public services undergo transformations. These concerns are not antithetic to market opening, quite to the contrary; they can probably more efficiently be addressed in an open market context. Nevertheless, we are moving from a single focus on market access and market opening to a more complex policy setting – which we term 'managed competition'. At the legal level, a formalistic paradigm may prove inadequate for managed competition, where many policy objectives intersect.

In the following pages, we will trace this process of paradigm shift, first, in relation to the substance of EU regulation of network industries, including also Article 106(2) TFEU as the central conceptual foundation for such regulation (B.) and, second, in relation to the institutions used for such regulation (C.).

B. Substantive law

As far as the substance of the law is concerned, the evolution of electronic communications law (1.) most vividly exemplifies the tension between the two paradigms exposed above, i.e. the shift from a formalistic to a more integrative approach. The existing regulatory framework, has, as recognized by the Monti report[2], been instrumental in market opening but has not yet created a single regulatory space for electronic communication. In the next section (2.), we will compare the evolution of energy law and the extent to which a paradigm shift has occurred here also. The challenges faced in both sectors are considerable but by no means identical. The energy market, unlike the electronic communications market remains dominated by the presence of natural monopolies – i.e. the transmission system networks. Although this may indeed justify a more formalistic approach, grounded in the first paradigm, strains and cracks in the system are now evident. Both telecommunications and energy related services and their infrastructures remain highly fragmented along national borders. Finally we will turn to certain general substantive developments under Article 106(2) TFEU (3.). As mentioned, this article remains of

[2] Ibid. at 44.

paramount importance for non-harmonised sectors but its interplay with secondary legislation is also reflective of the gradual paradigm shift identified in this paper.

1. Electronic communications law

In the run-up to liberalization, from the 1980s through the lifting of remaining monopolies in 1998, EU regulation essentially turned around the dividing line between liberalized services and reserved services which could be kept under monopoly. The original liberalization package of Directive 90/388 kept under 'reserved services' all of the infrastructure as well as 'public voice telephony' – the latter concept being defined in a very intricate fashion in order to allow, broadly speaking, fixed telecommunications services to business customers to be liberalized.[3] Even if 'public voice telephony' might sound restrictively defined, in fact more than 80% of the sector as it existed at the time was left in the reserved services category. In legal terms, the road to telecommunications liberalization throughout the 1990s is a story of how the borderline between reserved and liberalized services was progressively shifted until no services were reserved any longer: first came mobile and satellite communications,[4] then cable TV networks,[5] then infrastructure used to provide liberalized services (so-called 'alternative infrastructure')[6] and finally the removal of all remaining monopoly rights on 1 January 1998.[7] Throughout the period, the mechanics of regulation, as laid out in the various amendments to Directive 90/388[8] and in the set of parallel directives enacted under what is now Article 114 TFEU,[9] was simple: sets of reserved and non-

[3] Commission Directive (EEC) 90/388 on competition in the markets for telecommunications services [1990] OJ L 192/10, Art. 1(1).

[4] Commission Directive (EC) 94/46 amending Directive 88/301/EEC and Directive 90/388/EEC in particular with regard to satellite communications [1994] OJ L 268/15.

[5] Commission Directive (EC) 95/51 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 [1995] OJ L 256/49.

[6] Commission Directive (EC) 96/19 amending Directive 90/388/EEC with regard to the implementation of full competition in telecommunications markets [1996] OJ L 74/13.

[7] Ibid.

[8] Dir 90/388 (n 3 above), as amended by Dir 94/46 (n 4 above), Dir 95/51 (n 5 above) and Dir 96/19 (n 6 above).

[9] Council Directive (EEC) 90/387 on the establishment of the internal market for telecommunications services through the implementation of open network provision [1990] OJ L 192/1 (as amended by EP and Council Directive (EC) 97/51 amending Council Directives 90/387/EEC and 92/44/EEC for the purpose of adaptation to a competitive environment in telecommunications [1997] OJ L 295/23), Council Directive (EEC) 92/44 on the application of open network provision to leased lines [1992] OJ L 165/27 (as amended by Dir 97/51), EP and Council Directive (EC) 97/33 on interconnection in Telecommunications with regard to ensuring universal service and interoperability through application of the principles of Open Network Provision (ONP) [1997] OJ L 199/32, EP and Council

reserved (liberalized) services were defined, and then key regulatory issues concerning reserved services and their interface with liberalized services (interconnection, universal service) were dealt with, together with market access to the provision of liberalized services (licensing).

(a) First step out of formalism: the ONP 1998 framework

In 1996-1997, as the EU institutions debated the regulatory framework to be applied after liberalization, as of 1 January 1998, it became clear that since the reserved/non-reserved services dichotomy would vanish, regulation would have to be articulated along different lines. Fundamentally, the issue is why regulate, or in other words, where to find the justification for regulation, if any, now that no special or exclusive rights remain. Broadly speaking, there are three possible answers to that question:

- *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 required to address that risk.

In Directive 96/19, the full liberalization directive based on Article 106(3) TFEU, the Commission did not reflect at length on the foundation for future regulation, knowing that the provisions of the Directive would be superseded by the more extensive Open Network Provision (ONP) network then being debated in Council and Parliament.[10] It chose a decidedly historic approach, attaching regulation to 'telecommunications organisations', meaning those firms which once held special or exclusive rights.[11] Given that these firms are easily identifiable, regulation continued to be articulated around the formalistic paradigm described above.

Directive (EC) 98/10 on the application of open network provision (ONP) to voice telephony and on universal service for telecommunications in a competitive environment [1998] OJ L 101/24 and EP and Council Directive (EC) 97/13 on a common framework for general authorizations and individual licenses in the field of telecommunications services [1997] OJ L 117/15.

[10] As reflected in the text of Articles 4a, 4c of Dir 90/388 (n 3 above, as amended by Directive 96/19, n 6 above).

[11] Ibid.

In the course of preparing the ONP 1998 directives,[12] the EU institutions had to take a more forward-looking approach. So the institutions were left to choose between technology and economics as the main articulation for regulation. A choice was made in favour of the latter, but it is neither clearly worked out nor applied consistently. Heavier regulation is made to rest on firms holding Significant Market Power (SMP), but SMP is defined rigidly as a 25% share[13] of one of a series of pre-defined markets.[14] The content of such regulation is already determined in the directive itself. Furthermore, the ONP 1998 framework must still bear with technical definitions such as 'telecommunications network', 'telecommunications service', including 'public' networks and services, as well as 'interconnection', 'network termination point', etc.

(b) The 2002 framework as the best example of integration

The current regulatory framework for electronic communications (2002 framework) – often referred to as the "new regulatory framework" – resulted from the review of the ONP 1998 framework. It is embodied in four directives enacted in 2002.[15] This framework provides the best illustration so far of the integrative paradigm in the regulation of network industries in the EU.

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*.

As regards reliance on economic analysis, the 2002 framework is no longer built around a set of categories to which consequences are attached, rather it relies on economic analysis. The main component, the SMP regime, mimicks competition law analysis. In a first step, markets are defined and selected for further analysis (without being pre-determined in legislation[16]). Subsequently, the degree of

[12] N 9 above.

[13] With the possibility to stray from the 25% threshold either way: Dir 97/33 (n 9 above) Art 4(3).

[14] These are defined peremptorily in Annex I of Directive 97/33, ibid. as (i) fixed public telephone network, (ii) fixed public telephone services, (iii) leased lines as well as (iv) interconnection for mobile networks and services.

[15] EP and Council Directive (EC) 2002/19 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive) [2002] OJ L 108/7, EP and Council Directive (EC) 2002/20 on the authorisation of electronic communications networks and services (Authorisation Directive) [2002] OJ L 108/21, EP and Council Directive (EC) 2002/21 on a common regulatory framework for electronic communications networks and services (Framework Directive) [2002] OJ L 108/33, EP and Council Directive (EC) 2002/22 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) [2002] OJ L 108/51, to which one should add Commission Directive (EC) 2002/77 on competition in the markets for electronic communications networks and services [2002] OJ L 249/21.

[16] The first Recommendation on relevant markets, Commission Recommendation 2003/311 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for

competition on these selected relevant markets is assessed with a view to identifying firms holding SMP. SMP is defined as dominance by another name. Thirdly, if one or more firms are found to have SMP, remedies are imposed. These remedies are chosen from a list of available remedies found in legislation,[17] however that legislation does not prescribe any specific remedy for any given case. The relationship between the 2002 framework and competition law has always been controversial. At the substantive level, the initial stance was that the 2002 framework was actually incorporating by reference key competition law concepts such as relevant market definition and dominance. Indeed the Commission seems to consider that the analysis conducted under the 2002 framework has precedent value for competition law.[18] Yet at the same time the subsequent evolution has brought some distance between the two: the Recommendation on relevant markets made it clear that market selection was a crucial step in the application of the SMP regime. The 'three-criteria test' used for market selection – high and persistent barriers to entry, limited prospect for effective competition behind such barriers, comparative inefficiency of competition law – obviously entails economic analysis, but it has no equivalent in competition law.[19] It merges certain elements of relevant market and of market power analysis into a stand-alone analytical step which does capture the specificities of a network industry like electronic communications, i.e. the presence of high and persistent barriers to entry in some parts of the industry, essentially due to sunk costs or network effects. So in the end the 2002 framework shares with competition law the reliance on economic analysis, but it does not necessarily follow the same analytical mold. After all, the 'relevant market – market assessment – remedies' trilogy, characteristic of competition law, is not the only way to incorporate solid economic analysis into law.

The universal service regime provides another example of reliance on economic analysis. According to the Universal Service Directive,[20] Member States are not obliged to impose universal service obligations,

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electronic communication networks and services [2003] OJ L 114/45, was based on a list of markets found in Annex I to Dir 2002/21, ibid. but the second one was established without prior legislative determination: Commission Recommendation 2007/879 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services [2007] OJ L 344/65.

[17] Regulatory authorities can also propose other remedies, subject to Commission approval: Dir 2002/19 (n 15 above) Art. 8(3).

[18] See P. Larouche and M. de Visser, "The triangular relationship between the Commission, NRAs and national courts revised" (2006) 64 Communications & Stratégies 124.

[19] Recommendation 2007/879 (n 16 above) para 2. In fact, it can be argued that market selection is the 'triggering factor' that is most material in the outcome, much like 'abuse' is the triggering factor in the application of Article 102 TFEU (given that dominant firms will not infringe Article 102 TFEU unless they abuse their position).

[20] Dir 2002/22 (n 15 above) Art 3, 8-14.

for example if market forces would suffice to ensure that a service meeting the requirements of the definition of universal service is provided. If they determine that universal service obligations must be imposed, then the addressee of the obligations must be assessed in an open, transparent and non-discriminatory procedure (including for instance an auction). Financial compensation on the addressee, if any, is limited to the net costs of providing universal service, and then only if that represents an unfair burden on the addressee (taking into account, for instance, the intangible benefits arising from providing universal service and the administrative costs of running a compensation mechanism). The financial compensation mechanism itself must be transparent and minimize distortion to the market.

