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## EC Telecommunications Regulation: Latest Proposals for Interconnection Arrangements: Whose Directive Is It Anyway?

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# EC Telecommunications Regulation

## Latest Proposals for Interconnection Arrangements: Whose Directive is it Anyway?

By Peter Crowther

### Summary

*As part of the liberalisation programme, the Community authorities have recently begun to address the problem of interconnection and the provision of universal service in telecommunications by issuing two proposals. This paper discusses the content and broader implications of these draft directives. The main conclusions of the paper are threefold: first that the two proposals on interconnection are currently in some ways inconsistent and must be amended before final versions are adopted; second that the regulatory frameworks envisaged by the directives do not give sufficient recognition to the intrinsic advantages which normally accrue to the dominant operator; and third that many of the requirements for introducing effective competition are defined only vaguely. More generally, this indicates that EU-wide competition in telecommunications looks set to be determined largely by future landmark competition law judgments than by specific regulatory control, since the implementation of the Directives is likely to be different across member states. The author concludes that this is not necessarily a bad thing, but that the scope of the competition provisions must be clarified in order to provide certainty for entrants and incumbents.*

### Introduction

The Treaty on European Union does not envisage a straightforward solution to the conflict between the existence of national monopolies and a system of fair competition within the internal market. The basic position is that member states must prevent such monopolies from acting in breach of the Treaty provisions. The respect for and protection of national property rights guaranteed by Article 222 EC<sup>1</sup>, coupled with the vague requirements set out by Article 90 in respect of revenue-producing monopolies meant however, that little action was taken until recently in the utilities sector generally. Since the mid-1980s, this position has changed, most notably in telecommunications. The Commission seized the initiative by issuing a Green Paper on Telecommunications in 1987<sup>2</sup>, and followed this by issuing Directives aimed at introducing competition and Decisions addressed to public sector undertakings which were found to have breached EC competition law. The liberal interpretation given to the competition provisions by the Commission in respect of their application to public companies has been broadly endorsed by the Court of Justice, a fact which has contributed to stimulating the Council into adopting measures of its own.

Until recently however, the Community authorities had not addressed the politically, economically and legally vex-

ing question of arrangements for interconnection<sup>3</sup> and the provision of universal service. This will be the single most important piece of legislation affecting how competition develops. The form in which these arrangements ultimately materialise is important for two basic reasons. The terms on which telecommunications operators (TOs) are permitted (required) to interconnect will have a huge impact upon the development of competition, not only in the telecommunications industry, but in all industries in the EU which rely heavily upon telecommunications for the organisation of their operations. Furthermore, the provisions for enforcing the interconnection arrangements must be clearly set out, with the most appropriate body adjudicating contested issues within a reasonable time frame. Within these issues

<sup>1</sup> Article 222 provides: This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.

<sup>2</sup> Towards a Dynamic European Economy: Green Paper on the Development of the Common Market for Telecommunications Services and Equipment COM(87) 290.

<sup>3</sup> Defined in the Article 100a proposal as the physical and logical linking of the facilities of organisations providing telecommunications networks and/or telecommunications services, in order to allow the users of one organisation to communicate with the users of another organisation or to access services provided by another organisation. (Art 1(c)).

mentioned are a whole array of sub-factors. For instance, a clear requirement for effective enforcement is that the access rules are clear, precise, and, where relevant, unconditional.

It is these fundamental and well-known general problems which must be solved through legislation for a successful European interconnection regime to emerge. However, in the European context, there are a number of further issues which must be resolved. The first of these is the need to strike a balance between liberalisation and harmonisation. It is not necessarily the case that a uniform set of access prices is optimal for the EU (harmonisation). Yet appropriate mechanisms must be in place to ensure that whatever the pricing rule adopted by the National Regulatory Authority (NRA), there is sufficient scope for competition (liberalisation)<sup>4</sup>. Second, the interconnection policy must be consistent with EC competition law, since no secondary<sup>5</sup> legislation may deprive the competition provisions of their effect. This raises difficult issues since the prescriptions for access pricing rules are somewhat different in a regulatory context than in a competition law context. Finally, whilst the *raison d'être* of Community law and policy is to achieve an internal market, the most appropriate means of doing so are far from clear. This raises issues at two separate levels: on the one hand, it is by no means clear which of the institutions should be involved in drafting legislation. Whilst there are a number of decision-making procedures available, the input of institutions is dependent upon which legal base is chosen<sup>6</sup>. The choice of legal basis is however much more than a lawyer's quibble, as will be seen here in the context of interconnection<sup>7</sup>, since it has an effect on how far-reaching the content of the legislation can be. The Court of Justice has already indicated that where options are available, the most democratic is to be chosen<sup>8</sup>. On the other hand, whichever legal basis is chosen, the substance of the legislation has to respect the principle of subsidiarity<sup>9</sup>. In short, this means that the legislation must allocate the appropriate functions to their respective levels. Any proposed legislation may be open to challenge on both or either of these points; the proposed legislation discussed below must therefore be read with this in mind<sup>10</sup>.

There are currently two separate proposals which seek to construct a European-wide regulatory framework for interconnection, and it is these proposals which are the main focus of this paper. First of all, a brief description of the basic principles contained therein is given, including the legal base on which the proposal is being made. This is followed by a section which compares the contents of the two Directives in respect of their main features. The latter half of the paper provides a commentary on the proposals, and attempts to set out the more problematic issues left open. Finally, some concluding remarks are made, in which some broad pre-requisites for an effective analysis of European telecommunications law and policy are set out.

There are two proposals which, when enacted, will establish a European-wide regulatory framework for interconnection and the provision of universal service. The first proposal is being adopted under Article 100a, and seeks to complement the existing Open Network Provision (ONP) legislation<sup>12</sup>. Article 100a is the most important legal basis for harmonising legislation and involves the most democratic decision-making procedure, set out in Article 189b<sup>13</sup>. The significant feature is that it provides for full co-operation between the Commission, the European Parliament, the Council and the Economic and Social Committee. The upshot of this, however, is an extremely complex decision-making procedure that can lead to lengthy delays.

