RAPPORT GENERAL

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# Competition Law Implications of * Deregulation and Privatisation

## General Report

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### Introduction

<table>
<thead>
<tr>
<th>A.</th>
<th>Overview of Answers to Questionnaire</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1</td>
<td>Definitions</td>
</tr>
<tr>
<td>A.2</td>
<td>The Political Context</td>
</tr>
<tr>
<td>A.3</td>
<td>The Sectors Affected</td>
</tr>
<tr>
<td>A.4</td>
<td>Role of EC Institutions</td>
</tr>
<tr>
<td>A.5</td>
<td>Methods of Privatisation</td>
</tr>
<tr>
<td>A.6</td>
<td>Methods of Deregulation</td>
</tr>
<tr>
<td>A.7</td>
<td>Preparation for Privatisation</td>
</tr>
<tr>
<td>A.8</td>
<td>Promotion of Competition After Deregulation/Privatisation</td>
</tr>
<tr>
<td>A.9</td>
<td>Protection of Consumers After Deregulation/Privatisation</td>
</tr>
<tr>
<td>A.10</td>
<td>Protection of Employees After Deregulation/Privatisation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B.</th>
<th>Community Law and Competition Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>B.1</td>
<td>Privatisation</td>
</tr>
<tr>
<td>B.1.1</td>
<td>State Aid</td>
</tr>
<tr>
<td>B.1.2</td>
<td>Merger Control</td>
</tr>
<tr>
<td>B.1.3</td>
<td>Retention of Government Control After Privatisation and Restrictions on the Acquisition of Shares by Foreign Nationals</td>
</tr>
<tr>
<td>B.2</td>
<td>Deregulation/Liberalisation/De-Monopolisation</td>
</tr>
<tr>
<td>B.3</td>
<td>De-Monopolisation of Networks</td>
</tr>
<tr>
<td>B.4</td>
<td>Deregulation in Specific Sectors</td>
</tr>
<tr>
<td>B.4.1</td>
<td>Energy</td>
</tr>
<tr>
<td>B.4.2</td>
<td>Telecommunications</td>
</tr>
<tr>
<td>B.4.3</td>
<td>Post</td>
</tr>
<tr>
<td>B.4.4</td>
<td>Railways</td>
</tr>
<tr>
<td>B.4.5</td>
<td>Ports</td>
</tr>
</tbody>
</table>

* The views expressed in this Report, unless otherwise indicated, are those of the Rapporteur who acknowledges with gratitude the help of Diane Ingram in preparing the Report for publication.
C. SUGGESTED TOPICS FOR DISCUSSION

THE LEGITIMACY UNDER COMMUNITY LAW OF NATIONAL MEASURES TO PREVENT FOREIGN CONTROL OF, OR TO LIMIT FOREIGN PARTICIPATION IN, VITAL NATIONAL INDUSTRIES

TO WHAT EXTENT IS DEREGULATION A COMMUNITY LAW OBLIGATION?

- The Member States' Sovereignty approach
- The Limited Sovereignty approach
- The Absolute Competition approach
- The Limited Competition approach
- National security
- Need to ensure universal supply
- Maintaining special or exclusive rights

DE-MONOPOLISATION OF NETWORKS, WITH PARTICULAR REFERENCE TO VALUE-ADDED SERVICES, CREAMING-OFF AND CROSS-SUBSIDISATION

- Creaming-off
- Cross-subsidisation
INTRODUCTION

The Treaty is, at least in theory, neutral as to property ownership, and Member States retain, subject to EC/EU legislation, wide powers to regulate economic activity within their territory. Nevertheless, it has long been recognised that the existence of nationalised monopolies and divergent regulatory regimes are obstacles to economic interpenetration and to the creation of a single internal market. So deregulation and privatisation have, in some sense, always been on the Community agenda.

But deregulation, or "liberalisation", and privatisation have now become policy objectives pursued for their own sake, across the Community, by governments of widely differing political views. As policy objectives, they share the same general approach as accepted canons of Community competition policy, but the way in which they are implemented may be less easy to reconcile with the rules of Community competition law.

The interaction between Community competition law, on the one hand, and the new policy objectives of deregulation and privatisation, on the other, presents new problems partly of law and partly of policy. The aim of Topic 3 for the 1994 FIDE Congress is to identify these problems more clearly and to begin, at least, to look for solutions.

The National Reports are based on the questionnaire sent to the National Rapporteurs, which was divided into 2 parts. The aim of the first part was to obtain background information. The aim of the second was to gather specific information on the competition law aspects of privatisation and deregulation. It will be seen that the National Reports vary widely in their approach and depth of detail.

The Community Report follows its own scheme and includes a full discussion of the Community law implications.

The first part of this General Report consists of a general overview of the replies to the first part of the questionnaire. The second part is concerned with Community law aspects generally and the application of Community competition law in the field. The third part suggests some topics for discussion at the Congress.
A. OVERVIEW OF ANSWERS TO QUESTIONNAIRE

A.1. DEFINITIONS

In order to define the scope of the subjects for discussion, the questionnaire suggested definitions for "privatisation" and "deregulation".

"Privatisation" was defined as the process by which public economic undertakings of the type envisaged in Articles 37 and 90 of the EC Treaty are wholly or partly removed from the control or ownership of the state or public authorities and transferred to the private sector. The prevailing view is that this definition is adequate. In France and Greece, however, national law defines "privatisation", so the legal consequences of a planned operation could depend on whether it falls within the statutory definition of "privatisation" (French Report pp. 3-9 and Greek Report pp. 1-3). The French report also points out that the majority of writers regard privatisation as the reverse of "nationalisation" and therefore capable of being applied only to privatisation of state-owned undertakings.

The German and Danish Reports (pp. 3-5 of the German and pp. 1-2 of the Danish Report) draw a distinction between "genuine" and "non-genuine" privatisation. The former involves the sale of shares to the public or to a privately owned company, whereas the latter merely involves the conversion of a state undertaking into a limited company which is still owned, at least initially, by the state. This particular type of privatisation is described by the Dutch Report as "corporatisation" (verzelfstandigen) (Dutch Report p. 6) and by the Swedish Report as "incorporation" (Swedish Report p. 3 - see also Finnish Report pp. 2 and 5).

Certain Reports also mention a third way in which the concept of privatisation may be understood, namely the contracting out to private companies of certain services formerly carried out by the state (German and Dutch Reports, loc cit). Not all Reports agreed that this phenomenon could be characterised as true privatisation. For example, according to the French Report, it is better described as a means of managing a public service (French Report p. 9).