Technological neutrality is often overlooked, yet central to the advances brought about by the 2002 framework. It is explained somewhat vaguely as 'neither impos[ing] nor discriminat[ing] in favour of the use of a particular type of technology'.[21] Technological neutrality can be defined in many ways.[22] A weak definition would not go much beyond a simple non-discrimination rule, but that would limit the added value of the principle, considering that non-discrimination is already a well-established legal principle. A stronger definition would entail that the law is drafted and applied in such a way as to be sustainable over time against the background of diverse and evolving technologies, i.e. that the law is not tied to a specific technological model. A third and strongest definition, with a more economic underpinning, would imply that the law avoids influencing or distorting technological choices, leaving them to market forces as much as possible. The second and third definitions are mutually reinforcing and should be preferred, as they give technological neutrality its fullest meaning. In any event, just like the reliance on economic analysis shows that the EU lawmakers chose to base regulation on economic justifications, the principle of technological neutrality evidences *a contrario* that the lawmakers did not want to build the 2002 framework on technological categories and concepts. To be sure, some of the further implementing decisions may be open to criticism as regards technological neutrality,[23] but by and large the EU and its Member States have sought to live by that principle.

Once a choice is made in favour of economics as opposed to technology as the main justification for regulation – as enshrined in the two principles discussed above – the resulting framework will unavoidably tilt towards the second paradigm. So it can be seen that the mainstay of the 2002 framework, the SMP regime, eschews pigeonholing: the definitions of 'electronic communications networks' and 'electronic communications services', for instance, have been broadened to cover all

[21] Dir 2002/21 (n 15 above) Rec. 18.

[22] I. van der Haar, *The principle of technological neutrality: connecting EC network and content regulation* (2008), upon which the following discussion is based.

[23] See for instance the continued reluctance to include broadband networks based on cable TV, on the one hand, and on ADSL, on the other hand, on the same market for the purpose of SMP analysis: Recommendation 2007/879 (n 16 above) and the Explanatory Note, C(2007)5406 (17 December 2007), p. 31.

conceivable types of networks and services provided over such networks,[24] 'interconnection' has been repositioned as a subset of access,[25] the distinction between public and non-public networks and services has been downplayed, to name but the main ones. What remains is a light regulatory framework applicable across the board to all market players, plus a heavier regime for firms holding SMP. The SMP regime does not work with pigeonholes, rather it comprises a series of guiding principles,[26] with an analytical framework,[27] and offering a choice of possible remedies.[28] Throughout, the 2002 framework relies on economic concepts and therefore takes an inter-disciplinary approach; it cannot be administered using traditional legal methods only. It is meant to be applied by a specialized National Regulatory Authority (NRA), working on the basis of a Commission recommendation indicating which markets must be reviewed. The Commission recommendation and the NRA decisions are reviewed periodically, ensuring that regulation evolves in tune with the sector.[29]

(c) Remaining instances of separation

Unfortunately, some remainders of the formalistic paradigm can still be found in electronic communications regulation, in the form of strict separation between two categories.

For one, the whole of EU electronic communications regulation is itself put in a box, namely that of 'networks' or 'transport' as opposed to 'content', i.e. what is carried on over the networks. Content regulation is expressly left outside of the 2002 framework.[30] Instead, it is covered in two directives, the Audiovisual Media Services Directive (formerly 'Television Without Frontiers')[31] and the E-commerce

[24] This was the outcome of one of the key policy discussions which fed into the 2002 framework, concerning the convergence between the telecommunications, media and ICT sectors: see Green Paper on the Convergence of the Telecommunications, Media and Information Technology Sectors, and the Implications For Regulation, COM(97)623 (3 December 1997) and the subsequent consultation rounds.

[25] This did not eliminate all game-playing around definitions, given that Dir 2002/19 (n 15 above) Art 4 extends the obligation to negotiate interconnection only to the benefit of providers of public electronic communications networks: the ECJ became entangled in this issue in Case C-227/07 *Commission v Poland* [2008] ECR I-8403.

[26] Common to the whole of the 2002 framework: Dir 2002/21 (n 15 above) Art 8.

[27] Dir 2002/21, ibid, Art 14-16.

[28] Dir 2002/19 (n 15 above) Art 9-13, Dir 2002/22 (n 15 above) Art 17.

[29] Indeed, when revising the first Recommendation on relevant markets (n 16 above), the Commission removed 11 markets from the list , to reflect the changes which took place between 2003 and 2008.

[30] Dir 2002/21 (n 15 above) Rec 5, Art 1(3) and 2(c).

[31] Council Directive (EEC) 89/552 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) [1989] OJ L 298/23, as amended by EP and Council Directive (EC) 2007/65 amending Council

Directive.[32] This creates an intricate system of pigeonholes, whereby services are supposed to fall under one and only one of the following: "electronic communications services",[33] "Information Society services" (falling under the e-commerce Directive)[34] or "audiovisual media services".[35] Considering the rapid rate of innovation in this sector and the efforts deployed to find the "killer application", such a pigeonholing approach can only hamper the development of the sector by forcing firms to navigate around the definitions to seek the preferred regulatory regime, instead of simply ensuring that their activities are in line with public policy objectives as they may be articulated in regulation. For instance, in the recent reform of broadcasting regulation, most energies were dedicated not to reconsidering the appropriateness and the manner of regulation in a converged environment, but rather to chisel away at the definition of "broadcasting" (or linear) and "on-demand" (or non-linear) audiovisual media services in order to position certain services within one or the other box, or outside of them altogether.[36] As a result of this separation between network and content (and within content between the various types of services), a key issue such as network neutrality, which involves the relationship between content providers and network operators, cannot be addressed within the SMP regime, for instance.[37] It falls to be dealt with either in specific legislation or via EU competition law.

Secondly, the separation between competition law and sector-specific regulation – at the systemic level – also hampers the proper evolution of the sector. Even though sector-specific regulation and competition law are closely aligned in substance as was seen above, the mainstream opinion remains that the two realms are fundamentally different: for instance, competition law would be operating *ex post* and would aim at preserving existing competition on the market, whereas sector-specific regulation would be imposed *ex ante* and would aim to increase the level of competition on the market. In separate writing, one of us has sought to demonstrate that these distinctions cannot hold and that the

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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 [2007] OJ L 332/27.

[32] EP and Council Directive (EC) 2000/31 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce) [2000] OJ L 178/1.

[33] Dir 2002/21 (n 15 above) Art 2(c).

[34] Dir 2000/31 (n 32 above) Art 2(a).

[35] Dir 89/552 (n 31 above) Art 1(a).

[36] Ibid., Art 1(a), (e) and (g), as well as Directive 2007/65 (n 31 above) Rec. 16-25. See also van der Haar (n 22 above).

[37] F. Chirico, I. van der Haar and P. Larouche, 'Network Neutrality in the EU', TILEC Discussion Paper 2007-30, available on SSRN at http://papers.ssrn.com/abstract=1018326.

two realms are largely overlapping.[38] In any event, 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. The evolution of electronic communications law in the past decade tends to show that, even if sector-specific regulation is withdrawn in certain areas, it appears in others.[39] Sector-specific regulation will accordingly not disappear anytime soon. 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.[40] From such a public choice perspective, then, it might have been preferable to emphasize that some regulation could remain in place, as long as it was no more than necessary and closely integrated with competition law, instead of separating the realms of competition law and regulation.

2. Energy

Europe's energy sector has been radically transformed from a highly monopolistic, vertically integrated, state-owned or -controlled sector, organised on national lines and focused on national policy objectives. Although the goal of establishing a single energy market remains a complex and laborious task which is far from complete, few would disagree that the sector is now competitive, or could deny that the institutional changes that have taken place since the adoption of the first internal energy market legislation in the mid-1990s are considerable.

The first and second 'packages' of internal energy market legislation conformed to the established approach to network sectors – to ensure market access by removing formal, national regulatory and organisational barriers which had served to privilege incumbent national energy companies. The first directives of 1996 (electricity)[41] and 1998 (gas),[42] were framework measures, leaving substantial discretion to Member States on the speed of liberalisation as well as the method to accomplish it.

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[38] See P. Larouche, "A closer look at some assumptions underlying EC regulation of electronic communications" (2002) 3 Journal of Network Industries 129-149.

[39] For instance, since the 2002 framework was enacted, regulation of mobile operators has increased, with regulatory intervention on mobile termination, international roaming, SMS termination and international data roaming.

[40] For one, the most regarded NRA, Ofcom, has taken the habit of launching broad consultations – on the FCC model – on various topics of interest, in order to assess whether and if so, which regulatory intervention is warranted. See in recent years the Strategic Review of Telecoms or the Next Generation Access consultation round, to name but the main ones.

[41] EP and Council Directive (EC) 96/92 concerning common rules for the internal market in electricity [1997] OJ L 27/20.

[42] EP and Council Directive (EC) 98/30 concerning common rules for the internal market in natural gas [1998] OJ L 204/1.

Unsurprisingly, traditional market privileges enjoyed by state-dominated incumbents – including import/export rights, as well as monopolies over the production and transport of gas and electricity were removed. Ensuring access to national networks and to national markets for new players was however the principal aim of both the first and second packages. Thus a twin-track approach was first elaborated in 1996: the unbundling of the natural monopolistic functions of the 'TSOs' (transmission system operators) and the introduction of ex ante regulatory functions which were to be separated out from operational functions.[43] Whereas many national energy incumbents had been entrusted with wide-ranging public service obligations (PSOs) which included responsibility for maintaining energy security and reliability of supply as well as the provision of electricity and gas at low cost to all users, the adoption of the first directives heralded the end of that golden age. Competitive, open markets would ensure security and reliability as well as consumer choice.

(a) The second regulatory package of 2003

Subsequent regulation elaborated on this twin track approach. In 2003 when the second package of internal market measures was adopted,[44]the concept of functional unbundling or separation was further elaborated upon and the directives required further legal separation of the transmission function, so that TSOs had to create separate legal entities to operate their networks and to put in place various 'firewalls' and compliance codes to prevent covert discrimination in favour of their own production or trading subsidiaries. Distribution companies were subject only to administrative unbundling, however. A larger group of consumers, extending to all 'non-domestic' users became eligible to choose a supplier either from another Member State or from a national competitor to the local incumbent. By July 2007 all consumers were eligible to choose their suppliers. In order to protect vulnerable consumers, additional regulatory concepts such as 'suppliers of last resort' and universal supply obligations were now introduced.

The second package of 2003 Directives also sharpened sectoral regulation to a certain extent.[45] Member States now had to designate independent national regulatory authorities (NRAs). In addition, two Regulations on cross-border trade in electricity and in gas entrusted these bodies with enhanced ex ante powers, not just to regulate transmission access tariff methodologies and conditions, but also to address

[43] See M.M. Roggenkamp (ed.) *Energy law in Europe : national, EU and international law and institutions* (2nd ed 2006).

[44] EP and Council Directive (EC) 2003/54 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC [2003] OJ L 176/37; EP and Council Directive (EC) 2003/55 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L 176/57; EP and Council Regulation (EC) 1228/2003 on conditions for access to the network for cross-border exchanges in electricity [2003] OJ L 176/1 and EP and Council Regulation (EC) 1775/2005 on conditions for access to the natural gas transmission networks [2005] OJ L 289/1.

See generally, C. Jones and W. Webster, *The Internal Energy Market* (2nd ed., 2006).

complex technical issues, such as congestion management – that is, the allocation of capacity available in the energy networks, balancing and ancillary services. The Commission was empowered to extend and deepen this process through the comitology procedure. This in turn has allowed for the development of a further trend: the increasing harmonisation of technical or so-called non-essential measures, as well as tariff methodologies, at European level, with a concomitant decrease in national sovereignty. Economic decisions, i.e. on tariff rates, remain with the member states. Thus a further layer of separation has emerged between economic and technical regulation on the one the one hand, and national and European energy legislation on the other. Member States continued to enjoy considerable freedom to regulate production and supply activities, however, subject only to minimal harmonization requirements. The Directives did not confer on NRAs any powers to deal with market power or its abuse; this is left to competition law. In so far as market forces did not deliver, the remedy was to be found essentially in the application of competition law by the Commission or the national competition authorities (NCAs), as opposed to *ex ante* regulation The activities of TSOs, pigeonholed as natural monopolies, are the main focus of harmonized ex ante regulation. In the 2003 directives,TSOs are also deemed to be primarily responsible for guaranteeing security of supply as well as preferential access to the network for renewable energy. In so far as new investments were to be undertaken by non-TSO parties, an elaborate exemption procedure was introduced to encourage the construction of cross-border infrastructure. At the same time, however, the second package failed to provide a harmonized regulatory framework to co-ordinate national decision making on cross border issues – national legislation was harmonized but trade across national borders could not benefit from any form of joint decision-making.