The lengthy delays which have already plagued the ONP Voice Telephony Directive indicated that the Community would not meet its target of liberalising infrastructure and

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<sup>4</sup> This is somewhat of an oversimplification; in practice there will be a good deal of overlap. This is certainly true of the proposals discussed below.

<sup>5</sup> i.e. directives, decisions, regulations etc.

<sup>6</sup> Any piece of secondary legislation must have an adequate legal basis taken from the Treaty and be accompanied by an explanatory statement of reasons. Any legislation which fails on either ground may be declared invalid due to procedural irregularities.

<sup>7</sup> There are two proposals discussed below, both of which have been prepared under separate legislative procedures.

<sup>8</sup> The draft directive on the application of ONP to voice telephony had to be resubmitted following the entry into force of the Treaty of Maastricht under a more democratic procedure.

<sup>9</sup> The voluminous commentary on subsidiarity renders it impossible to make any kind of substantive contribution here. It will suffice to point out that the role of subsidiarity has (unsurprisingly) not been clarified by the Court of Justice. Subsidiarity will operate at two levels: first to determine whether the Community has competence to act (it has); and second to determine whether the substance of the legislation reflects the principle of subsidiarity. The jurisdictional delimitation must therefore be investigated carefully. It is, of course, not necessarily the case that an optimal interconnection policy is one which is consistent with the principle of subsidiarity.

<sup>10</sup> It is perhaps worthwhile to point out here that this is not mere conjecture. The two most important Directives commencing the introduction of competition in telecommunications were both challenged as to their validity by a number of member states. The result of these actions was a number of changes imposed by the European Court of Justice. The cases are discussed further below.

<sup>11</sup> These are, in the nature of things, liable to be altered. The following should therefore be read with this in mind.

<sup>12</sup> Council Directive 90/387/EEC of 28 June 1990 on the establishment of the internal market for telecommunications services through the implementation of open network provision OJ L 192, 4/07/90 p. 0001. This has been supplemented by a number of legislative measures and recommendations.

<sup>13</sup> This is known variously as the co-decision procedure, the joint decision-procedure and predictably, the Article 189b procedure.

voice telephony by 1 Jan 1998. As a result, the Commission is proposing a framework under Article 90(3) which seeks to achieve this, until the ONP Directive is passed. That paragraph provides that the Commission may issue directives or decisions to ensure that public companies and companies with special or exclusive rights do not infringe the Treaty provisions. The advantage of the Article 90(3) procedure is that it allows the Commission to act relatively quickly, since there is no need for formal consultations with other institutions<sup>14</sup>.

The basic way in which the proposals interact is as follows: the Article 100a proposal is "superior", since it is being adopted under the most democratic legislative procedure. The Article 90(3) proposal paves the way for the introduction of competition through the Article 100a Directive. One might therefore expect a good deal of consistency in the two proposals. It will be seen however that this is not the case; in fact, in some respects, the two proposals are openly incompatible.

### Article 100a ONP Proposal<sup>15</sup>

Article 1 sets out the aim of the Directive, which is to establish "... a regulatory framework for securing the interconnection and interoperability of telecommunications networks and services in the European Union, in an environment of open and competitive markets... It concerns the harmonisation of conditions for open and efficient interconnection to public telecommunications networks and public telecommunications services."

The timetable for the adoption by the EP and Council is 31 December 1996, with the target date for implementation into national law set at 31 December 1997. This is in accordance with the Council Resolution to liberalise telecommunications services and infrastructure by 1 January 1998<sup>16</sup>. The proposal builds on the 1990 Commission Directive on Telecommunications Services and the Council Directive on ONP, adopted at the same time.

The principal features of the Directive are:

- Application of the ONP principles: transparency, objectivity, and non-discrimination, in accordance with the principle of proportionality
- Priority given to negotiation by interconnecting parties
- Clear responsibilities for NRAs.

### Article 90(3) Proposal<sup>17</sup>

The purpose of the Directive is to amend Directive 90/388<sup>18</sup> which specifically excluded from its scope voice telephony and other services. It represents an important part of the liberalisation programme<sup>19</sup>. The Preamble to the proposal points out that the Council Directive on the application of open network provision to leased lines only harmonises conditions of access and use of leased lines. The aim of that Directive is not to remedy the conflict of interest

of the telecommunications providers as infrastructure and service providers. Nor does the Directive restrict the control of information used by the infrastructure provider. The broad aim of the proposal is to remedy this situation, by imposing a number of requirements on Member States and Telecommunication Operators (TO).

## Comparison of the two proposals

### Principles of Interconnection

In principle, it is expected in both proposals that TOs will negotiate their own interconnection arrangements. Only when this is impossible, do the parties have recourse to the NRA (and/or Community authorities). However, in the early stages of liberalisation, both Directives envisage that the NRA will play an important role in setting standard terms and conditions.

### Rights and obligations

From the Article 100a proposal, all TOs which "have significant market power"<sup>20</sup> must as a matter of principle meet reasonable requests for interconnection. What is a reasonable request is to be determined, in the first instance, by the NRA. Furthermore, all TOs have rights and obligations to negotiate interconnection with each other<sup>21</sup>. NRAs may provide where necessary that there are technically and commercially viable alternatives to the request for interconnection *and* that the request for interconnection is "inappropriate in relation to the resources available to meet the request". It would seem from this therefore that some form of capacity constraint as well as a possibility for bypass are required for a legitimate refusal to interconnect. The Proposal does not however stipulate how a NRA should arrive at the conclusion that there are com-

<sup>14</sup> As a matter of practice however, the Commission does invite comments from the other institutions on an informal basis.

<sup>15</sup> Commission proposal for a European Parliament and Council Directive on Interconnection in Telecommunications — Ensuring universal service and interoperability through application of the principles of Open Network Provision.

<sup>16</sup> Council Resolution 93/C 213/01, 6.8.1993.

<sup>17</sup> Draft Commission Directive amending Commission Directive 90/388/EEC regarding the implementation of full competition in telecommunications markets.