"Deregulation" was defined as the process whereby economic activities previously subject to state regulation are wholly or partly removed from state regulation or placed under a different but less burdensome form of regulation. Again there is general agreement with this definition. But the important point is made that deregulation and privatisation do not necessarily go hand-in-hand. In particular, privatisation of nationalised industries enjoying a monopoly or dominant position has had to be accompanied, not by deregulation, but by new regulatory regimes which may actually involve an increase of regulation.
The Italian Report points out (p. 2) that the suggested definition of "deregulation" is not really apt to embrace "liberalisation". "Liberalisation" can be defined as the process whereby competition is introduced or drastically enhanced in markets thanks to the removal of monopolies or exclusive rights held by the type of undertakings envisaged in Articles 77 and 90 of the EC Treaty. This might also be called "de-monopolisation".

Nevertheless, the National Reports generally treat liberalisation as coming under the general heading of deregulation.

### A.2. THE POLITICAL CONTEXT

Until recently, there was little uniformity in attitudes towards privatisation and deregulation. Attitudes were influenced *inter alia* by traditional views of the role of the state. For example, in Italy, since private capital was lacking, much of the capital for industrialisation was provided by the state which ran the sectors concerned with a view to providing cheap services for the general population, offering low prices and not necessarily aiming for optimum efficiency (Italian Report p. 4). And, as late as the early 1980s, while privatisation programmes were already under way in the UK, the Socialist government in France, which had made an electoral commitment to undertake more nationalisation, was still expanding the public sector (French Report pp. 9-11). In Portugal a vast nationalisation programme and strict price controls were implemented after 1974 (Portuguese Report pp. 4-5).

There seems now to be little overt hostility to privatisation and deregulation except on the part of trade unions and employees of companies which are liable to be privatised. The exceptions appear to be Belgium and Spain.

The Belgian Report (p. 3) says that there is little enthusiasm for privatisation and deregulation, and even that there are more forces preferring government ownership than groups actively promoting privatisation.

The Spanish Report (pp. 3-14) contrasts the timid first steps being taken at national level towards deregulation and privatisation with a preference at regional and local level for maintenance of regulation and (local) governmental control of politically significant services (e.g. funerals - see pp. 21-23).

The general public seems largely indifferent. Amongst politicians there seems to be a general acceptance of the need to reduce the role of the state, or at least to reduce the cost to the state of maintaining national monopolies, though this has not in all cases been

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1 Slightly adapting the definition suggested in the Italian Report.
translated into action. As one might expect, right-wing political parties are more enthusiastic than left-wing parties, but the Spanish Report (pp. 1-2) reminds us that a taste for regulation is not confined to the left.

Advocates of privatisation justify it on what could be termed ideological grounds - the desirability of reducing the rôle of the state in commercial activity - and/or on the ground that privatisation, like regulation, is a means of introducing the disciplines of the market into hitherto sheltered areas. These arguments are often buttressed by the consideration that privatisations may provide some direct revenue for the state.

In the UK, the Conservative party, in power since 1979, has been able to turn privatisation to its own advantage. First, one aim of obliging local authorities to sell council houses to their tenants was to weaken the council estate as a traditional bastion of support for the Labour party. Second, it was thought that privatisation of nationalised industries would weaken the public sector unions, also traditionally supporters of the Labour party. Third, the sale of shares to private individuals, often at a very attractive price, increased goodwill for the Conservatives, especially in the light of Labour threats to renationalise in the event of its taking power (UK Report pp. 2-3).

A.3. THE SECTORS AFFECTED

The Commission report provides figures on the percentage of the economy held by the public sector in the various Member States and also gives some details on the number of privatisations and the sectors affected (Commission Report pp. 5-9).

Not all of the National Reports are precise as to the sectors affected. Nor do they all distinguish between the sectors which have been deregulated and those where privatisation has taken place. Annexes I and II give such details as can be extracted from the National Reports.

A.4. RÔLE OF EC INSTITUTIONS

The perception of the rôle of the EC institutions appears to vary greatly across the Member States. For example, in Italy (Italian Report p. 13) and Belgium (Belgian Report p. 4), the institutions are perceived as important actors, at least in the field of deregulation. In Germany, however, this is the not the case (German Report p. 13). In Spain, EC/EU requirements may be a politically convenient excuse for unpopular measures (Spanish Report pp. 24-25).

In the EFTA states, requirements of EEA law and, in the event of accession, of EC/EU law have had at least a psychological effect (Austrian Report pp. 4-5, Finnish Report pp. 4-5, Swedish Report pp. 4 and 5).
The UK Report is at pains to point out that, as regards privatisation, it is policy developments in the UK that have influenced the institutions, not the other way round, and that, as regards dismantling monopolies, thinking in the UK was largely congruent with that of the Commission (UK Report p. 5).

As to the objective question of whether the EC institutions have in fact been active, the general view is, unsurprisingly, that the Commission has been more active in the area of deregulation than in that of privatisation. Commission influence in the area of privatisation must, in any case, be more indirect, e.g. in pressurizing governments not to discriminate against EC nationals in acquisition of shares in the newly privatised companies, or monitoring privatisation projects in order to ensure that the rules on State Aid are complied with. This aspect is studied in more detail in part 2 of this Report (infra).

A.5. METHODS OF PRIVATISATION

The precise methods of privatisation differ and depend, first and foremost, on what type of "privatisation" is involved (see "Definitions" above).

If the economic activity has been carried out directly under the tutelage of a minister, or by a non-profit-making body such as a quasi-governmental authority or board, a share company has to be set up before any disposal to the public can take place (see, for example, pp. 1-2 of the Italian and pp. 7-8 of the UK Report). In cases of "non-genuine privatisation", as in Denmark, this may be all that is done (Danish Report pp. 4-5).

If, on the other hand, the government's interest in the company to be privatised has simply been as sole or major shareholder, "privatisation" consists simply of reducing, wholly or partly, the government's shareholding. In some cases privatisation may take the form of increasing the company's equity. The state does not acquire any of the new shares and thus, even if it does not actually dispose of any of its existing shares in the company, its shareholding is proportionately reduced (see, for example, the Austrian Report p. 5).

The most normal method, however, is by sale of the shares in the privatised company. Open sale to the public is the preferred method when a wide dispersal of the shares is intended. This aspect may be reinforced by granting bonuses to small shareholders who do not dispose of their shares within a particular period. Direct sale (to one or more companies) may be favoured if the government wishes to have at least a "hard-core" of shareholders (see, for example, the Italian Report, pp. 16-17).

In the UK, a wide variety of techniques have been used and adapted with the benefit of experience. An ambitious privatisation may involve a wide variety of privatisation
techniques. For example, the reorganisation of British Rail involves public flotation, private sales, franchising and licensing (UK Report pp. 7-9). In France too, a wide variety of techniques have been used (pp. 41-55). In certain cases companies are prepared for privatisation by injection of cash and/or writing off debts to assist disposal (see below under section 7).