Indeed, that this form of pigeonholing would soon reach its inevitable limits, is illustrated by the recent *Federutility* case,[46] where the Court was required to establish the limits of the role of the Italian NRA in imposing PSOs on the liberalized gas market in the absence of effective competition. The Italian energy regulator had elected to fix "reference prices" for the sale of gas to certain customers by way of *ex ante* regulation. First, the Court noted that the price for the supply of natural gas must, as from 1 July 2007, be determined solely by market forces, a requirement that follows from the very purpose of the total liberalisation of the market for national gas. However, the Court also recognised that it was apparent that Directive 2003/55 is also designed to guarantee that 'high standards' of public service are maintained and the final consumer is protected.[47] Article 3(2) expressly allows Member States to impose 'public service obligations' on gas companies, which could relate to the 'price of supply'. Second, the Court also confirmed that – irrespective of harmonisation – Member States are entitled to define the scope of their 'public service obligations' and to take account of their own national policy objectives and national circumstances'. As a result, the Court concluded that the Directive still allows Member States to assess, after 1 July 2007, whether it is necessary to impose measures to ensure that the price of the

[46] Case C-265/08 *Federutility* 24 April 2010, nyr.

[47] Ibid. at Rec 20.

supply of natural gas to final consumers is maintained at a reasonable level. At the same time, the Court imposed several conditions in order to ensure that the national measure was also proportional. Significantly, as for the economic factors justifying intervention, the Court noted that, "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 an intervention is required".[48] As a result, a more integrated, inter-disciplinary approach would have to occur at the national level. Judicial review cannot be merely confined to assessing whether the NRA has the formal power under the Directive to act – a more complex assessment of the necessity to act is also required

(b) The third regulatory package of 2009

The third package of measures adopted in August 2009[49] now attempts to address some of the major gaps that were evident in the first stages of gas and electricity market liberalisation. First, the formalistic separation between the regulation of the network and other market and related functions is perhaps breaking down, as is evidenced in part by the two new Directives, which extend the role of the NRAs into more general market supervision, aligning their powers somewhat more closely to those of competition authorities. At the same time the so-called 'Climate Change package', adopted in 2008 gives both NRAs and TSOs important tasks in accomplishing the transition to a low-carbon economy by 2050. In accordance with the new energy directives, NRAs will be given an explicit mandate to promote sustainable and renewable forms of energy[50].

Second, the third package provides for substantive rules and joint decision making procedures on some cross-border issues, including tariffs and access to the network.

Third, the new package provides for far-reaching unbundling and requires that TSOs should be structurally unbundled from production and supply functions. The ownership as well as the management of transmission system assets should be transferred to separate legal entities although 'lighter' unbundling regimes for are also contemplated in the light of national opposition to full structural unbundling. As a result, effective control of these assets, including decisions on future investments is therefore now totally separated from production and supply interests.

Fourth, technical or non-economic regulation is subject to extensive harmonization in the form of detailed regulation of a wide range of issues, including network codes, investment plans, cross-border

[48] Ibid. at Rec 37.

[49] EP and Council Directive (EC) 2009/72 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009 OJ L 211/55; EP and Council Directive (EC) 2009/73 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94.

[50] See Dir 2009/72, ibid., Art 36 and Dir 2009/73, ibid., Art 30.

procedures, the collection and processing of market data, and this by means of comprehensive annexes which can be updated through the comitology procedure.

Finally, the third energy package seeks to separate national regulation from political control - NRAs must be independent not only from the industry but also from any political body. They must be fully resourced and there are strict rules on appointment and dismissal. Regulators must be appointed for a fixed term of 5 years minimum, renewable once.[51]

In accordance with the amended Renewable Energy Directive 2009/28, TSOs will have a pivotal role in meeting the EU's ambitious '20-20-20' targets in securing the development and priority dispatch of renewable energy across their networks. Albeit that the TSOs are expected to ensure that 20 per cent of Europe's energy supply is to consist of renewables by 2020, there is as yet little clarification as to how this task has to be realized and to what extent the Treaty rules on free movement of goods as well as the state aid regime will apply in this context.[52]

(c) Concluding remarks

Sector-specific energy legislation is not expected to be gradually phased out as markets mature and can be policed by general anti-trust law. Transmission systems are likely to remain natural monopolies, especially in the electricity sector. TSOs are now entrusted with extensive tasks, and must secure the promotion of renewables, reliability of supply as well as adequate investment in their networks as well as in cross-border infrastructure. The integration of competition law concepts into the sector specific regulation of TSOs is unlikely to serve this purpose. Rather, the trade-off is in terms of organization. A structurally unbundled TSO that is fully independent in legal and financial terms will be subject to 'lighter' regulation than the other less far-reaching options for the organization of the TSO function available under the Third Package.[53] If these alternative organizational forms are chosen, ex ante regulation is intrusive and exacting.

3. Services of general economic interest and Article 106(2) TFEU

The tension between a more formalistic and a more integrative approach can also be observed in the case-law concerning Services of General Economic Interest (SGEIs) under Article 106(2) TFEU. That provision can be seen as a central conceptual foundation for sector-specific regulation in network industries, and until recently it was also a hallmark of the formalistic paradigm.

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[51] See Dir 2009/72, ibid., Art 34(5) and Dir 2009/73, ibid., Art 38(5).

[52] EP and Council Directive (EC) 2009/28 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC [2009] OJ L 140/16, Art. 16.

[53] For a detailed discussion see E. Cabau, Chap 4 of Jones et al., *The Internal Energy Market: The Third Liberalisation Package* (2010).

(a) Formalistic approach to special and exclusive rights

Indeed Article 106(2) TFEU lends itself easily to an interpretation along categorical lines, for two reasons.

First of all, Article 106(2) TFEU, is an exception, an escape clause from the Treaty, in particular the provisions relating to the internal market or competition law. This has allowed this provision to be played up in grand debates about 'State versus market' where politics takes front stage, and therefore to antagonize – needlessly – what remains in essence one of the countless instances where conflicting public policy objectives must be reconciled. Most directives enacted on the basis of Article 114 TFEU also involve delicate balancing between the achievement of the internal market and competing policy objectives.[54]

Secondly, the concept of SGEI occupies an uneasy place in EU law, since it is an EU concept, subject to the powers of interpretation and monitoring of EU institutions, with a view to ensuring a uniform application throughout the EU, but at the same time it falls within the express province of Member States to decide which services are SGEIs.[55] The Commission (as well as the Courts) sought to solve this puzzle by professing to exert only marginal control on the way Member States organize SGEIs; on a closer look at the Commission decision practice,[56] however, one can argue that the control is more than just marginal. In any event, the concept of SGEI lends itself handily to a pigeonholing game between the Commission and the Member States.

The ECJ in recent years added an extra layer of complexity to the situation through an inconsistent approach to the line between 'economic' and 'non-economic' services, which runs through the Treaty, including through Article 106(2) TFEU. A number of cases – including core decisions under Article 106(2) TFEU such as *Höfner*,[57] *Pavlov*[58] or *Ambulanz Glöckner*[59] – take an objective and maximalist approach,

[54] One needs only to think of the directives concerning the harmonization of regulation in the financial sector, be it in the banking, insurance or other financial markets.

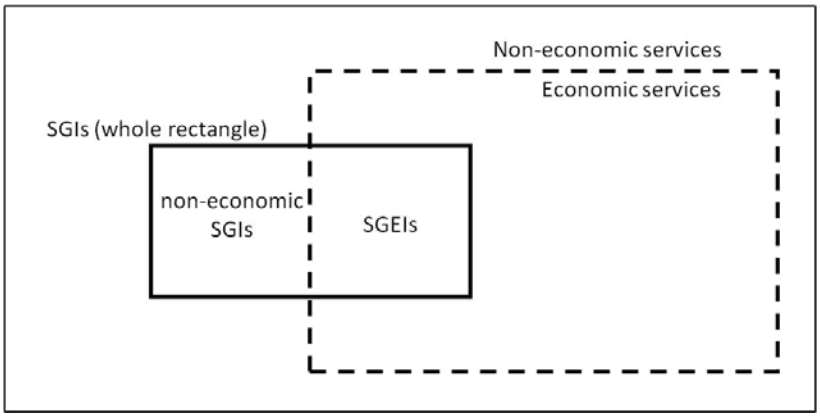
[55] See the TFEU Protocol (No 26) on Services of General Interest [2010] OJ C 83/310, as well as Article 36 of the Charter of Fundamental Rights of the EU.

[56] See for instance in public service broadcasting – where the position of Member States is further bolstered by TFEU Protocol (No 29) on the system of public broadcasting in the Member States [2010] OJ C 83/312 – where under the guise of marginal control, the Commission reviews the scope of the public mission of public broadcasters in great detail: Commission Communication on the application of State aid rules to public service broadcasting [2009] OJ C 257/1 at para. 43-49 and for a good illustration, Case E-3/05, *Financing of public broadcasting in Germany* [2007] OJ C 185/1, Rec. 237-242.

[57] Case C-41/90 *Höfner* [1991] ECR I-1979.

[58] Case C-180/98 *Pavlov* [2000] ECR I-6451.

holding that any activity consisting in the offering of goods and services on a market is an economic activity, even if the activity is carried out by the public sector or under public service obligations. At the same time, other cases, such as *Poucet et Pistre*[60] and *AOK*,[61] have carved out a 'solidarity' exception via the definition of 'undertaking', or have used the definition of 'services' at Article 57 TFEU to exclude services organized by the State, such as higher education.[62] That line of case-law also suggests that the State would have the power to take certain services out of the 'economic' basket through its legislative and regulatory measures, i.e. that the concept would be subjective. Given the uncertainty surrounding the line between 'economic' and 'non-economic' services, the Commission issued a series of policy documents concerned with an overarching concept of Services of General Interest (SGIs), which would include both SGEIs as well as those services, which while of general interest, remain non-economic and therefore fall outside of the purview of the Treaty competition and state aid rules.[63] This complex conceptual architecture was completed with the Treaty of Lisbon, which adds a Protocol on SGIs, comprising two provisions applicable to SGEIs and 'non-economic services of general interest', respectively.[64] The result can be seen in the following diagram:



[59] Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089.

[60] Case C-159/91 *Poucet and Pistre* [1993] ECR I-637.

[61] Case C-264/01 *AOK* [2004] ECR I-2493.

[62] Case 263/86 *Humbel* [1988] ECR 5365.

[63] Green Paper on Services of General Interest, COM(2003)270 final (21 May 2003), White Paper on services of general interest, COM(2004) 374 final (12 May 2004), Commission Communication on services of general interest, including social services of general interest: a new European commitment, COM(2007) 725 final (20 November 2007).

[64] N 55 above.