<sup>18</sup> 90/388/EEC: Commission Directive of 28 June 1990 on competition in the markets for telecommunications services OJ L 192, 24/07/90 p. 0010. See also Commission Directive 94/46/EC of 13 October 1994 amending Directive 88/301/EEC and Directive 90/388/EEC in particular with regard to satellite communications.

<sup>19</sup> Telecommunications to be liberalised by 1 January 1998, with exceptions for some countries : Spain, Ireland, Greece and Portugal (5 years).

<sup>20</sup> Defined as a TO with a 25% share or greater of the relevant product or service market.

<sup>21</sup> Article 4.

mercially viable alternatives, except providing that this must be assessed on a case by case basis. This is unfortunate for the NRA since what is commercially viable to one company may not be to another. Whilst this *would* be reflected in a case by case basis, this is symptomatic of the problem rather than a solution for it. Treating different companies differently will possibly amount to discrimination amongst entrants<sup>22</sup>, which breaches a fundamental principle of the Treaty. The question remains whether this would be a justifiable form of discrimination. More generally, the Article 100a proposal presupposes an array of rights and obligations, the obligations turning upon the amount of rights which the entrant wishes to acquire.

The Article 90(3) Proposal provides that

”Member States shall withdraw all those measures which grant:

- (a) Exclusive rights for the supply of telecommunications services, including the supply of telecommunications networks required for the provisions of such services, and
- (b) special rights which limit to two or more the number of undertakings authorised to supply such telecommunications services or such networks, otherwise than according to objective, proportional and non-discriminatory criteria, and
- (c) special rights which designate, otherwise than according to such criteria, several competing undertakings to provide such telecommunications services or such networks.”

The Preamble states that exclusive rights to construct infrastructure must be abolished, since although this is apparently non-discriminatory, their practical effect is to breach Article 90 in conjunction with Article 52<sup>23</sup> or 59<sup>24</sup> EC. A similar provision is made in respect of voice telephony.

### Universal service obligations

The Art. 100a proposal provides that the NRA shall determine where Universal Service Obligations (USOs) amount to an unfair burden. When setting the level of contributions, the NRA must take account of three well known principles in Community law: transparency, non-discrimination and proportionality. The proposal leaves it to the member state to determine the methodology for calculating the costs. Under no circumstances may an amount for universal service be levied for anything other than a public telecommunications network. The charge may be made either through a separate fund or as a supplementary charge added to the interconnection charge.

The onus is upon the TO to calculate USOs when requested by NRAs, and must be audited by an independent body. Until the NRA requests the calculation of the USO costs, where a TO demands USO contributions from an interconnecting party, the NRA and the Commission must be

notified. Whilst the presumption is in favour of the NRA setting the appropriate charge, the gate is left open for Commission Guidelines on setting charges.

The Article 90(3) proposal also recognises that there are a number of different means of financing universal service obligations<sup>25</sup>. In its Preamble, it recognises that the level of US contributions may have a detrimental effect on the development of competition. Accordingly, it suggests that the contribution towards USOs must be linked to the turnover of the company concerned. The principle of proportionality is used to suggest that companies with a small market share should not contribute to USOs; this would be the case for any company with less than 25% of the relevant market. Whilst this is a guiding principle, the Preamble indicates that in no circumstance should a company contribute to USOs where its share of the relevant market is less than 5%.

The Art 90(3) proposal sets out some specific guidelines on the financing of USOs:

- USOs may only be financed for public telephone networks and voice telephony.
- Non-discrimination and proportionality.
- No contributions from undertakings which do not have a significant market share.
- Incentives to provide USOs as efficiently as possible and to ”allow any undertaking covered to propose to fulfil itself the relevant universal service obligation for a compensation equal or below the cost claimed by the TO”<sup>26</sup>.
- Provide an efficient procedure for settling disputes regarding charges.

When implementing the above obligations, the NRA must notify any proposed schemes to the Commission before implementing them, that the Commission may judge its compatibility with the Treaty. The Commission will review in 2003 the ”situation in the Member States where the financing scheme consists in a system of access charges to be paid in addition to the connection charges for interconnection at specified points of the public switched telecommunications network and assess in particular whether such schemes do not limit access to the relevant markets.” Finally, TOs must be allowed to re-balance tariffs and in particular adapt rates which are not in line with costs and which increase the burden of universal service provision. The proposal seems to envisage that USOs will

<sup>22</sup> See further below, in the Commentary.

<sup>23</sup> Article 52 preserves the right of establishment.

<sup>24</sup> Article 59 guarantees the freedom to provide services.

<sup>25</sup> In an earlier draft the Directive required US to be paid through a separate fund.

<sup>26</sup> There appears to be no equivalent to this in the Article 100a proposal.

become a thing of the past, and the Commission will actively attempt to ensure this is the case by undertaking wholesale reviews within five years of the date for liberalisation.

### Non-discrimination and transparency

On non-discrimination, the Article 100a proposal provides that the TO must "apply similar conditions in similar circumstances to interconnected organisations providing similar services, and shall provide interconnection facilities and information to others under the same conditions and of the same quality as they provide for their own services, or those of their subsidiaries or partners"<sup>27</sup> All interconnection charges are to be published and any changes must be notified 6 months in advance. These principles apply to those companies determined as having a significant amount of market power (25%).

The Art 90(3) proposal makes the general statement:

"1. Without prejudice to future harmonisation of the national interconnection regimes by the European Parliament and the Council in the framework of ONP, Member States shall ensure that the telecommunications organisations provide interconnection to their voice telephony service and their switched telecommunications network on non-discriminatory, cost-orientated and transparent terms and according to the principle of proportionality."

### Principles for setting charges

The Article 100a proposal makes an interesting provision on the setting of charges. It requires that interconnection charges "shall follow the principles of transparency and cost-orientation, and promote economic efficiency and *sustainable market entry*." (emphasis added). The onus is upon the TO to demonstrate that its charges are cost-orientated. Although the TO has the right to set charges at the level it sees fit, this is subject to control by the NRA and alternative price levels may be imposed. Article 7(3) sets out the two elements of a normal<sup>28</sup> interconnection charge, to be documented separately:

- charge to recover one-time costs
- charges based on the use of the network, which may include capacity-based and/or traffic related charges.