A.6. METHODS OF Deregulation

The National Reports show that, in the majority of countries, extensive deregulation has been carried out or is planned - see Austrian Report p. 2-4; Danish Report pp. 3 and 6; French Report pp. 31-36; German Report pp. 10-11; Italian Report pp. 11-13; Dutch Report pp. 13-51; Swedish Report, Annex, pp. 9-13; UK Report pp. 9-10.

However, the National Reports also show that there is a considerable overlap between privatisation and deregulation, suggesting that the proposed definitions (see above) are not watertight. But the point has already been made that "privatisation", as defined, may actually involve a greater degree of regulation than previously existed ("re-regulation" rather than "deregulation").

A.7. PREPARATION FOR PRIVATISATION

No general pattern emerges with regard to specific steps taken to prepare undertakings for privatisation. A great deal will obviously depend on how profitable and efficient the undertaking in question is. In some countries extensive financial and operational restructuring has taken place (see, for example, the Portuguese Report, p. 17). In some, the state has taken over the debts of the company to be privatised or provided new capital from state resources, but this is not the rule in every case. In the UK, preparation for privatisation has become more sophisticated with time and has involved balance-sheet restructuring, cash injections and debt write-offs (UK Report p. 10).

A.8. PROMOTION OF COMPETITION AFTER DEREGLATION/PRIVATISATION

In some respects, from a competition point of view, deregulation and privatisation are two sides of the same coin in that their rationale is the introduction of the free play of competition into the sector or sectors involved. This may automatically be the case with deregulation. It is not necessarily the case with privatisation, in particular where a monopoly remains intact upon the transfer of a nationalised industry to the private sector. In such a case privatisation may entail more rather than less regulation, and in some cases a very elaborate regulatory regime has been the concomitant of privatisation. Experience in the United Kingdom has certainly been that the more the monopoly element remained intact, the greater became the tension in the regulatory regime.

Partly as a consequence of this factor, later privatisations have involved the restructuring of the relevant industry before sale. For example, whereas British Gas was privatised intact in 1986, its gas supply business being only recently restructured, the electricity
industry was restructured before privatisation by dividing the Central Electricity Generating Board into three generating companies and a further company to own and operate the national transmission grid.

Details of the regimes adopted in the UK in the telecommunications, gas, electricity and rail transport sectors and the evolution of the schemes adopted to promote competition are set out extensively in the UK Report at pp. 12-17.

A.9. PROTECTION OF CONSUMERS AFTER Deregulation/PRIVATISATION

The new regulatory regimes accompanying privatisation generally include quality and price control mechanisms. This is particularly necessary where there is a "natural monopoly" and the consumer has to be protected against the power of the new privatised monopolist.

For example, in the UK, a standard feature of the price control mechanism operating in the privatised utilities is a formula whereby prices are permitted to rise by the rate of inflation minus a figure which reflects the regulator's estimate of the increased scope for efficiency of the utility. Thus, real prices are forced to fall while scope for improvement still exists (see the UK Report pp. 19-20).

A.10. PROTECTION OF EMPLOYEES AFTER Deregulation/PRIVATISATION

In general, no special measures have been taken to protect the employees of privatised public undertakings.

Indeed, the German Report (p. 18) points out that in the special context of privatisation carried out by the Treuhandanstalt, it has been necessary to shed staff, in the preparatory phase, to make the companies viable and attract potential investors.

The French Report (pp. 88-89) says that since employees of public undertakings are not civil servants, transfer of the undertaking to the private sector should not, theoretically, entail a change in an employee's status. In fact, since dismissal of employees of public undertakings has been rare, transfer to a private undertaking is likely to make conditions more precarious.

In Denmark (pp. 10-11), employees of public undertakings do enjoy the status of civil servants, and they have been given the option either of transfer to the status of a "normal" employee or of retaining civil servant status and being loaned to the new company.
B. COMMUNITY LAW AND COMPETITION LAW

B.1. PRIVATISATION

The attitude of the EC Treaty towards privatisation is neutral, in that Article 222 provides that the Treaty shall in no way prejudice the rules in the Member States governing the system of property ownership. As some of the Reports are at pains to stress, the institutions should therefore be neutral as regards the question whether privatisations are appropriate (see, for example, the French Report at pp. 94-95). The Commission has, however, committed itself2 to encouraging privatisation as a means of improving the competitiveness of undertakings, in particular small and medium-sized enterprises.

Consistently with the requirement of neutrality, the rôle of the Commission in the area of privatisation has been reactive rather than innovatory, and has thus been limited to ensuring that the provisions of Community law are complied with when undertakings are privatised. Of particular relevance in this aspect have been the rules on state aid, the Merger Regulation3 and the various provisions prohibiting discrimination on grounds of nationality.

B.1.1. STATE AID (see, generally, Commission Report, pp. 28-46)

The rules on state aid have been particularly relevant since successful privatisation has often entailed "fattening up" the particular undertaking to be privatised by various means such as the writing off of debts, cash injection or, in the case of private sales, cash inducements paid directly to the buyer.

The policy of the Commission has consistently been to ensure that public undertakings are on an equal footing with privately-owned undertakings from a competitive point of view.

In 1980 the Commission adopted the so called "Transparency Directive" (subsequently amended)4 which requires Member States to ensure transparency in the financial

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relations between public authorities and public undertakings with a view to assisting the Commission in its monitoring of the granting of state aid to such undertakings. The lawfulness of the Directive was upheld by the Court of Justice in 1982⁵.

In order to quantify the aid granted by the state to a public undertaking, the Commission developed the "market economy investor principle", according to which the amount of aid granted is the difference between the funds actually invested and those which a private investor would find it prudent to invest. The lawfulness of this test has also been upheld by the Court of Justice⁶. As the Commission Report points out (pp. 32-33), this test, if taken to its logical conclusion, may require a Member State to allow an uncompetitive public undertaking to go into liquidation. This factor may, at least indirectly, have helped to create a climate favourable to privatisation.

Even if the Commission is, broadly speaking, in favour of privatisation, the principle of neutrality, as embodied in Articles 90 and 222 of the Treaty, precludes automatic derogation from application of Article 92 on the sole ground that state aid is being granted in the context of privatisation. Where state aid has been permitted (under Article 92(3)(c)), it has tended to involve a restructuring plan and authorization has been accompanied by strict conditions, including an undertaking not to increase capacity in areas where overcapacity already exists.

One of the best known cases, and probably the most controversial, arose in the UK on the sale of Rover to British Aerospace. The UK Government wished to inject £800 million into Rover, but the Commission concluded that only £469 million worth of aid was compatible with Article 92(3) and, even then, payment was authorised only on a number of conditions. The Commission subsequently learned that the Government had made financial concessions worth £4.5 million - the so-called "sweeteners" - directly to British Aerospace. After the original decision ordering repayment had been quashed by the Court of Justice on procedural grounds⁷, the Commission opened fresh Article 93(2) proceedings and again ordered British Aerospace to repay the sweeteners, which it ultimately did (see UK Report pp. 24-25 and Commission Report p. 38).