Initially, the application of Article 106(2) TFEU concerned cases of monopoly rights (and primarily, market access issues).[65] Because of the nature of monopoly rights, which must be delineated, these cases fit easily within a formalist paradigm. In the original line of case-law, starting with *Sacchi*,[66] the existence of the monopoly right was not challenged, but rather whether the behavior of the holder of the right, in exercising that right, infringed the Treaty – typically Article 102 TFEU – and if so, whether Article 106(2) TFEU could apply. Starting in the late 1980s, the Commission merged Articles 106(1) and (2) together to argue that the very existence of a monopoly right ran against Article 106(1) if it was not justified for a SGEI pursuant to Article 106(2). This argument underpinned the use of Article 106(3) TFEU to liberalize the telecommunications sector, and it was endorsed by the ECJ.[67] At its most elaborate, this line of argument led to a complex inquiry under Article 106(2), as seen in *Corbeau*[68] or *Glöckner*,[69] into: (i) whether the mission entrusted to the monopolist constituted an SGEI, (ii) whether the SGEI could not be profitably undertaken without the monopoly right and (iii) whether the scope of the monopoly right was such that it delivered to the monopolist a financial stream which was sufficient to discharge the SGEI but not excessive. In theory, the second and third issues require a mix of legal and economic analysis which echoes the integrated paradigm. But in practice, given that monopoly rights are blunt instruments, the third issue could not be answered with much precision. Since analytical accounting was not yet very developed in utilities sectors 20 years ago, the second issue was also summarily handled. This left the first issue, an issue of categorization which lent itself better to the formalistic paradigm.

(b) Public financing and the beginning of an integrative approach in *Altmark*

With the liberalization programme of the past 20 years, most large-scale monopolies in the utilities or network sectors are now removed. In the 2000s, the application of Article 106(2) shifted to another class of measures, public subsidies given to firms entrusted with a public service obligation. Initially, there was much confusion in the Commission practice and in the case-law of the ECJ and the General Court,[70] having to do more with divergences on the notion of State aid at Article 107(1) TFEU than with any difficulties with Article 106(2). Two approaches emerged.[71] Under the 'State aid approach', the public subsidy given to the firm is deemed to distort competition within the meaning of Article 107(1) TFEU

[65] See further, Hancher's chapter in the first edition of this book.

[66] Case 155/73 *Sacchi* [1974] ECR 409.

[67] Case C-202/88 *France v Commission* [1991] ECR I-1223 and Case C-271/90 *Spain v Commission* [1992] ECR I-5833.

[68] Case C-320/91 *Corbeau* [1993] ECR I-2533.

[69] N 59 above.

[70] Case C-244/94 *FFSA* [1995] ECR I-4013; Case C-53/00 *Ferring* [2001] ECR I-9067; Case T-46/97 *SIC* [2000] ECR II-2125.

[71] These two approaches are best outlined in AG Jacobs' opinion in Case C-126/01 *GEMO* [2003] ECR I-13769.

and therefore to constitute State aid in and of itself, even if the firm is entrusted with a public service obligation. The public service obligation can however be used to argue that the conditions of Article 106(2) TFEU are fulfilled and that an exception should be made to the prohibition of Article 107(1) TFEU.[72] In contrast, under the 'compensation approach', it is assumed that competition is distorted only if the subsidy exceeds the net extra costs imposed on the firm by the public service obligation. In other words, as long as the subsidy can be seen as compensation for these extra costs, it does not constitute State aid at all under Article 107(1) TFEU. Accordingly, Article 106(2) TFEU does not even need to be relied upon.

Matters came to a head in the pivotal *Altmark* ruling[73], where the ECJ sought to find a compromise between the 'State aid' and 'compensation' approaches by adding to the compensation approach a number of safeguards which seemed to originate from the test used under Article 106(2) TFEU. It formulated the now-famous four *Altmark* criteria whereby a subsidy does not constitute State aid pursuant to Article 107(1) TFEU – and therefore does not need to be notified to the Commission – if:[74]

1. The recipient firm is actually required to discharge public service obligations and those obligations have been clearly defined;

2. The parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner;

3. The compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations; and

4. Where the firm which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation has been determined on the basis of an analysis of the costs which a typical firm, well-run and adequately provided with means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

In *Altmark*, the ECJ tries to push the treatment of public service obligations – certainly when it comes to those supported by subsidies – away from the formalistic paradigm inherent in Article 106(2) TFEU towards a more integrative paradigm. In essence, *Altmark* can be seen as an attempt to shift the debate

[72] Of course, it is also possible that the aid would qualify for one of the exemptions set out under Article 107(2) and (3) TFEU and implementing legislation.

[73] Case C-280/00 *Altmark* [2003] ECR I-7747.

[74] *Altmark*, ibid., par. 88-95.

away from a pigeonholing exercise, namely whether the public service mission in question constitutes a SGEI (and therefore can be used to justify limiting market access). Accordingly, the locus of the discussion is shifted to Article 107(1) TFEU, which implies that the financing of public service obligations can be accommodated from within State aid law, without the harshness and formality of a rule/exception relationship. The *Altmark* test is both more complex, since it requires greater use of economics and accounting, and more rigorous, away from the lofty discussions on what belongs in the SGEI category. On the one hand, the concept of SGEI is evacuated – Article 106(2) TFEU does not come into play – and a vague and general idea of 'public service obligation' replaces it. Member States therefore gain some latitude as to which public service missions they want to entertain. On the other hand, the *Altmark* criteria are more severe than Article 106(2) TFEU was as regards the transparency of the public service obligation, the need to fix the rules on funding in advance and – most importantly – the assessment of the amount of funding needed, using either a public procurement mechanism or an external efficiency benchmark. The latitude on substance is balanced with stronger procedural and financial disciplines.

Despite the daring push by the ECJ to solve the conundrum of public financing for the discharge of public service missions , that judgment left many issues open. In the seven years which have lapsed since the judgment, the most remarkable developments concern, first, the relationship between the *Altmark* test and Article 106(2) TFEU and secondly, the fourth criterion of the *Altmark* test.

(c) The relationship between *Altmark* and Article 106(2) TFEU

It is interesting to note that the Commission and the General Court – both of which preferred the 'State aid' over the 'compensation' approach before *Altmark* – seem to read *Altmark* in such a way as to bring it back into the fold of Article 106(2) TFEU. For one, the Commission, in its decision practice since 2003, seldom found that *Altmark* is applicable: typically, cases founder on the second (formula for calculating compensation known in advance) or fourth criterion, and the applicability of *Altmark* is dealt with expeditely in a few paragraphs.[75] For example in its first decision after *Altmark*, in BBC Digital Curriculum,[76] the Commission held that the fourth criterion had not been met as there had been no public procurement procedure and the UK authorities had failed to provide the Commission with any information which would have allowed it to determine whether those costs could be considered as corresponding to those of a 'typical' undertaking. The Commission then went on to apply Article 106(2) to rule on the compatibility of the state aid measure. This seemed to imply that it was possible for an undertaking to receive aid that exceeded the costs of an ideal, efficient undertaking, without this resulting in overcompensation, as long as the examination was carried out under Article 106(2) TFEU. This approach has become the standard. Even though the General Court reminded the Commission to

[75] The Guidelines on State aid to public service broadcasting (n 56 above) aptly generalize this attitude when *Altmark* is mentioned and dealt with in a single paragraph (par. 23).

[76] Case N-37/03, *BBC Digital Curriculum* [2003] OJ C 271/47.

take *Altmark* seriously,[77] in practice most of the assessment continues to take place under Article 106(2) and not 107(1) TFEU.

Furthermore, the Commission has suggested that *Altmark* is about SGEIs, thereby further blurring the line between *Altmark* and Article 106(2) TFEU. Considering that the *Altmark* test remains entirely within Article 107(1) TFEU, it was no coincidence that the ECJ referred to 'public service obligations' rather than SGEIs, a concept found in Article 106(2) TFEU.[78] While the Commission tracked the language of *Altmark* in its policy statements, in its decision practice concerning subsidies for the roll-out of broadband networks, however, it considered that the *Altmark* criteria could only apply if the broadband project could qualify as an SGEI.[79] The latter point is subject to Commission review, whereby the definition of SGEI is further narrowed down to a concept which comes close to universal service as it is understood in secondary EU legislation, namely services which are provided to all citizens with specific availability, quality and affordability requirements.[80] So in the end the Commission reduces the applicability of *Altmark* by introducing SGEI instead of 'public service obligation' as the ECJ intended and by narrowing SGEI down to universal service. Accordingly, most broadband cases were treated under Article 107(3)(c) TFEU instead of *Altmark* or even Article 106(2) TFEU. Most unfortunately, in *BUPA*,[81] the General Court endorsed this trend, seemingly without in-depth examination,[82] holding that 'public service obligation' as referred to in *Altmark*, means the same as SGEI within the meaning of Article 106(2) TFEU.[83] However, the Court rejects the narrow Commission reading of SGEIs as something akin to universal

[77] Case T-266/02, *Deutsche Post AG* v. *Commission* [2008] ECR II-1233, para. 74.

[78] Of course, one could argue that the term 'public service obligation' made sense in the specific context of *Altmark* (n 73 above) which concerned the transport sector. After all, Article 93 TFEU refers to 'public service obligations'. Yet it can be seen that, in subsequent cases, the Court continued to use 'public service obligation', even outside of the transport sector: see for instance Case C-451/03 *Servizi Ausiliari Dottori Commercialisti* [2006] ECR I-2941, par. 63 (provision of tax advice to individuals) or Case T-274/01, *Valmont Nederland BV* [2004] ECR II-3145, par. 132 (public use of a car park).

[79] Commission Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks [2009] OJ C 235/7 at par. 20-30.

[80] This narrow reading of SGEI is put forward in the Green Paper on Services of General Interest (n 63 above).

[81] Case T-289/03 *BUPA v Commission* [2008] ECR II-81

[82] The issue was uncontested as between the parties.

[83] Ibid., at Rec. 162 and ff. The Court goes on by completely collapsing the *Altmark* and Article 106(2) tests by examining, in its discussion of *Altmark* (n 73 above), the extent of the Commission review power over whether the service is an SGEI and then the actual conclusion that the service if an SGEI.

service.[84] Subsequent General Court cases continued to blur *Altmark* and Article 106(2) TFEU,[85] and yet other cases have underlined that the two must remain separate.[86]

(d) The efficiency of the public service firm

The fourth *Altmark* criterion – also referred to as the 'efficiency' criterion – seems to indicate that the Court requires that public services should also be organised as far as possible on market-based lines and that Member States would have to demonstrate that the most efficient operator had been selected.[87] For the Court, the optimal policy solution is a public tender entrusting the performance of the SGEI to the most efficient bidder in the market. And of course that should not only mean the national or regional market. Given that the Court have also drawn upon the free movement rules to extend the requirements to organise some form of tender to a myriad of situations falling outside the scope of the EU public procurement regime,[88] a tender procedure would attract publicity for even the most local SGEI. At the same time, the ECJ was not prepared to stretch the limits of its own competence and require the Member States to organise tenders in all cases. Indeed to have done so might have resulted in a breach of the principle of subsidiarity (Article 5(3) TEU), especially if this had been required for areas of exclusive Member State competence, such as health care or public broadcasting. Moreover a strict requirement to hold a tender would have cast doubts on the legality of numerous existing arrangements where the operators in question had not been selected by way of a public tender.

What is of interest here is that while the introduction of the efficiency criterion opened the door to the Commission to impose a more market-based approach to public service provision, its exact degree of influence was left undefined. Rather *Altmark* raised a new set of questions – what is a typical and well-run undertaking? What are the precise benchmarks – can these also be hypothetical? And most importantly, would the efficiency test limit the freedom of the Member States to define not only the scope of their public services but also their quality? Could this fourth test provide the Commission with a

[84] Ibid. at Rec. 186-190.