Annex IV provides some loose guidelines<sup>29</sup> as to the type of costs which can be included here.

As is to be expected, interconnection charges must be unbundled, in order that the "entrant" is not required to pay for services not used and can readily identify any USO element. The cost accounting systems to achieve this function are to be set out by member states. Annex V sets out what kind of information should be included in the publication of the cost accounting methodology. It refers to different cost measurements e.g. fully distributed costs, long-run average incremental costs, marginal costs and so on, but

expresses no preference for any particular cost standard. The same applies to the methods used for cost allocation, whether direct or common or joint, and to the accounting conventions employed to establish costs, i.e. the timescale for depreciation of fixed assets and so on. All charges and cost accounting systems are to be open to public inspection.

As with the financing of USOs, the setting of interconnection charges is to be monitored chiefly by NRAs. The Commission reserves itself the power however to issue recommendations for a common approach to the setting of interconnection charges.

Article 4A of the Article 90(3) proposal sets out that NRAs must ensure that by 1 July 1997 TOs publish the terms and conditions for interconnection. The Directive expresses the view in the Preamble that unless member states do this, there will be *de facto* no liberalisation in the immediate period after the liberalisation date set at 1 January 1998<sup>30</sup>. It then goes further to establish the specific elements which must be included:

- one time costs of making the physical connection,
- variable costs for supplementary services (charging, operator assistance etc.), — conveyance charges and the manner of calculation, whether a call-per-call basis and/or any additional network capacity required,
- amount of costs incurred in ensuring equal access — i.e. identical end-user procedures, costs of ensuring essential requirements,
- any charges covering universal service obligations.

In respect of the accounting requirements, Article 4A(4) provides that member states must keep the accounting system used at the disposal of the Commission.

### Accounting separation

The Article 100a proposal states that those TOs with significant market power and who interconnect with competitors must provide separate accounts for each activity.

<sup>27</sup> Article 6(a). This would appear to allow for an ECPR/Ramsey-type rule, where charges are made on the basis of demand rather than cost conditions alone.

<sup>28</sup> The proposal also envisages the granting of bulk discount schemes.

<sup>29</sup> Costs may be based on call-per-call basis, and/or on the basis of additional network capacity required. They may include contributions towards ensuring network integrity, number portability, and so on, all of which is subject to the principle of proportionality.

<sup>30</sup> Furthermore, the Preamble states: The failure by Member States to adopt the necessary safeguards to prevent such a situation should be considered as a measure strengthening the dominant position of the telecommunications organisations and therefore incompatible with Article 90 in conjunction with Article 86.

The Directive also provides that NRAs shall have the right to obtain any relevant information to ensure the fulfilment of this obligation and the right to publish any information not deemed confidential which would "contribute to an open and competitive market"

With one exception, the Art 90(3) proposal does not make any explicit requirements for accounting methods or separation, but provides that NRAs must keep the cost accounting system implemented by the TOs at the disposal of the Commission. The Commission may require information from the NRA on the methodology used for calculating interconnection costs. The exception to this is the reference in the Preamble to undertakings possessing special or exclusive rights in areas *other than* telecommunications. Where they have a turnover of more than 50 million ECU, they are required to provide cost and revenue accounts for each of the activities. Furthermore, it is arguably implicit in the general requirement of transparency that separate accounting will be required for separate activities.

### General responsibilities of the National Regulatory Authority

In addition to setting out the role of NRAs with regard to specific issues, the Article 100a proposal also sets out in general terms their responsibilities. The general obligation is to provide a framework which "provides maximum economic efficiency and gives the maximum benefit to end-users"<sup>31</sup>. In achieving this goal, NRAs must have regard to the following factors:

- ensuring satisfactory end-to-end communications
- stimulating a competitive market
- promoting the development of trans-European networks
- principle of non-discrimination
- universal service obligations

The Article 90(3) proposal does not set out broad policy objectives to be pursued by the NRAs, but sets out specific obligations with respect to certain aspects of the liberalisation programme. An example of this is the obligation to keep reports of the methodology used in setting interconnection and US charges. Further examples are considered below in their respective categories.

### Facility sharing

The Article 100a proposal provides<sup>32</sup> that where a TO is granted a general right to install facilities NRAs must "*encourage* the sharing of such facilities and property with other organisations providing public telecommunications services" (emphasis added).

On the other hand, Article 4D of the proposed Article 90(3) Directive provides for a *mandatory* sharing of resources: "... Member States should ensure mandatory

sharing at reasonable terms of resources established under rights of way and which may not be duplicated." The same Article provides that granting rights of access to only one telecommunications company can only be justified on the grounds of essential requirements<sup>33</sup>.

### Dispute resolution

The Article 100a proposal sets a regime for dispute resolution at two separate levels: national and Community. At the national level, the NRA will step in at the request of either party to a contested interconnection negotiation. In resolving the dispute, one interesting factor into which the NRA may take into account is the relative market positions of the parties<sup>34</sup>. The NRA is obliged to take account of the following factors, some of which will no doubt be highly contentious:

- the user interest,
- regulatory obligations or constraints imposed on any of the parties,
- the desirability of stimulating innovative market offerings,
- availability of alternatives,
- the desirability of ensuring equal access arrangements,
- maintaining the integrity of the public telecommunications network,
- nature of the request in relation to the resources available,
- the relative market positions of the parties, — the public interest (e.g. the protection of the environment).

After a period of two months, if the NRA has not achieved a solution which is satisfactory to both parties, either party may request the dispute to be brought to the Community level. Briefly, this involves the ONP Committee with the final decision resting with the Commission<sup>35</sup>.

The Article 90(3) proposal also makes certain provisions on dispute resolution<sup>36</sup>:

"Member States shall .. ensure that organisations providing telecommunications networks and/or services who so request can negotiate interconnection agreements for access to the public switched telecommunications regarding special network access and/or conditions matching their specific needs. If commercial negotiations do not lead to an agreement within a reasonable time period, the

<sup>31</sup> Article 9.

<sup>32</sup> Article 11.