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B.1.2. MERGER CONTROL

The Merger Regulation\(^8\) applies to any form of privatisation liable to give rise to a concentration with a Community dimension (Article 1) and provides that a concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market shall be declared incompatible with the common market (Article 2). Under Article 4, the person or undertaking acquiring a controlling interest is required to notify the Commission of the concentration. As the Commission points out (Commission Report p. 27), it is desirable, in the case of a privatisation, though this is not specifically required by the Regulation, that the State concerned suspend the sale until the Community procedures have been carried through.

According to the Commission Report (p. 27), only four cases of privatisation have been notified to the Commission under the Merger Regulation. Two of these concerned acquisitions from the Treuhandanstalt in the context, *sui generis*, of privatisation of East German firms. As is pointed out in the German Report (p. 17), competition could be endangered if a West German firm which already enjoys a dominant position on the West German market were to acquire the sole East German undertaking in a particular sector. In fact, the majority of mergers with GDR firms examined by the Bundeskartellamt did not give rise to competition problems.

B.1.3. RETENTION OF GOVERNMENT CONTROL AFTER PRIVATISATION AND RESTRICTIONS ON THE ACQUISITION OF SHARES BY FOREIGN NATIONALS\(^9\)

In some cases difficulties have been caused by governments wishing to retain an element of control or influence over newly privatised undertakings and, in certain cases, by their concern to ensure that foreigners do not acquire too great a degree of control in those undertakings (see French Report pp. 72 et seq and UK Report pp. 17-19).

In France, the Conseil Constitutionnel stipulated in 1986 that upon privatisation *l'indépendance nationale devra être préservé* (Decision of Conseil Constitutionnel No 86-207 of 25 and 26 June 1986). In the UK, Part II of the Industry Act 1975 gives the Secretary of State power to limit, on grounds of national interest, investment by non-residents in important manufacturing undertakings.

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8 cf Footnote 2.

A typical way in which governments may retain a certain amount of control in newly privatised companies is the device of the "golden share". A "golden share" is typically a share enjoying special rights held by the government or its nominee. Certain matters may be specified in the company's constituent instrument as involving variation of the rights of the special share and therefore capable of being implemented only with the shareholder's written consent (see, in particular, the UK Report at p. 18, the Italian Report at p. 17 and the French Report at pp. 73-75). According to the French Report (p. 75), some commentators have argued that the device of the "golden share" is contrary to the free movement of capital and the various Community directives on company law.

In certain cases governments have, directly or indirectly, imposed limitations on foreign shareholdings as such. In others, overall limitations on shareholdings have been imposed but are applicable without distinction on the basis of nationality. For example, it may be stipulated that no person, or group of persons acting together, may acquire more than a certain percentage of the shares sold. Alternatively, it may be stipulated that no more than a certain percentage of the shares of privatised companies may be sold to persons of foreign nationality with an exception for Community investment.

A third device, adopted in France in the 1993 privatisation legislation, subjects to authorization by the State investments by all foreigners in excess of 5% of the capital of privatised companies participating in the exercise of official authority, or concerned with public policy, public security or public health, or concerned with the production of, or trade in, arms, munitions and war material. The relevant provision specifically invokes Articles 53, 56 and 223 of the EC Treaty as a legal basis for this control.

In certain other cases, however, such as in the United Kingdom, national legislation permits the government to impose limits inter alia on holdings by Community nationals without specifically invoking Articles 53, 56 and 223.

Although insisting in principle that all citizens of the EC should be treated equally, it appears, at least from the UK Report (p. 18), that the Commission has hitherto adopted a pragmatic attitude and has accepted reasonably generous limits, provided that in practice EC nationals do not have difficulty in acquiring shares in privatised companies. However, the UK Report (p. 18), states that the Commission has now begun Article 169 proceedings against the UK in relation to the 1975 Industry Act which allows the government, on grounds of national interest, to limit foreign investment in British companies.\footnote{No such case seems, as yet, to have been registered at the Court Registry.}
B.2. DEREGULATION/LIBERALISATION/DE-MONOPOLISATION

As pointed out above (section A.1), the definition of deregulation suggested in the questionnaire does not specifically cover "liberalisation" or "de-monopolisation", but some National Reports refer to liberalisation under the general heading of deregulation.

In contrast to its neutral attitude on privatisation, the Treaty contains specific provisions regarding the adjustment of state monopolies of a commercial character (Article 37) and application *inter alia* of the Treaty's competition rules to public undertakings and undertakings to which Member States grant special or exclusive rights (Article 90(1) and (2)). Furthermore, Article 90(3) confers specific powers on the Commission to ensure the application of the provisions of Article 90 and, to that end, to address appropriate directives or decisions to the Member States. The extent of this power has yet to be precisely worked out. In *France v Commission* \(^{11}\), the Court described the Commission's power as a "legislative power" \(^{12}\), but further on \(^{13}\) appears to limit the possible scope of that dictum by saying that the provision "empowers the Commission to specify in general terms the obligations arising under Article 90(1) by adopting directives". The Court did not, therefore, say to what extent, if any, the Commission can impose on the Member States any obligation which does not flow directly from the Treaty.

Whatever the extent of the powers conferred on it by Article 90(3), the Commission has declared \(^{23}\) that it now prefers to adopt a consensual approach and pursue gradual liberalisation, taking account of the time required to restructure rates and to ensure that the task of providing universal services is fulfilled.

B.3. DE-MONOPOLISATION OF NETWORKS

The Commission has described de-monopolisation as being one of the most fundamental challenges in the area of competition policy (see, in particular, the 22nd Report on Competition Policy for 1992 at paragraph 22). In its view, the introduction of competition into areas hitherto characterised by the existence of special or exclusive rights will have beneficial effects on the consumer, by stimulating technological innovation and reduction of prices, and in the long term on the labour market, by the introduction

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12 Point 15 of the judgment.

13 Point 17 of the judgment.
of new undertakings on the relevant market (see, for example, 23rd Report on Competition Policy at paragraph 37).

This is particularly so for the telecommunications, gas and electricity and postal sectors. The situation in the majority of these areas has, for a long time, been characterised by the existence of monopolies exploiting extensive networks which, by virtue of a public service obligation, supply basic services within all or part of the territory of a Member State. In the Commission's view, such a form of organisation is a priori incompatible with the Community competition rules, inter alia because it presupposes a structure which favours abuses of a dominant position, impedes the free movement of goods and freedom to provide services, and often involves discrimination based on nationality.

In the Commission's view, these sectors must become part of the single market.

In all of them there has been considerable technological progress. The services consumers require have often become more complex than the basic services which the monopoly has traditionally supplied.