[85] See *Deutsche Post AG* (n 77 above) Rec 72-74; Case T-254/00 *Hotel Cipriani* v *Commission* [2008] ECR II-3269 Rec 110; Case T-189/03 *ASM Brescia* v. *Commission* [2009] ECR II-1831 Rec 124 and ff.

[86] Case T-354/05 *TF1* v *Commission* [2009] ECR II-471 Rec. 126-140.

[87] In its previous ruling in *Ferring* (n 70 above), the Court had not addressed this concept at all. Its ruling was criticized for leaving a wide discretion to Member States to finance the activities of inefficient, and invariably incumbent, firms. This would not only prevent the optimal allocation of taxpayers' money but might also allow these same firms to expand their activities into neighbouring, liberalised markets.

[88] Case C-231/03 *Coname* [2005] ECR I-7287; Case C-458/03 *Parking Brixen* [2005] ECR I-8585.

vehicle for substantive 'regulation' through the application of the EU state aid regime to control the quality and not just the level of public financing for SGEIs?[89]

For instance, in *Chronopost*,[90] handed down three weeks before *Altmark*, the Court had to consider whether the Commission could and should have compared La Poste to a private operator in order to establish whether a state monopoly, La Poste, had been a source of state aid to one of its subsidiaries. The ECJ effectively acknowledged that certain services and networks do not operate on purely commercial lines. Thus, La Poste was in a very different position to that of a private operator acting under market conditions as it had been entrusted with a SGEI mission, and was the only operator on the market. The Court concluded that in the absence of any possibility of comparing La Poste with that of a private group of undertakings in a reserved sector, normal market conditions which are necessarily hypothetical, must be assessed by reference to the objective and verifiable elements which are available. Any assessment of a hypothetical market price would produce excessively abstract and arbitrary results ill-suited to determine any economic advantage'[91]. The correct method of assessment would have been to establish whether the price charged 'covers all the additional, variable costs incurred providing the logistical and commercial assistance, an appropriate contribution to fixed costs arising from the network and an adequate return on the capital investment in so far as it was used for [Chronopost's] competitive activity'[92]. Unfortunately the ECJ did not clarify the relationship between *Chronopost* and the fourth *Altmark* criterion in *Altmark* itself. In the meantime, several commentators have contended that *Chronopost* stands for a 'lex specialis' which must be applied when no market exists for the services provided, and consequently no comparable operator can be found as a suitable comparator.[93]

BUPA,[94] which concerned public and private health insurance, could also be seen as a retreat from the strict approach set down in *Altmark*. There the CFI modified the efficiency criterion and held that it was not necessary to draw a comparison between the costs of the recipient and an efficient undertaking. Based on the purpose of the fourth *Altmark* criterion, the Commission was only required to satisfy itself

[89] See in this respect, EP and Council Regulation (EC) 1370/2007 on public passenger transport services by rail and road and repealing Regulation 1191/69 and 1107/70 [2007] OJ L 315/1, Rec. 27. See also Case C16/07, *Postbus-Austria* [2009] OJ L 306/26, para 86.

[90] Case C-83/01 P *Chronopost* [2003] ECR I-6993.

[91] Ibid. at para 38.

[92] Ibid. at para 40.

[93] See for example, T. Jaeger in (2009) European State Aid Law Quarterly vol. nr. pp

[94] N 81 above.

that the compensation scheme did not entail the possibility that the compensation might result from inefficiencies on the part of the insurer subject to the scheme.

In the end, the Commission in fact applies a two-tier test, as expounded in is 2005 Community framework for State aid in the form of public service compensation.[95] It starts with a sometimes cursory examination of the four *Altmark* criteria, more often than not concluding that *Altmark* does not apply and that the subsidy in question constitutes State aid. Unless the aid is covered by one of the exemptions found in, or based on, Articles 107(2) and (3) TFEU, it then proceeds to assess it under Article 106(2) TFEU, with the following steps:

- The firm receiving the subsidy is entrusted with a genuine SGEI, whereby the Commission claims to test for manifest error only;[96]
- An official act entrusts the firm with the SGEI, wherein the SGEI is specified in detail, including any compensation regime;
- The amount of compensation does not exceed what is necessary to cover the costs incurred in discharging the public service obligations, taking into account the relevant receipts and reasonable profit for discharging those obligations.
- Costs are assessed by reference to the costs of the firm in question, without benchmarking them for efficiency.

Whilst the Commission has obviously drawn inspiration from *Altmark* in developing and refining its decision practice under Article 106(2) TFEU, it remains rather cautious as regards the fourth *Altmark* criterion. The Commission hesitates to introduce a stricter efficiency benchmark, on the *Altmark* model, in Article 106(2) TFEU. This is perhaps to be explained by the fact that the SGEI Decision, which exempts from notification any compensation measures meeting the first three criteria as further specified in Articles 4 and 5, was in part adopted to address concerns about the retroactive effect of *Altmark*. Thus the SGEI Decision allows compensation to cover the costs of inefficient undertakings even although it provides detailed rules on entrustment, costs and revenue and reasonable profit calculations. Furthermore it requires member states to ensure adequate control to prevent 'over compensation', in the sense that revenues from entrusted activities should not exceed the recognised costs. A similar approach is followed in the Framework.[97]

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[95] Community framework for State aid in the form of public service compensation [2005] OJ C 297/4.

[96] See n 56 above and the accompanying text.

[97] For a comparison between the Article 106(2) test and the tests applied under the Decision and Framework, see Case NN-54/2009, *Financing of public hospitals in Brussels region* [2010] OJ C 74/1, para 167.

This should not prevent the Commission, though, from paying more attention to the robustness of the compensation mechanism and to its proper implementation;[98] such a supervisory task, however, is time- and labour-intensive for a thinly-staffed authority like the Commission. Nevertheless, in recent broadcasting cases, the General Court has chastised the Commission for not being sufficiently rigorous in verifying the actual operation of the compensation mechanism.[99]

(e) Conclusion

Art 106(2) TFEU cannot be applied in a simple way - distinguishing a rule and an exemption to it. The formalistic paradigm, resting on a separation between the general rule that EC law applies and the exception for services falling within the SGEI category, puts Member States in a paradox. Either they insist on their competence to decide on their public services, and they remain within the SGEI exception, subject to pressure through Commission review. Alternatively, as was done in electronic communications and energy, public service obligations – in the form of universal service – can be anchored at European level in EU legislation, so as to balance them with internal market and competition policy objectives; but then Member States have to relinquish their competence. In a way, the ECJ in *Altmark* attempted to thwart this paradox by restoring a larger Member State autonomy to define public services against closer scrutiny (through EC and national institutions) of the modalities of public financing.

So under Article 106(2) TFEU as well, the formalistic paradigm seems to be under pressure and the exact dividing line between the respective roles and rights of the Member States and those of the EC are becoming blurred. The Courts seem reluctant to confer powers on the Commission to control the quality of SGEIs – this is a matter for the Member States, and may be even so where markets are extensively regulated, as the Federutility case confirms. The Courts, and now the Commission are as a result taking a tougher stance on supervisory procedures – and both ex ante and ex post controls, and demanding clearer rules and tougher sanctions.

4. Conclusion

The dividing lines between Community, state and market are and remain, despite two decades of regulation, by no means clear. The creation of an internal market is certainly not a matter of elevating 'market' at the cost of either 'state' or 'Community'. Yet much of the regulation is based on inherent separations, as explained in this section, including the now obsolete separation between reserved and liberalized sectors, the separation between various steps of the production chain (production,

[98] See its subsequent decision in Case N-582/2008, *Health Insurance Intergenerational Solidarity Relief* [2009] OJ C 186/2, para 41-42 and 60.

[99] See Case T-442/03 *SIC v Commission* [2008] ECR II-1161 Rec 219-256; Case T-309/04 *TV 2 / Danmark v Commission* [2008] ECR II-2935 Rec. 192-223.

transmission, distribution, supply in the energy sector; content and networks in the electronic communications sector) and the separation between competition law and sector-specific regulation. The most recent set of directives have introduced more radical lines of separation, to isolate transmission systems[100] or local networks.[101] We have concluded that looking across the substantive regulation of the sectors, there is a certain risk that there has been too much separation. Separation is no longer the remedy – it is the root of the problem. This is not merely a matter of legal conceptualism. The challenge of securing huge investments to meet the revised Lisbon objectives, to implement the Union's climate change policy and to bridge the 'broadband divide', will not be met by insisting on the old separations of roles, concepts and functions. In this respect, the 2002 regulatory framework for electronic communications represents the furthest reaching step away from the formalistic paradigm and towards the new integrative paradigm.

C. Institutions

As stated in the introduction, the formalistic paradigm characterized not only the substance of the law, but also the institutions. A number of lines of separation, discussed below, threaten to infuse the implementation of the law with arcane debates on matters of competence, where institutions guard the boundaries of their jurisdictions instead of cooperating with one another to achieve public policy objectives. The evolution of sector-specific regulation already shows a departure from formalism towards a more integrative institutional structure (1.), which could serve as an inspiration for Article 106(2) TFEU (2.).

1. Sector-specific regulation

While electronic communications and energy regulation might have traveled different evolutionary paths on substance, their institutional development has been more in step.

The starting point in both cases was the default institutional scheme for the enforcement of EU law, namely the reliance on Member States to implement and apply EU law in their respective jurisdictions, with various mechanisms to report to the Commission (if only about implementing measures) and the usual threat of infringement proceedings. This scheme is the institutional expression of the formalistic

[100] Dir 2009/72 (n 49 above) Art 9; Dir 2009/73 (n 49 above) Art 9.

[101] Dir 2002/19 (n 15 above) Art 13a and 13b as introduced by EP and Council Directive (EC) 2009/140 amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services [2009] OJ L 337/37. Contrary to energy regulation, separation is not compulsory in the electronic communications sector. It is one of the remedies at the disposal of NRAs and its use must be justified to the Commission.

paradigm: EU and Member State institutions are given distinct and separate functions, with a limited amount of interaction.[102] What is more, each national jurisdiction operates in isolation from the others. Lines of separation run between the EU and national levels and between the Member States.

(a) Away from separation between EU and Member State levels

Early on, in the case of electronic communications,[103] it became clear that the default scheme would not work, if only because almost all Member States would find themselves in a conflict of interest, with a significant if not controlling interest in the former monopolist, on the one hand, and the obligation to implement EU legislation designed to introduce competition to that former monopolist, on the other hand. So the first set of directives enacted in 1990 already provided for the creation of a 'body independent of the telecommunications organizations' to administer regulation.[104] With full liberalization, in 1998, National Regulatory Authorities (NRAs) were introduced in EU legislation, in a way which already broke the separation between EU and national institutions, in that EU legislation required that Member States endow NRAs with powers to gather information and provide for a right of appeal against NRA decisions.[105] For the first time as well, EU legislation required that NRAs be separated from the rest of the administration (if Member States have ownership or control of one of the market players).[106]

EU law continued to penetrate the design and operation of Member State institutions with the 2002 Framework. Provisions were added or expanded concerning the relationship of NRAs with national competition authorities, the appeal mechanisms from NRA decisions, transparency, confidentiality, information gathering and management as well as consultations.[107] In addition, the objectives to be pursued by NRAs were set out in detail.[108] In order to ensure that NRAs would exert their powers in the

[102] Member States remain subject to general principles of EU law – including loyalty (now Article 4(3) TEU), effectiveness and equivalence (the two exceptions to the principle of national procedural autonomy) – when designing and operating the national-level institutions which are meant to give effect to EU law. Within the boundaries set by these principles, Member States retain a significant amount of discretion.