<sup>33</sup> .e.g. Maintaining network integrity and so on.

<sup>34</sup> Others are given in Article 9. They include straightforward issues, such as the user interest and the need to maintain network integrity.

<sup>35</sup> It does not preclude recourse to normal actions under Community law.

<sup>36</sup> Art 4A(6).

Member State shall take upon request from either party and within a period of four months, a reasoned decision which establishes the necessary operational and financial conditions and requirements for such interconnection without prejudice to eventual procedures under the applicable national and Community law.”

This regime is intended to operate for five years after the abolition of special and exclusive rights, unless the Article 100a proposal is adopted during this time.

### Commentary

The fact that there are two proposals is not surprising in itself. Experience with previous Article 100a Directives suggests that the Council’s political commitment to liberalise voice telephony and network infrastructure by January 1, 1998 is unlikely to be met; therefore the Article 90(3) proposal is essential to furthering the liberalisation effort. After reviewing some issues specific to the Article 90(3) proposal, the paper then discusses some of the general aspects of the regulatory framework envisaged by the Article 100a proposal. In doing so, it gives brief consideration to a number of outstanding issues, in particular the role of the EC competition provisions.

#### Legal issues specific to the Article 90(3) Proposal

Only a short time ago, this proposal would have been regarded by most as *ultra vires per se*. The scope of Article 90(3) as a legal basis in telecommunications was challenged on both occasions where it was previously used by the Commission to abolish special and exclusive rights. We commence therefore with a brief review of the use of Article 90(3) as a legal basis, since this gives some indication of the likelihood of the Directive being implemented without challenge.

The text of Article 90 provides as follows:

- ”1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Art. 7 and Arts. 85 to 94.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.
3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary,

address appropriate directives or decisions to Member States.”

As is clear from the text, the Commission is empowered to issue Directives and Decisions to ensure that Member States and undertakings ”entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly..” respect the Treaty provisions. It is noteworthy that Paragraph 1 does not *preclude* the existence of special or exclusive rights *per se*. Early case law of the Court of Justice confirmed this<sup>37</sup>. Yet despite the fact that the proposal seeks to abolish certain special and exclusive rights, more recent jurisprudence suggests that, in respect of the provisions of voice telephony at least<sup>38</sup>, this will be upheld. Two important directives which help to open up competition in telecommunications are the ”terminal equipment” directive and the ”services” directive. Both of these were adopted under Article 90(3) and both were challenged as to their validity before the Court of Justice.

#### The Terminal Equipment Directive

Briefly, the terminal equipment directive contains the following important provisions:

- Member States must remove special and exclusive rights in the area of terminal equipment.
- Member States must allow competitors to provide terminal equipment.
- Specifications and type approval procedures are to be vested in a body independent of those providing goods and services.
- Member States must publish the relevant specifications, that manufacturers may adapt their products accordingly.

The impact of the Directive was perceived to be far-reaching. By requiring the special and exclusive rights to be abolished, a number of member states considered that the

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<sup>37</sup> See e.g. Case 155/73 *Saachi* 1974 ECR 409. At paragraph 14 it found that ”Article 90(1) permits Member States inter alia to grant special or exclusive rights to undertakings. Nothing in the Treaty prevents Member States, for considerations of public interest, of a non-economic nature, from removing radio and television transmissions,.. from the field of competition by conferring ... an exclusive right to conduct them. However, for the performance of their tasks these establishments remain subject to the prohibition against discrimination and, to the extent that this performance comprises activities of an economic nature, fall under the provisions referred to in Article 90.” The original distinction thus appeared to be between the existence and exercise of the rights. A similar distinction has been employed in the field of intellectual property rights. In this field as well, however, the distinction appears to have been blurred. See *RTE & ITP v. Commission* [1995] (*Magill*), not yet reported, judgment of 6 April 1995, noted by Crowther [1995] ELRev, October issue.

<sup>38</sup> See below for comments on the abolition of special and exclusive rights in respect of infrastructure.



Commission had exceeded its powers and challenged the validity of the directive before the Court of Justice. Here it appeared that the Commission was attempting to use Article 90(3) to circumvent the provisions in Article 90(1).

The Court of Justice held<sup>39</sup> that the directive was valid but annulled two provisions, the provisions seeking to abolish special rights and the provision requiring the termination of long-term leases. Significantly, the Court did not annul the provision requiring the abolition of exclusive rights, holding in this respect that the exclusive rights were incompatible with the EC Treaty. However, the difficulty left by this judgment is the exact scope of the special right, not defined in Article 90. In his Opinion, Advocate General Jacobs considered that special rights would arise when there were only a limited number of telecommunications providers in a national market. This means that the interconnection directive could have a potentially important role. Member States will not longer be able to hide behind a special rights defence where there are numerous<sup>40</sup> telecommunications operators.

### Telecommunications services

Most telecommunications services were opened up as a result of the Services Directive and it was also challenged by a number of member states. The Directive provides for the liberalisation of all telecommunications services excepted so-called reserved services<sup>41</sup> and those specifically excluded<sup>42</sup>. In doing so, it required the abolition of all restrictions existing as a result of special and exclusive rights being granted. Furthermore, the Directive imposed obligations on member states to publish access conditions which must be nondiscriminatory.

The Directive was also challenged before the Court of Justice. The Court gave a judgment which was in many respects similar to its *Terminal Equipment* judgment, again, however, not clarifying the scope of the special rights. It declared invalid the abolition of the special rights referred to in the Directive, stating that such rights were imprecisely referred to and no indication had been given as to how such rights might be contrary to the Treaty.

Careful analysis is therefore required of the justifications given for the abolition of special and exclusive rights as sought by the Article 90(3) proposal. A particularly problematic example of this is the abolition of special and exclusive rights for the provisions of infrastructure. This goes far beyond determining what is anti-competitive on the part of a TO, and the reasoning for this provision is suspect from a legal perspective. The Directive mentions that to maintain the existing exclusive rights in this field would be contrary to Article 90 in conjunction with Articles 52 or 59. Article 52 gives a right of establishment for undertakings in member states "... under the conditions laid down for its own nationals by the law of the country where such establishment is effected." Article 59 preserves the freedom to provide

services for those "who are established in a State of the Community other than that of the person for whom the services are intended."