The Commission's priority is therefore to take the necessary initiatives to permit a competitive and open environment in the relevant sectors, but also to take into account the justifications which have been invoked in support of the monopolies such as security of supply, safety or the maintenance of a universal service. In the Commission's view, these concepts must be defined on a Community-wide and not merely a national basis.

The matter is complicated by the fact that telecommunications and energy in particular are characterised by the existence of networks to which newcomers must be able to have access in order to permit real competition. Consequently, one of the Commission's priorities has been to facilitate third party access to the networks on equitable terms.

B.4. DEREGULATION IN SPECIFIC SECTORS

B.4.1. ENERGY

The Commission takes the view that an integrated internal energy market is a vital step in completion of the internal market. There still exist substantial obstacles to trade in electricity and gas across borders which are the result of the exclusive rights granted to the national utilities in these sectors. The sheltering of national energy markets from competition has resulted in significant price differences between the various national markets.

In 1986, the Council specifically recognised greater integration of national energy markets as a way to improve security of supply, reduce costs and improve economic


The Commission has also presented proposals for directives concerning common rules for the internal market in electricity and natural gas. Only the UK supported the Commission's initial proposals for liberalisation in the gas and electricity sectors, whereas most Member States have opposed attempts by the Commission to open up markets (see on this point the UK Report at p. 22). The proposals originally submitted in 1992 have had to be amended or, in the view of the United Kingdom Rapporteur "watered down" (see OJ 1994, C 123, pages 1 and 26 respectively for a comparison of the original and amended proposal).

Parallel to its efforts in the legislative field, the Commission has recently brought actions under Article 169 of the Treaty against Ireland, the Netherlands, France and Spain, alleging that those Member States have infringed Articles 30, 34 and 37 of the Treaty by maintaining national legislation restricting the importation and exportation of electricity and, in the case of France, also gas (Cases C-156 to 160/94).

B.4.2. TELECOMMUNICATIONS

Telecommunications is the sector in which the Commission has been most active in imposing obligations on the Member States to introduce deregulation. To this end, the Commission has adopted directives in respect of both terminal equipment and telecommunications services. A two-tier approach was adopted in both fields which involved legislation to abolish national monopolies and harmonisation of relevant technical conditions. It is important to note that the Commission decided not to require deregulation in respect of the national telecommunications network infrastructure. This was seen as necessary to ensure the integrity and stability of the provision of networks (see the "Green Paper on the Development of the Common Market for Telecommunications Services and Equipment" COM(87) 290 final, 30 June 1987).
Commission Directive 88/301 on Competition in the Markets in Telecommunications Terminal Equipment (OJ 1988, L 131, p. 73) required the Member States to abolish the monopolies enjoyed by the national telecommunications bodies in relation to terminal equipment and to recognise the right of economic operators to import, market, connect, bring into service and maintain terminal equipment. Further, the Directive required the Member States to separate the "competitive" and "regulatory" functions of national telecommunications bodies. The drawing-up of technical specifications and the granting of type approval for terminal equipment must be entrusted to a body which is independent from the national telecommunications body. (The approach of the Commission was supported by the Court of Justice in Case C-18/88 RIT v GB-Inno-BM [1991] ECR I-5491, where it held that failure to ensure separation of such functions was contrary to Article 86 and 90 of the EC Treaty.)

The Terminal Equipment Directive was adopted by the Commission under Article 90(3). The general power of the Commission to adopt such directives was, subject to certain minor exceptions, confirmed by the Court of Justice in Case C-202/88 France v Commission [1991] ECR I-1223.


In relation to services, Commission Directive 90/388 on Competition in the Markets for Telecommunications Services (OJ 1990, L 192, p. 10) provides for the abolition of national monopolies in relation to value-added services. The Directive does not require the abolition of national monopolies in relation to voice telephony, which constitutes a very large part of the whole telecommunications market. (See p. 65 of the Commission Report.)

In relation to harmonisation, the Commission adopted Directive 90/387, the ONP (Open Network Provision) Directive (OJ 1990, L 192, p. 1). This is a framework directive which provides for the adoption of specific ONP directives in relation to leased lines, packet- and circuit-switched data services, telex services, mobile services and voice telephony. The ONP directives provide harmonised conditions in relation to, for example, technical interfaces, usage conditions and tariff principles.

The Commission has also published a document entitled "Guidelines on the Application of EEC Competition Rules in the Telecommunications Sector" (OJ 1991, C 233, p. 2). These guidelines deal in detail with the potential application of the competition rules to specific situations which are likely to arise in the telecommunications sector.
B.4.3. POST

In 1992 the Commission adopted a Green Paper on the development of the single market in postal services. The Green Paper recognises the importance of maintaining a universal service and concedes that it may be necessary to grant individual undertakings certain exclusive rights in order to maintain this service. However, the range of these exclusive rights should not go beyond what is strictly necessary to ensure the universal service.

In *Corbeau* 14 the Court held essentially that Article 90 allows Member States to exclude competition in order to ensure that a universal service is offered at uniform prices, serving profitable and unprofitable areas without distinction. However, the Court held that Article 90(2) does not permit the exclusion of competition in relation to specific services going above and beyond the normal postal service, such as collection at home, greater speed or reliability in distribution, etc. The judgment is described in the Report from the Netherlands (p. 43) as providing, in rather general terms, the criteria to be taken in account in assessing the borderline between the exclusive rights of the state postal service and private postal services; and in the United Kingdom Report (p. 26) as the first tentative pronouncement of the Court on the "creaming-off" argument.

B.4.4. RAILWAYS

The Netherlands Report (p. 45) draws attention to the Community legislation recently adopted in this sector, in particular, Council Directive 91/440/EEC 15. The Directive requires *inter alia* that Member States take the measures necessary to ensure that, as regards management, administration and internal control over administrative, economic and accounting matters, railway undertakings have independent status in accordance with which they will hold, in particular, assets, budgets and accounts which are separate from those of the state (Article 4). As regards separation between infrastructure, management and transport operations, Article 6 requires Member States to take the measures necessary to ensure that the accounts for business relating to the provision of transport services and those for business relating to the management of railway infrastructure are kept separate. The period allowed for transposition of the Directive expired on 1 January 1993.

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14 Case C-320/91 ECR [1993] 2533.
The Italian Report (p. 14) draws attention to the liberalisation of port operations in Italy brought about largely as a result of the judgment of the Court of Justice in *Merci convenzionali Porto di Genova*\textsuperscript{16}. Although the case arose in the context of exclusive rights to organise dock work, the judgment of the Court is of great significance in that it holds that a Member State is in breach of Article 86 in conjunction with Article 90(1) in granting exclusive rights to an undertaking if those rights are liable to create a situation in which the undertaking is induced to commit such abuses\textsuperscript{17}.


\textsuperscript{17} Point 17 of the judgment.
C. SUGGESTED TOPICS FOR DISCUSSION

The National Rapporteurs were asked to suggest topics for discussion at the Rome Congress.