[103] EU energy regulation did not deal with national regulatory authorities until the 2nd generation of Directives in 2003.

[104] Dir 90/388 (n 3 above) Art. 7.

[105] Dir 90/387 (n 9 above) Art. 5a.

[106] Ibid.

[107] Dir 2002/21 (n 15 above) Art. 3-6.

[108] Ibid. Art 8. In fact, this detailed statement of objectives has been criticized for its open-endedness: the objectives listed therein will often point in contradictory directions, i.e. the promotion of investment in infrastructure and the lowering of consumer prices.

EU interest, an elaborate system of supervision was put in place, whereby NRA draft decisions concerning the SMP regime are submitted to the Commission for comment; the Commission can veto alternative market definitions or SMP assessments.[109] The notion of NRA was also introduced in the second package of Energy Directives (2003), and here as well EU law dealt with a number of key organisational aspects, including tasks, powers and resources.[110]

With the new sets of directives in 2002 and 2003, the separation between EU and Member States institutions was breached in the other direction as well. Not only did EU law specify in greater detail how Member States organize their NRAs, but these NRAs started to play a greater role in the development of EU policy. In the electronic communications and the energy sectors, NRAs were brought together in regulatory networks, respectively, ERG and ERGEG.[111] ERG and ERGEG were created to advise the Commission, but also to bring NRAs together and to force them to look beyond their borders and take a European perspective on their respective activities. And indeed these networks soon began to conduct benchmark exercises, to form study groups and to issue policy documents and non-binding guidelines on various regulatory topics.[112]

The creation of these regulatory networks marked a large step away from the formalistic towards the integrative paradigm: the Commission and the regulatory networks are working together as part of an enforcement community, with the Commission taking care of higher supervisory and policy-making functions, in consultation with the NRAs which deal with the day-to-day application of the law. Despite lingering issues as to legitimacy, by and large regulatory networks represent a robust enforcement model for EU law, with definite advantages when compared to the traditional model or to the agency model.[113]

(b) Beyond separation along national borders

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[109] Ibid. Art 7. The Article 7 procedure has given rise to a large decision body, with the Commission having so far reviewed more than 1000 draft NRA decisions (as of 1 January 2010) and issued 7 veto decisions over the years.

[110] Dir 2003/54 (n 44 above) Art 23; Directive 2003/55 (n 44 above) Art 25.

[111] See Commission Decision (EC) 2002/627 establishing the European Regulators Group for Electronic Communications Networks and Services [2002] OJ L 200/38 and Commission Decision (EC) 2003/796 establishing the European Regulators Group for Electricity and Gas (ERGEG) [2003] OJ L 296/34.

[112] Including the massive effort of the ERG to draw up a Common Position on Remedies, ERG (06) 33 (May 2006), available at berec.europa.eu.

[113] See the thorough study made by M. de Visser, Network-Based Governance in EC Law – The Example of EC Competition and EC Communications Law (Oxford: Hart Publishing, 2009) and S. Lavrijssen and L. Hancher, "Networks on Track: From European Regulatory Networks to European Regulatory 'Network Agencies'" (2008) 34 Legal Issues of European Integration 23-55.

While the creation of NRAs and regulatory networks broke down the separation between EU and Member State institutions, it did not address the other separation line running through the institutions in EU regulation of network industries, namely the line running along national borders. In other service sectors where regulatory supervision has been harmonized at EU level, such as banking, insurance or broadcasting, at least a home-country supervision system was put in place, so that firms can operate throughout the EU under a single license granted by one NRA (in the 'home country' as defined in the applicable directive). The experience with broadcasting over the years – where stricter Member States have tried to assert jurisdiction over broadcasters established in laxer Member States – already indicates the limits of this approach. Conversely, the failure of banking supervision ahead of the current crisis shows that national authorities did not fully exert supervision over the activities of the regulated banks outside of their jurisdiction.[114] In any event, EU regulation of network industries did not even make it that far: early on, it became clear that Member States wanted to retain jurisdiction over firms operating on their respective territories.

For electronic communications, the EU institutions chose a different strategy to try to minimize regulatory burdens across the EU: instead of working with an institutional solution (home-country control), a procedural solution was sought, namely making regulation (and in particular licensing requirements) as light as possible, so as to limit the regulatory burden for firms in each Member State. The 2002 framework removed any individual license requirements at national level, replacing them with a general authorization procedure.[115] Even if the administrative requirements for market entry were reduced as much as possible, the 2002 framework contains a heavier regulatory scheme applicable to specific firms, namely firms with SMP on selected relevant markets.

In the energy sector, however, the separation running along national borders was not addressed. Although the obligations on TSOs and DSOs have been increasingly harmonized and national regulation of their activities is now the subject of detailed, technical regulation, there was no attempt to deal with the regulation of cross-border infrastructure and shared regulatory responsibilities until the adoption of the recent third package in 2007. [116]

In the light of the above, it comes as no surprise that many market players and industry observers have criticized the EU for failing to realize the internal market in network industries. The main line of criticism is that even if at a general level the substantive law is harmonized, Member States and their NRAs continue to follow diverging approaches in implementing and applying EU law to the firms active in their

[114] T. Tridimas, chapter [X] in this volume

[115] 'Rights of use' must still be sought by each market player, however, in order to have access to scarce resources such as frequencies, numbers or rights-of-way: Dir 2002/20 (n 15 above) Art. 5.

[116] Under Reg 1228/2003 (n 44 above), the relevant national authorities involved had jurisdiction over cross-border infrastructure and had a duty of cooperation but remained fully entitled to take autonomous decisions.

respective jurisdictions. As a result, firms face a regulatory patchwork across the EU. The Commission has taken these criticisms to heart; it has always insisted on a high degree of convergence among NRAs. On the other hand, it is often forgotten that, on issues where there is no obvious regulatory solution, such as for instance how to regulate Next Generation Networks so as to foster the appropriate amount of investment in new infrastructure, it can be advantageous to allow room for experimentation; in such case, 'maverick' NRAs from smaller Member States could take the lead and follow more daring regulatory approaches, while NRAs from larger Member States would wait for a best practice to emerge.[117] In practice, such experimentation has not taken place, however.

The 2002 and 2003 directives, as well as the second energy package already contained measures to ensure sufficient coordination and convergence amongst NRAs, including the regulatory networks mentioned above. The ERG and ERGEG, however, did not succeed in bringing about the expected level of convergence among NRAs, at least as far as the Commission is concerned. The ERG and ERGEG decided on a consensus basis, resulting in a very inter-governmental dynamic. In response to criticism, the ERG improved its internal procedures, whereas ERGEG recommended its transformation into a fully-fledged independent agency. [118]

In addition to the 'voluntary' coordination taking place within the ERG and ERGEG, the Commission also has means to force the NRAs to follow its line, or even to override or sideline them. As mentioned above, within the 2002 electronic communications framework, the Commission first of all selects markets for NRAs to assess,[119] secondly issues guidelines as to how NRAs should conduct their assessment[120] and thirdly reviews NRA draft decisions and can veto them if they would undermine the internal market or conflict with EU law.[121]

(c) The use of competition law powers

Beyond sector-specific regulation, the Commission can also intervene in NRA matters via its competition law powers; issues relating to the regulation of SMP firms (electronic communications) or large energy operators can typically be reframed as competition law issues, under Article 102 TFEU. In the 1990s, the Commission used its competition law powers against incumbents to 'convince' Member States to

[117] Larouche and de Visser (n 18 above).

[118] See Lavrijssen and Hancher (n 113 above).

[119] Dir 2002/21 (n 15 above) Art 15.

[120] Ibid.

[121] Ibid., Art. 7. See also P. Larouche, "Coordination of European and Member State Regulatory Policy – Horizontal, Vertical and Transversal Aspects", in D. Geradin et al., eds., Regulation through agencies in the EU, (Cheltenham: Edward Elgar, 2005) 164-179, also in (2004) 5 Journal of Network Industries 277-293.

support telecom liberalization.[122] As regards the actions of NRAs in particular, the Commission intervened in pricing matters by fining incumbents for predatory pricing or price squeeze under Article 102 TFEU.[123] The *Deutsche Telekom* price squeeze case is particularly relevant here, since DT relied on the regulatory approval of its wholesale and retail tariffs by the German NRA to argue against the application of competition law. The Commission replied that compliance with regulation did not absolve a firm from liability under competition law, a stance confirmed by the CFI on appeal; here EU law is at variance with US law, however.[124] Finally, in one instance concerning international roaming, the Commission, dissatisfied with the way NRAs had failed to act, simply circumvented the general regulatory scheme of the 2002 regulatory framework and proposed a separate regulation.[125]

Against the backdrop of the incomplete transition from a more formalistic to a more integrative regulatory paradigm in the substantive regulation of the energy sector, as mapped out at section 2 above, the recent use of competition law powers in the energy sector is remarkable. It had as its prelude a major sector inquiry – culminating in a comprehensive report gathering extensive data on the industry and its practices.[126] As many aspects of market structure and indeed firms' conduct are beyond the scope of the energy directives, competition rules have had a vital role to play to support the transition to more competitive markets. However, recent developments in the practice of the European Commission, and in particular the development of the commitment procedure on the basis of Article 9 of Regulation 1/2003[127] alongside a significant increase in fines, indicate that competition rules have an

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[122] P. Larouche, *Competition Law and Regulation in European Telecommunications* (2000), Chapter II.

[123] Case COMP/37.451 *Deutsche Telekom AG* [2003] OJ L 263/9 (upheld in Case T-271/03 *Deutsche Telekom* [2008] ECR II-477), Case COMP/38.233 *Wanadoo Interactive*, available on ec.europa.eu/competition (upheld in Case C-202/07 P *France Télécom* [2009] ECR I-2369), Case COMP/38.784 *Telefónica*, available on ec.europa.eu/competition.

[124] D. Geradin, "Limiting the Scope of Article 82 EC: What can the EU Learn from the U.S. Supreme Court's Judgment in Trinko in the Wake of Microsoft, IMS and Deutsche Telekom?" (2004) 41 CMLRev 1519; N. Petit, "Circumscribing the Scope of EC Competition Law in Network Industries? A Comparative Approach to the US Supreme Court Ruling in the Trinko Case" (2004) 5 Journal of Network Industries 347; P. Larouche "Contrasting legal solutions and the comparability of US and EU experiences", in F. Levêque and H. Shelanski, eds., *Antitrust and Regulation in the EU and US: Legal and Economic Perspectives* (Cheltenham: Edward Elgar, forthcoming).

[125] EP and Council Regulation (EC) 717/2007 on roaming on public mobile telephone networks within the Community [2007] OJ L 171/32.

[126] Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) COM(2006) 851 (10 January 2007).

[127] Council Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L 1/1.

important substantive role to play, as an effective tool for market design, and can transcend the increasingly technical focus of sector-specific energy regulation outlined above.