It is a moot point whether this is a proper interpretation of the Treaty provisions. Articles 52 and 59 operate to prevent discrimination on the grounds of nationality. Since any exclusive rights would apply indistinctly to both nationals and foreigners, it is difficult to see how any discrimination on the grounds of nationality would materialise. The Preamble anticipates this criticism:

"Given the fact that most new entrants will originate from other Member States such a measure, would in practice affect more foreign companies than national undertakings. Such measure [sic], although non-discriminatory in its wording, would therefore constitute a discrimination in breach of Article 90 in conjunction with Articles 52 or 59 of the Treaty and should accordingly be abolished<sup>43</sup>."

It is inappropriate to enter into a detailed discussion of its legality based upon this point. It will suffice here to point out that if the Directive was challenged, the Court of Justice may take a broad view of what constitutes discrimination. In other areas of Community law, in particular relating to free movement of goods, the Court has held that even indistinctly applicable measures may fall foul of Community law where they have an effect, direct or indirect, upon inter state trade. More recently however, it has shown a reluctance to continue the jurisprudence it has developed in this area, a recognition, according to some commentators, of the emergence of the principle of subsidiarity<sup>44</sup>.

The strongest legal argument for abolishing exclusive rights on infrastructure is that the TO would be induced to abuse its dominant position by both owning the network and setting the terms of access, mentioned in the Preamble. The difficulty with this is that, whilst it may find some support from the Court of Justice based on its previous case law, the ONP Directive on leased lines already provides for nondiscriminatory access based on shared use of infrastructure. Equally significantly, the Article 100a proposal does not require *mandatory* sharing of resources. That proposal only requires that interconnection should be facilitated and where possible, sharing of resources (rights

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<sup>39</sup> *France v. Commission* [1991] ECR I-1223.

<sup>40</sup> The Article 100a proposal refers to special rights granted to two or more undertakings.

<sup>41</sup> voice telephony (and until the end of 1992, packet and circuit-switched data services).

<sup>42</sup> radio/TV broadcasting, telex, mobile radio telephony, paging and satellite services. See Art 1(2).

<sup>43</sup> The Preamble makes the same comment as to Indefeasible Rights of Use (IRU) in international circuits, stating that the restriction on IRU breaches Article 59.

<sup>44</sup> The land-mark judgment in this respect is *Keck*, a judgment rendered two weeks after the entry into force of the Treaty of Maastricht which enshrined the principle of subsidiarity. The case has subsequently been termed the November revolution.

of way) is to be encouraged. Finally, the proposed Article 90(3) Directive does not establish *why* the existing provisions do not suffice, a factor which would be significant if the Directive was challenged on this point.

Much of the content of the proposed Article 90(3) Directive is very much open to challenge. In particular, the proposal aims to establish a very specific regulatory framework for telecommunications. Whilst this is a perfectly feasible objective for a piece of harmonising legislation<sup>45</sup>, it is arguably beyond the powers of the Commission under competition policy to make such stipulations. The requirements of Article 90 could be met by setting out basic principles which must be met in order that the competition provisions are not breached. In respect of the proposed regulatory arrangements it is presumably perfectly possible to have widely differing regimes at the national level all of which meet the requirements of competition policy.

### The proposed regulatory framework

The proposed Directives have a number of features in common. However, these features are derived mainly from what the Directives do not provide for, rather than vice-versa. Neither provides for an access pricing rule, nor a method for funding universal service; rather both set out in general terms what is to be required of a national regulatory authority. In a number of significant respects however, the proposals differ.

It is interesting to consider the view taken by both Directives on the intrinsic advantages which are generally recognised as accruing to the dominant telecommunications operators in national markets. Whilst the ONP proposal does not envisage taking any particular steps to counteract this, this is not the case with the Article 90(3) Directive. Although the Commission has not set out any particular regime for dealing with these advantages in terms of directions given to the NRAs, it has sought to overcome the limitations of Article 90(3) as a legal basis by taking a slightly different approach. As what appears to be a poor substitute for vertical separation, it is proposing that mandatory access should be granted to the construction of new facilities. Whilst this may be evidence of the difficulty in giving specific direction within the confines of an Article 90(3) directive, (and of the lack of initiative the Commission expects NRAs to take in this respect), it does rather appear as if the Commission may be cutting off its nose to spite its face.

Where there is evidence of anticompetitive behaviour, there is sufficient scope for the Commission to issue a decision under Article 90(3) which, by its very nature, may be much more specific. However, the costs of obtaining such evidence are likely to be prohibitive, and the resource constraints of DGIV, the Directorate responsible for competition, are well-known. By taking the mandatory access approach however, if successful, the Commission may well be encouraging inefficient duplication of networks. Of course,

where new networks are designed which confer significant technological improvements, the situation is different. The mandatory access provision makes no requirement for there to be any value-added. The possible scenario is that an impression of vigorous competition is given, whilst consumers pay the cost of inefficiencies.

The legality of an implicit requirement that US should be funded through a separate scheme was mentioned above. There appears to be no sound economic basis for insisting that this should be the case. In so far as the relevant aspects of interconnection charges are separated, funding of US can be achieved equally effectively. The institutional arrangements should not, in this case, affect the transparency of the charging system.

Another way in which the proposals differ is the requirement of prior notification of regimes envisaged by the NRA to the Commission in the Article 90(3) proposal. In the Article 100a proposal, it is assumed that in the absence of a cross-border dispute, the Community authorities will not be involved. A careful reading of the Article 90(3) proposal however, reveals that the Commission has retained the possibility of exerting much more control than is immediately apparent. For instance, in respect of arrangements for universal service, "Member States shall communicate the envisaged scheme to the Commission to that it can verify the scheme's compatibility with the Treaty before its implementation". This provision is unlikely to be ultra vires as it stands, but it could prove to be an extremely important clause. By introducing the element of control in this manner, the Commission is arguably not outstepping the realms of the Article 90(3) legal base *per se*, but is placing itself in a position to both receive information automatically and issue specific directions in the form of a decision. Therefore, whilst on the face of it, the Commission is giving little direction to the member states, the reality may be quite different. If the Commission does act to set out a specific method of financing universal service obligations for any member state it considers is breaching the principles of the Directive, the result will be a very different regulatory framework from that envisaged by the Article 100a ONP proposal. The potential for conflict (and therefore challenge) looks ripe in this respect<sup>46</sup>.