The two main areas of interest are:

(1) Continued government control of privatised entities

   (a) the permissibility of "hard core" or "golden share" restrictions (Austrian Report p. 12, Italian Report p. 32)

   (b) the potential conflict of interest between government as regulator and government as owner (Danish Report p. 14).

(2) The potential conflict between competition criteria and other policy aims in assessing privatisation proposals, particularly:

   (a) application of the Merger Regulation (German Report pp. 23-24)

   (b) as regards the risk of divergent assessments, on competition or "industrial policy" grounds, of privatisation proposals in different Member States (Italian Report p. 32)

As regards the second point, the Danish Report (p. 14) raises the question whether the principle of subsidiarity requires the EU to tolerate divergent regimes in the Member States.

The Danish Report (p. 14) also raises the problem of applying the rules on public procurement to privatised entities.

The Spanish Report (p. 29) raises the problem, not confined to Spain, of ensuring effective application of Community law rules to the activities of governmental entities at regional and local level.

The following topics seem to the General Rapporteur to merit some further written comment:

(1) The interface between competition policy and other policies (e.g. industrial policy, employment policy or social policy) in assessment of proposals for privatisation and deregulation.
(2) The legitimacy under Community law of national measures to prevent foreign control of, or to limit foreign participation in, vital national industries.

(3) To what extent is deregulation a Community law obligation?

(4) De-metropolisation of networks, with particular reference to value-added services, "creaming-off" and cross-subsidisation.

THE INTERFACE BETWEEN COMPETITION POLICY AND OTHER POLICIES

Topic 3 is concerned, explicitly, with competition aspects of privatisation and deregulation. Nevertheless, as the Italian Report (pp. 28-32) points out, there is a serious risk that proposals for privatisation or deregulation in different Member States will be treated differently by the Community authorities because considerations other than strict application of the competition rules have been taken into account. To what extent, if at all, is it permissible to take into account considerations of industrial policy, employment policy or social policy (cf the German Report pp. 23-24)? And, if they are taken into account, are they to be assessed in a purely national context or on a Community-wide basis?

Further, as the Spanish Report shows (pp. 13-14), there may, in a decentralised state, be serious divergences between the policy aims of central government, which will be more sensitive to Community policies, and those of regional or local government. How far, as the Danish Report asks (p. 14), should the principle of subsidiarity be allowed to operate both as between the EC/EU and the Member States and, within the Member States, between national, regional and local government?

It is clear that, the more different policies are taken into account at different levels, the greater is the risk of incoherence in application of Community rules. Perhaps more important, there is a serious risk of perceived unfairness, as between Member States, in the attitudes and rulings of the Community authorities.

So, it is suggested that the discussion in Rome should bear two points clearly in mind.

First, competition policy is now only one amongst many policies that the EU seeks to pursue. Privatisation and deregulation may be pursued, as policy objectives, for reasons which have very little to do with a genuine desire to promote competition for its own sake.

Second, for this very reason, it is important to define what goals competition policy seeks to pursue when set alongside other policies. Is competition policy an end in itself which
will, of itself, produce economic benefits and should therefore take precedence over other policies? Or is competition policy complementary to industrial policy, employment policy and social policy and, if so, how should it relate to these policies? In particular, what is the proper role of competition law in this context? To what extent are these issues justiciable in the courts (see further below, under "De-monopolisation of Networks")?

THE LEGITIMACY UNDER COMMUNITY LAW OF NATIONAL MEASURES TO PREVENT FOREIGN CONTROL OF, OR TO LIMIT FOREIGN PARTICIPATION IN, VITAL NATIONAL INDUSTRIES

As noted above, many privatisation arrangements seek to restrict foreign participation in the newly privatised entities.

Article 52 EC requires abolition of restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State. The second paragraph of this article provides that "Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 58, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital" (Emphasis added).

Article 221 of the EC Treaty provides that "...Member States shall accord nationals of the other Member States the same treatment as their own nationals as regards participation in the capital of companies or firms within the meaning of Article 58..." (Emphasis added).

The General Programme for the abolition of restrictions on the freedom of establishment prohibits restrictions limiting participation in limited companies and provisions which limit the possibility of acquiring moveable property.

The Court has held on a number of occasions that the rules regarding equality of treatment forbid, not only overt discrimination by reason of nationality, but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result (see, for example, the judgment in Sotgiu v Deutsche Bundespost, Case 152/73 [1974] ECR 153 and Commission v Luxembourg, C-111/91 [1993] ECR 1817).

It seems to follow logically that legislative provisions or provisions inserted into a company's statute which limit the shareholdings of persons of foreign nationality or of
persons not resident in the Member State of establishment of the relevant company are, insofar as they discriminate against Community nationals, *prima facie* contrary to Community law.

It could even be argued in the light of the Court's recent case law on Article 52 (see, in particular, *Vlassopoulou*, Case C-340/89 [1991] ECR I-2357 and *Kraus*, Case C-19/92 [1993] ECR I-1697) that *non-discriminatory* rules limiting participation in privatised companies are contrary to Article 52, in that they have the effect of impeding nationals of other Member States in the exercise of the right of establishment guaranteed by Article 52 of the Treaty. Such an interpretation seems inconsistent with Article 221 and the second paragraph of Article 52, which require Member States only to accord nationals of other Member States the same treatment as their own nationals. In any event, even if the Court were to hold non-discriminatory rules to be potentially in breach of Article 52, there might still be room for a "rule of reason" to permit Member States to justify such a limitation.

Assuming that only *discriminatory* rules would fall foul of Article 52, a Member State can invoke Articles 55, 56 and 222 of the Treaty. As mentioned above, this has been done in France in the 1993 privatisation law. Article 55 provides that the provisions of the Chapter on the right of establishment "shall not apply so far as any given Member State is concerned to activities which in that State are connected even occasionally, with the exercise of official authority". Article 56 provides that "The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health". Article 223(1)b provides that "any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material...".

While these provisions might usefully be invoked by a Member State in a specific case where they apply, they can hardly be invoked to justify a blanket power to limit foreign participation, particularly where discretionary power is conferred, for example, on a Minister.

On the other hand, Article 222 provides that the "Treaty shall in no way prejudice the rules of Member States governing the system of property ownership". A Member State is under no obligation to privatise a given undertaking and could always retain control by deciding not to privatise. It would be ironic if the obligation to ensure equal treatment, with its concomitant danger of control passing into foreign hands, were to prompt a Member State not to privatise an undertaking it would otherwise have privatised.
Whilst it is true that the rules on non-discrimination have not hitherto caused too many problems, this can not be ruled out in the privatisations planned for the future. Should the attitude of the Commission be strict or "pragmatic"? How should the law be developed?

TO WHAT EXTENT IS DEREGULATION A COMMUNITY LAW OBLIGATION?