Increasingly, the Commission is resorting to *quasi*-regulatory measures to foster competition in the EU electricity and gas markets. Unilateral commitments by the parties involved have become a standard part of the toolbox used by the Commission to restructure the European electricity and gas market and promote competition. The commitment procedure allows the Commission to accept legally binding commitments offered by defendants if is satisfied that these sufficiently address the underlying competition problem. This procedure has the virtue of both procedural economy and speed. It allows the Commission to bring infringement procedures to an end without the parties being forced to concede that they have indeed breached the rules. Confirmation and approval of this strategy in the context of merger review was given by the General Court in the *EDP/Commission* cases.[128] Further examples can be found in the *EDF/EnBW* and *GDF/SUEZ* merger cases.[129] Commitments should in theory, be suitable, necessary and proportional to dealing with the underlying competition law problem to be lawful.[130]

As of 2008 the Commission also began to accept commitments of divestiture in the context of Art 102 TFEU cases in the German market, when first E.ON[131] and then RWE[132] accepted to divest their transmission networks to avoid further antitrust scrutiny when at the same time, the German government was still strongly opposing ownership unbundling during the negotiations on the Third Package. An Article 102 TFEU investigation could therefore lead to a structural remedy - the divestiture of the essential facility. The Commission was now able to address the shortcomings of the sector-specific legislation through 'ex post' antitrust control, and to realize the potential of the commitment procedure to carry through rapid changes in the market structure.

Importantly, the commitment procedure allows the Commission to bargain liberalization outcomes directly with the incumbent, without going through the interface of NRAs and Member States. This outcome is well-illustrated in the Svenska Kraftnet (SvK) decision.[133] The Commission reached the preliminary conclusion that SvK was dominant on the Swedish electricity transmission market and may have abused its dominant position by reducing interconnection capacity for trade between Sweden and

[128] Case T-87/05 *EDP v Commission* [2005] ECR II-3745.

[129] Case COMP/M.1853 *EDF/EnBW* [2002] OJ L 59/1; Case COMP/M.4180 *Gaz de France/Suez* [2007] OJ L 88/47.

[130] Case C 441/07 *Alrosa*, pending.

[131] Cases COMP/39.388 and COMP/39.389 *German Electricity Wholesale and Balancing Markets* [2009] OJ 36/8.

[132] Case COMP/39.402 *RWE Gas Foreclosure* (Decision of 18 March 2009), available on http://ec.europa.eu/competition.

[133] Case COMP/39.351 *Swedish Interconnectors* [2010] OJ C 142/28.

its neighbouring EU and EEA partners, thereby discriminating between discrimination between domestic and export electricity transmission services and segmenting the internal market. SvK had arguably only been carrying out national policy objectives, i.e. maintaining a single price area in Sweden. Nevertheless Regulation 1228/2003 also forbade these types of practices and it should have been open for the complainants to raise a challenge before the national regulator. Given the apparent lack of independence of the Swedish regulator from the government, the Commission was able to rely on Article 102 to circumvent the national level and force SvK to accept far-reaching commitments, including the building of new network infrastructure.

(d) Increased separation between the NRA and the national legislative and executive power

Despite all of the means at the Commission disposal to influence or even control to work of NRAs, the perceived need for more consistency across the EU led the Commission to propose the creation of regulatory agencies in both the electronic communications and energy sectors.

In order to fully understand such proposal, it is necessary first to look at yet another line of separation running through the institutional framework, this time between the NRAs, on the one hand, and the Legislature and the Executive, on the other hand.

As mentioned above, the starting point for this line of separation was the potential conflict of interest arising when the State both conducts the regulation of the sector and holds a significant interest in one of the players (the incumbent).[134] In that sense, the independence of the NRA from the Legislative and Executive was an extension of the separation of regulatory and operational functions.

When NRAs were originally created, most Member States were still holding a significant if not controlling share in the incumbent, so they had to give the NRA a measure of independence from the rest of the administration. Furthermore, the leading example, the British Oftel (now Ofcom), was operating largely independently. So most NRAs were created as separate authorities enjoying a measure of autonomy. Once created, these NRAs generally sought to consolidate and even increase that autonomy.

However, it soon became clear that expanding NRA autonomy beyond what is necessary to avoid conflict of interests ran into significant problems. In most Continental public law traditions, autonomous executive agencies can only be entrusted with the – presumably mechanical – implementation or application of higher-ranking norms, as opposed to policymaking.[135] Indeed the delegation of norm-making power to an autonomous body would run against the separation of powers (to the extent that such norms would otherwise be set by the Legislature) or against the political accountability of the Executive (to the extent that such norms would otherwise be set by the Executive pursuant to legislative

[134] Dir 90/387 (n 9 above) Art 5a; Dir 2002/21 (n 15 above) Art 3(2).

[135] M. Thatcher, *Internationalisation and Economic Institutions; Comparing European Experiences* (2007).

delegation). Accordingly, NRAs could enjoy considerable autonomy as long as their tasks were limited to the mere implementation or application of law and policy. It should be apparent to the reader that the range of tasks to be performed by a NRA does not lend itself easily to formalistic categories such as 'policy-making' and 'implementation'. Rather, regulatory decisions essentially involve policy trade-offs.[136] It seems more accurate to model the regulatory process as a chain of decisions, each involving a further refinement in the trade-offs, always with a view to deal with uncertainty as well as possible.

While it is not accurate to shrug off the issue as a clash between a regulatory model inspired by the common law and a Continental public law tradition,[137] it remains nevertheless that some theoretical foundation must be found to explain not just the existence of NRAs, but also the division of tasks between the Legislature and the Executive, on the one hand, and the NRA, on the other. Recent developments point towards a generalization of the conflict-of-interest rationale: in short, even if Member States have no direct interest in any of the market players, regulatory matters are high-stake games where market players will deploy considerable resources to try to influence the outcome (rent-seeking behaviour). Regulatory decisions must therefore be made in an environment which is shielded from undue influence as much as possible: this would imply transparency, independence of the decision-maker, openness, a duty to state reasons and the possibility of review, i.e. the characteristics of a regulatory agency.[138] By implication, the role of the Legislative and the Executive would be limited to issues where there is no clear controversy among market players, i.e. issues where a decision does not immediately make winners and losers. This would explain why, in a decision chain model, the Legislative and the Executive can deal with the highest levels – provide guidelines and set out policy objectives – but cannot go very far down the decision chain, since very rapidly market players will begin to hold diverging views on the outcome and will engage in rent-seeking behaviour.[139] The justification just set out was put forward by the ECJ in a recent ruling which enshrined the position of the NRA via-à-vis the

[136] For instance, short-term gains in consumer welfare from lower prices and increased competition routinely have to be weighed against longer-term gains from investments in new technologies and increased dynamic efficiency. Similarly, the interests of one category of customers often have to be balanced with those of another category.

[137] The same debate took place in common law systems when regulatory authorities were put in place, but that debate dates back from the mid-20th century.

[138] L. Hancher, P. Larouche and S. Lavrijssen, "Principles of Good Market Governance" (2003) 4 Journal of Network Industries 355.

[139] This is not to say that NRAs are not vulnerable to rent-seeking behaviour as well, as public choice theory argues with regulatory capture, etc.

Legislature.[140] Similarly, the recent directives on electronic communications and energy invoke the need to avoid undue influence as a reason why the independence of NRAs should be strengthened.[141]

Of course, the more NRAs are independent towards the national Legislative or Executive, the more accountability becomes problematic. Many commentators argue that the NRAs are not sufficiently accountable, all the more when they act under the cloak of the ERG or ERGEG.[142] Yet a good argument can also be made that NRAs are already subject to many measures designed to ensure accountability. First of all, *ex ante*, while as is clear from the above NRAs cannot be told how to decide, the Legislature and the Executive have nonetheless given them some directions, i.e. they have filled in the upper echelons of the decision chain. NRAs are not told simply to act in the public interest,[143] rather they are given specific objectives,[144] their tasks are defined[145] and their powers are also set out.[146] In the case of electronic communications, the Commission even tells them which markets to analyse and which methodology to apply.[147] Secondly, *ex post*, a number of mechanisms are in place. The NRAs are subject to the disciplines arising from good governance principles: transparency, openness, need to consult and give reasons, etc. Usually, they are also bound to file regular reports with the Legislature. As outlined earlier, the Commission also has means to exert pressure on them, including through its competition law powers. Within the networks, they are also accountable towards other NRAs. Last but not least, their decisions are subject to judicial review. If accountability means that the NRA must feel that it has to answer for its actions, then NRAs are accountable; of course, they are accountable to so many principals that the incentives on NRAs might be distorted.[148]

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[140] See ECJ, 3 December 2009, Case C-424/07, *Commission* v. *Germany*, nyr in particular Rec. 91 and the Opinion of AG Maduro at Rec. 63. In ECJ, 29 October 2009, Case C-274/08, *Commission* v. *Sweden*, nyr the Court also defended the position of the NRA as against the Legislature, this time in the energy sector.

[141] Dir 2009/140 (n 101 above) Rec 13 and the new Art 3a added to Dir 2002/21 (n 15 above); Dir 2009/72 (n 49 above) Rec 33-34 and Art 35.

[142] Hancher and Lavrijssen (n 113 above).

[143] As is the case with some US authorities, such as the FCC.

[144] Dir 2002/21 (n 15 above) Art 8.

[145] Ibid.

[146] Throughout the Directives making up the 2002 framework (n 15 above).

[147] Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services [2002] OJ C 165/6.

[148] As was the case in *Commission* v. *Germany* (n 140 above) where one principal (the German Parliament) disagreed with another one (the Commission) on the proper treatment of emerging markets.

(e) NRAs and the Commission: the creation of ACER and BEREC

In the Commission's view, inadequate political independence at national level hampers an effective and impartial application of European law. As mentioned already, the new electronic communications and energy directives adopted in 2009 reflect at least in part, a new policy direction: NRAs must now be independent, not just from industry, but increasingly from national governments, without political interference. Their ability to do so will be strengthened through the creation of the two new institutions, the Agency for the Co-ordination of Energy Regulators (ACER) and the Body of European Regulators for Electronic Communications (BEREC). The originality of ACER and BEREC compared to other agencies in the EU regulatory landscape is that they are *"network agencies*".[149] Of necessity, multi-level governance complicates the allocation of responsibility and the accountability of these different actors from a political as well as a legal perspective.[150] Much of the legal and political science literature has focused on the accountability deficits of the networks themselves, but in the light of the repositioning of the regulatory networks as European network agencies, their position *vis–à-vis* the Commission – and the division of competences and tasks between these new agencies and the Commission itself – is an important dimension in the new institutional paradigm. Ironically, the formalistic distinction between policy-making and implementation, which undermined the position of NRAs in many Member States, is also at work at European level under the guise of the so-called *Meroni* doctrine.[151]

Regulation 713/2009 stipulates that 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*". Its task is to provide a framework for the cooperation of NRAs, and to complement their actions at EU level to address regulatory gaps on cross-border issues and provide greater regulatory certainty. ACER will primarily have an advisory role. Its opinions and recommendations should contribute to ensuring more coordination among TSOs and among regulators of the different Member States, spread good practices and in particular contribute to the

[149] In terms of internal governance, ACER broadly follows the principles of the Draft Interinstitutional Agreement on the Operating Framework for the European Regulatory Agencies, COM(2005)59 final (25 February 2005). It comprises an Administrative Board, a Board of Regulators regrouping the NRAs and a Director. As for BEREC, even if, for institutional reasons, it is expressly not set up as a 'Community agency' within the meaning of EU law (EP and Council Regulation (EC) 1211/2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office [2009] OJ L 337/1 Rec 6), for the purposes of discussion here it will be treated as such. Its institutional structure is not far from the model set out in the Draft Interinstitutional Agreement either: it comprises a Board of Regulators on which NRAs sit, assisted by a Management Committee and a Administrative Manager. In comparison to ACER, BEREC leaves more power in the hands of the NRAs acting together as Board of Regulators.

[150] Hancher and Lavrijssen (n 113 above).