A further way in which the Article 90(3) proposal differs from its counterpart is in the arrangements for interconnection. The proposal appears to assume a greater role for the NRA in the early stages of liberalisation (the first 5 years) than the Article 100a proposal. That proposal sets out that from the beginning, negotiations for interconnection are to be conducted by the parties, with the NRA only stepping in

<sup>45</sup> i.e. the Article 100a proposed Directive.

<sup>46</sup> One must perhaps not overlook the fact that the Article 90(3) proposal is being prepared by DGIV (competition), whereas the Article 100a proposal has been made by DGXIII (telecommunications). This may itself explain some differences between the two proposals, but such considerations fall beyond the scope of this paper.

to resolve conflicts. More realistically perhaps, the Article 90(3) proposal assumes that the NRA will enforce certain standard conditions, allowing only later a greater amount of flexibility to the incumbent(s). The biggest difficulty with this is the lack of guidance given on what might be acceptable standard terms and conditions. It is noteworthy that the Commission has again reserved itself the right to investigate these terms, after a period of five years. The proposal also mentions that guidelines may be drawn up to clarify the relationship between interconnection and competition law<sup>47</sup>.

The stated role of the proposed Art 90(3) Directive is to set out how the competition rules are to apply, at least until some further harmonisation by the Art 100a Directive. One major omission by the Directive is a requirement on accounting separation<sup>48</sup>. Effective enforcement of the competition provisions requires the relevant cost base to be located, in order that allegations of anti-competitive behaviour can be investigated. The Directive assumes either that these information requirements are already in place, or that Member States will put such mechanisms into place as a result of the Directive. This is arguably a serious omission, since whilst it may be possible for the Commission to find a breach of Article 90(3) together with Article 86 for not requiring the relevant accounting separation, this is missing the point. Accounting separation is a lengthy task and cannot be undertaken quickly as a precursor to every competition law investigation. Making a reference to accounting separation in the Preamble will not solve the problem here. The fact that the proposal does not make any reference in the operative part of the Directive is perhaps surprising, given the amount of control which other provisions in the directive will seek to impose.

### The role of competition law

Both of the proposals discussed in this paper recognise the use of the competition provisions to enforce the Directives<sup>49</sup>. However, the scope of EC competition law in this context remains far from clear. The Commission has begun to develop an essential facilities doctrine which sets out in general terms the obligations of owners of essential facilities towards entrants. However, this has yet to be tested in an economically complex situation<sup>50</sup>, and there have been no cases in which the price of access to an infrastructure has been at issue<sup>51</sup>. It is arguable that an Article 90(3) Directive would have been more suited to setting out the role of the competition provisions rather than attempting to impose positive, detailed and specific obligations on NRAs. As the proposals stand, however, it is extremely difficult to anticipate the position which will be taken by DGIV against alleged anticompetitive behaviour<sup>52</sup>. The main reason for this is that neither Directive takes a stance upon the appropriate pricing rule or the level of US to be employed. Whilst this is perhaps to be welcomed in that it allows NRAs to set rules according to

the state of the market<sup>53</sup> in individual member states, there remains the rather obvious danger of inconsistency. The fact that much of the terminology remains vague seems certain to result in the directive being implemented into national law in very different ways<sup>54</sup>.

Whilst both Directives envisage some form of dispute resolution mechanism, these are without prejudice to normal remedies under national and Community law. Moreover, whilst the Commission is empowered to issue fines against companies which breach the competition provisions, it is not able to grant damages in favour of those

<sup>47</sup> For the role of competition law, see further.

<sup>48</sup> This is mentioned in the Preamble but is not to be found in the operative part of the Directive. The Preamble provides that Member States should ... require ... undertakings once they achieve a significant turnover in the relevant telecommunications service and/or infrastructure provision market, to keep separate financial records, distinguishing between inter alia, costs and revenues associated with the provision of services under their special and exclusive rights and those provided under competitive conditions. For the time being, a turnover of more than 50 million ECU could be considered as a significant turnover.

<sup>49</sup> Strictly speaking, neither an Article 90(3) nor an Article 100a Directive could in any case render Articles 85, 86 and 90 inoperative in this context. The situation is different where there is a common policy, for instance transport.

<sup>50</sup> The *Eurotunnel* Decision might be regarded as an exception to this. The Commission did not, however, embrace a particularly sophisticated approach in this case, as noted by Crowther, *Utilities Law Review* 1995. The case is currently on appeal.

<sup>51</sup> On the essential facilities doctrine, see Cave and Crowther, "The Essential Facilities Doctrine" *Network Utilities Conference*, Milan May 1995.

<sup>52</sup> It is understood that the Commission is currently preparing a draft Notice on the relationship between interconnection and competition law. This would serve to clarify the position, without being legally binding. Details of the Notice were, unfortunately, unavailable at the time of writing.

<sup>53</sup> Liberalisation is at differing stages in different member states and different states have specific problems to deal with, e.g. small networks.