The EC Treaty sets out two principles of particular importance in relation to the creation of legal monopolies by Member States. Firstly, article 3(g) establishes the principle of free competition as one of the fundamental objectives of the Treaty. This principle is the subject of further detailed rules, notably Articles 85 and 86. Secondly, Article 222 maintains Member States’ systems of property ownership. Unlike the principle of free competition, the preservation of national rules governing property ownership is not listed as a fundamental objective of the European Community in Article 3.

There is clearly tension between these principles. Article 90 seeks to provide a balance. 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 Article 7 and Articles 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."

Is the grant of special or exclusive rights subject to EC law?
There are four possible approaches:

(a) Member States have exclusive competence in relation to the grant of legal monopolies ("the Member States' Sovereignty approach");

(b) Member States are free to grant legal monopolies provided that the operation of the monopoly does not have the necessary consequence of contravening the rules of the EC Treaty ("the Limited Sovereignty approach");

(c) The mere grant of a legal monopoly is a breach of Article 90(1) by the Member State as it necessarily places the relevant undertaking in a dominant position, free of the normal market constraints, so that it is able to pursue abusive practices ("the Absolute Competition approach"); and

(d) Member States may create legal monopolies but only where this is necessary in order to fulfill a legitimate national objective ("the Limited Competition approach").

The first and second approaches look at the problem from the point of view of Member State powers; the third and fourth start at the other end, so to speak, looking at the problem from the point of view of the competition rules.

The Member States' Sovereignty approach

This approach was rejected by the Court of Justice in Case C-202/88 France v Commission (Telecoms Terminal Equipment) [1991] ECR I-1223. The French government argued that on the proper interpretation of Article 90(1), the Commission could not interfere with the grant of special or exclusive rights by Member States by adopting directives or decisions under Article 90(3). France argued that Article 90(1) presupposed the existence of special and exclusive rights and therefore, the grant of such rights could not itself constitute a "measure" within the meaning of the Article. In effect, France was arguing that Member States were free to create legal monopolies, without the act of granting such rights (as opposed to the operation of such monopolies) being subject in any way to the rules of the EC Treaty. The Court rejected this argument by holding (at paragraph 22):

"...even though that article presupposes the existence of undertakings which have certain special or exclusive rights, it does not follow that all the special or exclusive rights are necessarily compatible with the Treaty. That depends on different rules, to which Article 90(1) refers."
It follows from this judgment that Member States have not retained complete sovereignty in relation to the creation of legal monopolies. Rather, the creation of such monopolies must be balanced with the principle of free competition. However, the precise point at which the balance is to be struck is far from clear.

The Limited Sovereignty approach

Under this approach, the Member States are free to grant legal monopolies provided that the operation of the monopoly does not have the necessary consequence of contravening the rules of the EC Treaty. This approach was adopted by the Court of Justice in Case C-41/90 Höfner v Macrotron [1991] ECR I-1979, where a German law reserved the provision of employment recruitment services to a public employment agency. In its judgment, the Court reiterated that an undertaking vested with a legal monopoly may be regarded as occupying a dominant position within the meaning of Article 86 and that the territory of a Member State may constitute a substantial part of the common market (paragraph 28). The Court then emphasised (at paragraph 29) that "the simple fact of creating a dominant position...by granting an exclusive right...is not as such incompatible with Article 86 of the Treaty". A Member State will only be in breach of Article 90(1) where "the undertaking in question, merely by exercising the exclusive right granted to it, cannot avoid abusing its dominant position".

The nature of the Limited Sovereignty approach is clarified by the following sentence in the French language judgment, "...serait incompatible avec les règles du traité toute mesure d'un Etat membre qui maintiendrait en vigueur une disposition légale créant une situation dans laquelle un office public pour l'emploi serait nécessairement amené à contreviennent aux termes de l'article 86." (Emphasis added). On the facts of the case, the public employment agency was manifestly unable to satisfy the demand for executive recruitment services. There was an abuse within the meaning of Article 86(b) in that it limited the provision of a service to the prejudice of those seeking to avail themselves of it.

It is important to note the distinction between the liability of the State under Article 90(1) and the liability of the undertaking under Article 86. Under the Limited Sovereignty approach, an undertaking may act in a way which is contrary to Article 86, without the Member State automatically being liable under Article 90(1). In order to establish whether a Member State is in breach of Article 90(1), one must first consider whether there has been a breach of Article 86 by the relevant undertaking AND second whether that breach was necessarily caused by the behaviour of the relevant Member State.
The Absolute Competition approach

Under this approach, the mere creation of a legal monopoly is contrary to Article 90(1). This follows from the fact that the grant of special or exclusive rights will, by definition, place the undertaking concerned in a dominant position in which it will be able to pursue anti-competitive practices.

This approach can be observed in a number of cases. In Case C-260/89 ERT [1991] ECR I-2925, the Court held that the grant of exclusive rights to a state radio and television company was a breach of Article 90(1), "where those rights are liable to create a situation in which that undertaking is led to infringe Article 86 of the Treaty by virtue of a discriminatory broadcasting policy which favours its own programmes". In contrast to Höfner, there was no suggestion that any national regulations obliged ERT to pursue a discriminatory policy. Rather, it seemed to be sufficient that the mere granting of exclusive rights to ERT placed it in a position where it might pursue such a policy.

Similarly, in Case C-179/90 Merci convenzionali porto di Genova SpA v Siderurgica Gabrielli SpA [1991] ECR I-5889, stevedore services were exclusively reserved to certain dock work undertakings. Merci enjoyed the exclusive right to organise dock work in the Port of Genoa for ordinary goods. It appeared from the evidence that the dock work undertakings which enjoyed exclusive rights were responsible for a number of abuses of their dominant positions, namely, demanding payment for services which had not been requested, charging disproportionate prices, refusing to have recourse to modern technology and operating discriminatory pricing policies. The Court held that a Member State is in breach of Article 90(1) if it creates a situation in which an undertaking is induced to commit abuses. There is no clear indication in the judgment that the Italian laws necessarily led to an abuse of a dominant position under Article 86. They simply created a situation in which such an abuse was possible. The Opinion of Advocate-General Van Gerven follows a similar approach. He states (at paragraph 22 of the Opinion):

"In fact, the scale of charges and other, presumably unfair, contractual conditions applied by Merci...are made possible, if not inevitable, by the national legislation applicable, and are facilitated, if not made compulsory, by the port authorities under the powers conferred on them by national legislation. The other abuses too are made possible by that legislation."

(Emphasis added.)

In practice a literal application of the Absolute Competition approach would mean that every grant of special or exclusive rights would constitute a breach of Article 90(1). By definition, the creation of a legal monopoly places the relevant undertaking in a dominant position, that is "...a position of economic strength enjoyed by an undertaking which
enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers" (Emphasis added) (Case 322/82 Michelin v Commission [1983] ECR 3461 paragraph 30). The creation of a dominant position enables the relevant undertaking to abuse that position. Under the Absolute Competition approach, this would be a breach of Article 90(1).