[151] Case 9/56, *Meroni* [1958] ECR 11.

implementation of the new (non-binding) Community-wide ten-year network development plan, i.e. monitoring the work of the new European Network of Transmission System Operators (ENTSOs) for electricity and gas, an new organization also created under the third energy package. Under the third package, the powers of the Commission to adopt general technical measures through comitology procedures are greatly extended.[152] ACER will only have an advisory role in the formulation of general binding measures. At the same time, it has limited autonomous powers to take decisions on cross-border energy infrastructure projects. The new Regulation 714/2009, modifies the allocation of regulatory powers among the NRAs who can jointly decide to delegate their power to the new ACER; in case of sustained disagreement between the NRAs involved, ACER can even take the decision itself, subject, however to Commission veto. As the ERGEG has concluded, to its regret, in reality the ENTSO has been given more important powers than the Agency itself. This is perhaps a reflexion of the dominance of technical regulation in the energy sector, which has led to the inclusion of TSOs as key players in the regulatory framework. But the powers of the Agency vis-à-vis the Commission also remain weak. From a legal perspective, ACER has been conceived in strict compliance with the *Meroni* doctrine.[153] Its powers to define the terms and conditions for access and operational security of cross-border infrastructure are inherently technical and case-specific, and subject to close Commission scrutiny. Regulatory independence from national governments does not necessarily imply independence at the European level.

The creation of BEREC was more laborious.[154] The Commission proposal was as ambitious as in the energy sector, but in the end, as the recitals to Regulation 1211/2009 indicate, BEREC is rather a reinforced ERG. It is much less of an agency than ACER. Its governance structure is developed further than was the case with the ERG, and it is endowed with more staff (the Office).[155] It now decides by a two-thirds majority instead of consensus, which could make BEREC more efficient than ERG.[156] As with ACER, however, the relationship of BEREC with the Commission is comparatively underspecified: on the surface, BEREC is set up so as to comply with the *Meroni* doctrine, in that it is merely advising the

[152] These now include the network codes, the certification of TSOs, rules on the provision of information, rules for the trading of electricity and lastly, rules on investment incentives for the construction of interconnector capacity

[153] N 151 above.

[154] One need only parse the various acronyms which gained currency during the legislative procedure to see that the lawmaking institutions were at odds: the Commission proposed a European Electronic Communications Market Authority (EECMA), whereas the Council in its common position wanted a Group of European Regulators in Telecoms (GERT), and not a Body of European Regulators in Telecoms (BERT), as found in the first reading of the EP.

[155] Reg 1211/2009 (n 149 above) Art 6.

[156] Ibid., Art. 4(9).

Commission (and the NRAs), without taking any decisions, much like EMEA, for instance.[157] As the case of EMEA shows,[158] however, if BEREC ends up with a sizeable expert staff and the Commission starts to rely increasingly on its advice, then BEREC will in practice be taking decisions for the Commission, including some decisions going beyond mere implementation. In any event, if BEREC is eating away at any authority's policy-making autonomy, it is the NRA's and not the Commission's, so that no *Meroni* issue would then arise. Indeed BEREC is designed to increase 'consistency' among NRA decisions, especially as regards remedies. If the Commission retains a significant role in the matters on which it is advised by BEREC, then ultimately BEREC could serve as an additional lever to exert pressure on NRAs to fall into line.[159]

For both ACER and BEREC, the dividing lines between the practical competences of the Commission and ACER/BEREC on the one hand, and between ACER/BEREC and the NRAs on the other hand, are likely to evolve following continuous interactions in this new substantive and institutional regulatory space.

Even although the regulatory gaps on cross-border issues (in energy) and the perceived lack of consistency across borders (in electronic communications) will be incrementally reduced thanks to strengthened harmonization and cooperation at the EU level, it would be wrong to conclude that a definitive paradigm shift towards centralised powers has occurred with the creation of ACER and BEREC. Economic regulation will to a large extent remain a national competence, albeit that the NRAs should heed the European interest. Yet if European sector-specific regulation remains relatively weak and very partial in its coverage, there would appear to be some scope to 'fill in the gaps' in the current institutional architecture by resorting to a more imaginative use of ex post competition controls.

2. Article 106(2) TFEU

As we have explained above, in the wake of *Altmark* and the subsequent adoption of the 'Monti' package in 2005, the Commission has been confronted with the task of ensuring legal certainty for the Member States and their public service providers and at the same time ensuring sufficient flexibility to

[157] T. Tridimas, "Community Agencies, Competition Law and ECSB Initiatives" (2009) Yearbook of European Law 216.

[158] J. Pelkmans, S. Labory and G. Majone, "Better EU Regulatory Quality: Assessing current initiatives and new proposals" in G. Galli and J. Pelkmans, *Regulatory Reform and Competitiveness in Europe – Vol. I* (2000) 461 at 519.

[159] The pressure for 'consistency' essentially concerns remedies, since market definition and SMP designation are already subject to Commission supervision (and ultimately veto) under Dir 2002/21 (n 15 above) Art 7. Whether BEREC will succeed in bringing more consistency in the remedies imposed by NRAs will also depend on how the intricate review procedure of Dir 2002/21, Art. 7a (as added by Dir 2009/, n 141 above) works out in practice. On the face of Article 7a, NRAs may ultimately persist with their original proposal concerning remedies, but they will face considerable pressure to follow the views of the Commission and BEREC.

address local as well as sectoral variation in how public services are organized and operated, as well as the scope and quality of those services. This has led to some confusion as to how strictly Article 106(2) TFEU should be interpreted, and in particular its scope as an exemption to the Treaty state aid regime. As discussed above, the fourth *Altmark* criterion is not applicable in the context of Article 106(2); Member States must nevertheless ensure that public service obligations are clearly defined and entrusted through legal acts, and that the compensation for their performance is proportionate. Finally, and in accordance with the Transparency Directive,[160] cross-subsidisation should be avoided through separation of accounts for PSO (or SGEI) activities from all other functions.

Yet these rules are not always easy to apply, let alone police in sectors where there is little or no harmonizing legislation and as a result, where sector-specific regulation and sector-specific regulators are not available to take up these tasks. The result is often an opaque situation at national level. The exact scope of the relevant PSO may only be inferred from a pot pourri of national as well as regional and local norms, while neither the modes nor the levels of compensation are defined ex ante in a transparent manner. Benchmarks for 'reasonable' levels of compensation remain elusive. Ex post control may be a potential substitute to avoid over-compensation, but this too is not assigned in a consistent or transparent manner. Accounting separation is not subject to harmonized rules and the failure to apply any sort of system at all is not subject to any effective sanction. Although, following the Monti Report of 2010,[161] the Commission has recently launched a consultation exercise on the possible reform of the 2005 Community Framework for State aid in the form of public service compensation and accompanying enactments,[162] its efforts to create legal certainty and preserve the necessary flexibility are likely to be frustrated unless it is prepared to abandon the 'market access' paradigm that has dominated its approach to date, and to embrace a more integrated paradigm which will allow not just for the development of the requisite substantive norms but also for the design of a suitable institutional architecture to supervise more closely how PSOs are entrusted, performed and policed at national or where appropriate, regional or local level.

This has to be the correct 'quid pro quo': if Member States are to enjoy the flexibility to deliver and organize these services in accordance with their own policy objectives, then they must at the same time be prepared to ensure the necessary level of supervision to ensure that those entrusted with such tasks do what is to be expected of them. This could mean a more pro-active role for national bodies such as courts of auditors, or even competition authorities or alternatively for specially created, de-centralised

[160] Commission Directive (EEC) 80/723 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings [1980] OJ L 195/35, as amended.

[161] N 1 above at 73-75.

[162] N 95 above.

bodies, who are given a clear mandate to supervise PSOs in a transparent, independent and democratic manner. The institutional developments in sector-specific regulation could serve as an inspiration: conceivably national authorities could be integrated in a network and placed under the supervisory powers of the Commission. It is only in this way that a true reform can succeed in integrating the aspirations of the Union and the Member States to ensure universal access to such services for European citizens with further consensus building on the objectives of an integrated, highly competitive social market.

3. Concluding remarks

Just as with the developments in substantive law, the dividing lines between Community, state and market remain unclear. Although recent institutional developments have lessened the dividing lines between the EU and the national regulatory institutions, they have not resulted in a straightforward transfer of powers from Member State to the Community level. Furthermore, inherent separations remain – in particular along physical borders, so that cross-border network issues/activities are still not fully coordinated at either national or European level

The transition to a more integrative paradigm is by no means complete. As we have argued, separation has become the root of the problem and not the remedy. It will take time to recalibrate the institutional architecture and revise the substantive rules. Given the inherent division of competences between the EU and Member States, one may also speculate on whether certain dividing lines can ever be fully eradicated.

D. Conclusion

We have argued in this paper that an examination of recent trends in both substantive and institutional aspects of network regulation in two key sectors illustrate that the formalistic, 'market access' paradigm, initially relied upon by the Commission to force market access is gradually breaking down. We have explained that this paradigm is being replaced by a more integrative approach, which attempts to overcome the various separations imposed by the formalistic paradigm and which seeks to balance internal market objectives with other goals. We have traced the emergence of a more integrated institutional approach, where the dividing lines between European and national regulation are no longer clear-cut but where a choice for a more co-operative and multi-layered approach is evident. We have also argued that the substantive norms have evolved so that 'pigeon-holing' of problems is no longer the dominant perspective. Instead the latest packages of regulation adopt a more integrative approach too.

We have suggested that the original assumption that informed the design and scope of early network regulation – that sector-specific rules should give way to general competition law - has not been possible to maintain. Regulation in the electronic communications sector has become more not less

intensive. In spite of the introduction of structural unbundling in the energy sector, the regulation of the TSOs and transmission functions has not become 'lighter'. Indeed the TSOs must now ensure market access and reliable supply, but must also take on responsibility for additional longer-term objectives, including investment, dissemination of market information, and the promotion of renewables. Their quasi-regulatory tasks sit somewhat uneasily alongside their commercial organization and objectives, especially if they are not fully unbundled from other activities and functions within a vertically integrated firm.

As the substantive norms have become more intricate, complex and challenging, so has the institutional architecture which is now required to manage regulatory co-ordination across national boundaries. The Commission's role in the context of the realisation of the internal market exercise in the network sectors has become far more complex as a result. We argue that in the light of our analysis of both the institutional as well as the substantial features of network regulation, the Commission has been gradually forced to accept, if reluctantly, a new role. It is no longer possible for the Commission to content itself with realising market access or stimulating the creation of sustainable competition, or to correct market failures. The Commission's role has become one of 'managing competition' in the network sectors, alongside NRAs and NCAs.

The effective accomplishment of this task will require a further shift to more integrative approach – at both substantive as well as institutional levels. This is equally true with respect to Article 106(2) TFEU even in the absence of sector-specific legislation. The Commission will have to ensure that it is has the means at its disposal to ensure that all stakeholders involved can both subscribe to as well as meet its ambitious objectives in a complex policy setting. These objectives are, as we have explained, no longer limited to a single-minded pursuit of market opening and short term efficiencies. Instead complex policy trade-offs must be made across a multi-level institutional framework where sector-specific regulatory tools as well as competition law tools must be mobilised at Union and national level in pursuit of a careful balancing exercise. Managed competition involves managing and steering the continued interaction of 'Community, state and market'; it is not about drawing boundaries and dividing lines, and policing the relevant spheres of competence or elaborating formalistic 'pigeonholes' so that inherent tensions between 'state versus Community' or 'state versus market' can be conveniently side-stepped. With the coming of age of EU regulation in network industries, the end of the old formalistic approach is surely inevitable.

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