<sup>54</sup> The argument might be made that if the relevant directive has not been implemented (or implemented improperly) an entrant which suffers as a result may be able to rely on the direct effect of the directive. This has a number of problems, not least the fact that directives are only ever vertically directly effective (i.e. apply to state-individual relationships). Where the TO is not an emanation of the state, this will mean that the entrant cannot rely on it. The concept of an emanation of the state has however been given a broad interpretation. In *Foster v. British Gas*, the Court of Justice held that despite British Gas being a privatised company, it was nonetheless regarded as an emanation of the state. For a provision to be directly effective, it must be clear, precise and unconditional, which given the obscurity of many of the provisions, may well not be the case. Where this is not the case, there remains the lesser known doctrine of indirect effect. In short, this places a duty on the national court to do all in its power (pursuant to Article 5 EC) to interpret national law to give effect to Community law. The obvious restriction here is that there must be some national law to interpret. A final possibility is that the entrant may be able to obtain damages from the state for its failure to respect its Treaty obligations (*Francovich*).

who suffer from the actions of dominant companies. This means that an action in the national courts would be favourable to an entrant, since national courts can grant damages under Community law. Where a national court is unsure as to the proper application of Community law it will ask the European Court to make a ruling on the issue. This means that the competitive environment will be determined, to some extent at least, by the Court of Justice. Based on the court's existing case law, it is to be expected that a pro-competitive policy will be followed. However, given the economic complexity of the issues which are likely to fall before the court, it remains questionable whether a general court is the most appropriate forum for the resolution of such disputes.

Similar concerns may be voiced in respect of whether it is appropriate for the competition law and policy to aim to solve what are essentially regulatory issues. The distinction between competition policy and regulation is typically that competition law sets only general parameters and leaves the rest to the competitive process. Regulation exists, however, precisely because the competitive process cannot be left unchecked and therefore some positive solution to a particular problem must be sought. With this in mind, it is conceivable that problems may arise. For instance, would it be legitimate for the ECJ to strike down a pricing rule set by an NRA which aims to achieve competitive parity, and replace that rule with a regime which effectively is entry-promoting? It is arguably neither the role of competition law nor the role of general courts to determine how property rights should be distributed other than neutrally. Under "normal" circumstances it would be regarded that this could only be legitimately achieved through specific legislation. However, European telecommunications law (as it looks set to emerge) is something of a hybrid creature, for which EC competition law is the tail which wags the body of regulation.

In the absence of more specific guidance, the basic position appears to be this: NRAs will be able to adopt any particular strategy they choose, providing this meets the minimum standards imposed by competition law. Those minimum standards will be set by taking into account the general policy issues familiar to Community law, i.e. fair competition, protection of small and medium sized enterprises and market integration. In this respect, competition law will set a ceiling above which a NRA is not permitted to go in setting access charges. The level of this ceiling will be based largely upon the interpretation given to the nature of the costs incurred. For instance, the requirements of cost-orientation in both directives alone imply that a Ramsey-type rule might not be favoured by the Court of

Justice. So far, there is little guidance on what constitutes an excessive price, the broad requirement being that the price must bear no reasonable relation to the value of the good being sold. If faced with a multitude of pricing rules, its own jurisprudence suggests that the Court would be more likely to opt for a rule which is more likely to generate competition than one which is not. It may derive support for this from the proposed Article 100a Directive which requires NRAs to adopt a mechanism which allows for "sustainable market entry".

### Concluding remarks

A clear European policy on interconnection and universal service has not yet emerged, and the two proposals discussed in this paper will not entirely remedy this situation. The dust will arguably not settle until the scope of the competition provisions has been defined by a Notice on Interconnection and/or a judgment of the Court of Justice. The nature of European Community competition law means that the traditional relationship between regulation and competition law must be re-examined. Generally, the amount of control exerted by competition law is less than regulation. In the context of Community law, the opposite may be true. Given the obscurity of many of the provisions, it will be up to the Community courts to determine what is an acceptable access price. At the most, some form of competitive parity approach would be followed at the Community level, but allowing a stricter approach (entry promotion) at the national level.

This discussion has demonstrated that the analysis of interconnection in a European context must continue by asking the right question. It is submitted that this question is, what is an acceptable access charge in the context of EC competition law? This is not the same question as what constitutes an economically efficient set of access prices. Answering such a question is, however, beyond the scope of this paper.

### Postscript

In the time which has elapsed since writing this paper, further legislative developments have occurred. The Article 90(3) Directive has been adopted. See Commission Directive 96/19/EC amending Directive 90/388/EEC with regard to the implementation of full competition in telecommunications markets OJ [1996] L 74/13: the Article 100a Proposal has been given its second reading in the European Parliament (November 1996), the common position having been reached in June 1996. Its adoption is scheduled for December 1996.

## Zusammenfassung

### **Die neuesten Vorschläge zur Netzzusammenschaltung: Um wessen Richtlinie handelt es sich eigentlich?**

*Als Teil ihres Liberalisierungsprogrammes haben die Europäischen Gemeinschaften kürzlich begonnen, das Problem der Zusammenschaltung von Telekommunikationseinrichtungen und das der Bereitstellung von Universaldiensten anzugehen. Dazu wurden zwei Richtlinienentwürfe veröffentlicht. Das vorliegende Papier diskutiert Inhalte und weiterreichende Implikationen dieser Vorschläge. Drei zentrale Schlußfolgerungen werden gezogen: Erstens, die beiden Richtlinienentwürfe zur Zusammenschaltung sind gegenwärtig in mancher Hinsicht inkonsistent und müssen geändert werden, bevor endgültige Fassungen verabschiedet werden; zweitens, die in den Richtlinien vorgesehenen Regulierungsrahmen widmen den Vorteilen, die normalerweise dem dominierenden Netzbetreiber unvermeidlich zufallen, nicht genügend Aufmerksamkeit; und drittens, viele der Voraussetzungen für die Einführung effektiven Wettbewerbs sind allzu vage formuliert. Allgemeiner gesagt: diese Schlußfolgerungen deuten darauf hin, daß Wettbewerb im Telekommunikationsbereich in Zukunft unweigerlich zum größten Teil durch richtungweisende Urteile im Wettbewerbsrecht bestimmt wird und weniger durch spezifische regulatorische Kontrollmaßnahmen, denn die Implementierung der Richtlinien wird sich wahrscheinlich in den verschiedenen Mitgliedsstaaten unterschiedlich gestalten. Der Autor zieht die Schlußfolgerung, daß dies nicht unbedingt von Nachteil sein muß, Umfang und Zweck der wettbewerbsrechtlichen Maßnahmen müssen jedoch eindeutig geklärt werden, um Sicherheit für neue Marktteilnehmer und den ehemaligen Monopolisten zu schaffen.*