The Limited Competition approach

Under this approach, the creation of a legal monopoly will not contravene Article 90(1) if, but only if, creation of such a monopoly is necessary in order to attain a legitimate national objective. Support for this approach can be found in Case 155/73 Sacchi [1974] ECR 409, where the Court of Justice held (at paragraph 14) 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, including cable transmissions, from the field of competition by conferring on one or more establishments an exclusive right to conduct them." (Emphasis added.)

On this approach, the creation of a legal monopoly must: (a) be justified by a legitimate national objective and (b) satisfy the principle of proportionality. This approach has been advocated by certain commentators (see B. Van Der Esch, "Dérégulation, autorégulation et le régime de concurrence non faussée dans la CEE" [1990] C.D.E. 497 at 511-512; Carles Esteva Mosso, "La Compatibilité des monopoles de droit du secteur des télécommunications avec les normes de concurrence du traité CEE", [1993] C.D.E. 445 at 455-456).

Support for this approach can also be found in Case C-230/91 Corbeau [1993] ECR I-2533. Belgian law granted a legal monopoly to the Régie des postes under which it enjoyed an exclusive right to collect, transport and deliver all forms of correspondence throughout Belgium. Mr Corbeau provided his own form of postal services in Liège and neighbouring areas by collecting mail from the sender's residence and either delivering it before noon the next day if the destination was within the Liège area or dispatching it by the normal postal services if the destination was outwith that area. When Mr Corbeau was prosecuted, he challenged the legality of the Belgian postal monopoly under Community law. The Court held that Article 90(1) must be read in conjunction with Article 90(2), in relation to which it observed:
"Cette dernière disposition permet ainsi aux États membres de conférer à des entreprises, qu’ils chargent de la gestion de services d’intérêt économique général, des droits exclusifs qui peuvent faire obstacle à l’application des règles du traité sur la concurrence, dans la mesure où des restrictions à la concurrence, voire une exclusion de toute concurrence, de la part d’autres opérateurs économiques, sont nécessaires pour assurer l’accomplissement de la mission particulière qui a été impartie aux entreprises titulaires des droits exclusifs". (Emphasis added.)

On the facts of the case, the Court held that the obligation to ensure universal supply of basic postal services throughout Belgium at uniform tariffs and under similar conditions did constitute un service d'intérêt économique général. However, it held that it was for the national court to consider whether the existence of a total monopoly for such services was necessary to achieve such an objective.

In order to apply the Limited Competition approach, it is necessary to define what constitutes a "legitimate national objective". In the Corbeau judgment, the Court assumed that the provision of universal postal services at a fixed tariff was a legitimate objective, but it did not indicate what principles it applied in reaching that conclusion.

Two possible general principles spring to mind: (1) national security, and (2) the need to ensure universal supply.

National security

Article 223 of the EEC Treaty provides for a specific derogation from the Treaty rules for national measures which are "necessary for the protection of the essential interests of...security" and which are "connected with the production of or trade in arms, munitions and war materials". This principle could be relevant, for example, to energy or transport monopolies.

Need to ensure universal supply

In a modern society, the availability of certain goods and services may well be described as a basic social need for private citizens and businesses alike. Such goods and services may include the right to water, electricity or gas, the right to have access to postal services or the right to have access to telecommunications services. A Member State might argue that universal supply will only be possible if a legal monopoly is created in respect of the supply of such goods and services. If free competition were permitted, undertakings would restrict their activities to profitable areas, for example, densely-
populated urban areas, with the result that those who lived in remote areas might be
deprived of their social needs, either because no undertaking was prepared to offer a
supply in such areas or because the cost would be prohibitively expensive. By creating
a legal monopoly under which there is an obligation to ensure universal supply at
standard rates, the monopolist could offset the cost of providing goods and services in
remote areas with the profits made in urban areas.

Maintaining special or exclusive rights

The foregoing observations have focused on the question of whether the *grant* of a legal
monopoly is subject to EC law, but it appears that the same principles should also apply
to the *maintenance* of existing legal monopolies. In Corbeau, the Belgian postal
monopoly had been created by laws adopted in 1956 and 1971. At that time, demand
for specialised rapid courier services as provided by Mr Corbeau did not exist, or did not
exist to the same extent. When the problem of the legality of the Belgian postal
monopoly arose in 1993, the nature of the market had changed. The nature of the
problem was not whether the legal monopoly had conformed with Article 90(1) at the
time of its creation, but rather whether the legal monopoly conformed with Article 90(1)
given the state of the market in 1993. The judgment of the Court in *Corbeau* places an
obligation on the Member States constantly to review legal monopolies in light of
changing market conditions. (See further the case note by Leigh Hancher [1994] 31
CML Rev. 105 at 116.) This obligation may be particularly onerous in markets, such as
telecommunications, which are undergoing swift and dramatic changes.

DE-MONOPOLISATION OF NETWORKS, WITH PARTICULAR REFERENCE TO
VALUE-ADDED SERVICES, CREAMING-OFF AND CROSS-SUBSIDISATION

The whole area of liberalisation or de-monopolisation raises fundamental questions of
Community law:

- first, as regards definition of the area within which a universal service must be
  supplied and which can therefore be legitimately reserved for a given undertaking

- second, in relation to the prevention of cross-subsidising whereby monopolies use
  their privileged position in certain sectors to subsidise other activities, where
  competition is more open, to the detriment of their competitors, and
third, in relation to the converse problem of ensuring that liberalisation does not permit new enterprises entering the market to "cream-off" profitable activities, leaving the less profitable activities to be carried out by the public undertaking charged with providing a universal service. 19

A further feature of modern markets which depend on "networks", such as postal services or telecommunications services, is the development of "value-added services". These tend to be specialised services targeted at specific clients, for example, the provision of courier services, as in Corbeau or the use of leased telecommunications lines to transmit messages in data form which are then converted for reception in telex, facsimile, written or other visual form (as in Case 41/83 Italy v Commission [1985] ECR 873, "the British Telecom case").

Undertakings responsible for the provision of universal supply ("universal providers") often use profits raised from certain geographical areas or types of activity to subsidise less-profitable areas or activities. If private undertakings, unburdened by the obligation to provide a uniform supply, are permitted to concentrate their efforts on providing specialised and highly profitable services to limited sectors of society, there is a risk that the universal provider would not be capable of fulfilling its universal supply obligations. This is known as "creaming-off".

However, if a Member State legislates to prevent provision of value-added services by anyone other than the universal provider, that may constitute a _prima facie_ breach of Article 90(1) (in combination with Article 86(b)), either because such legislation would discourage the creation of new technologies and services (see the British Telecom Case, supra) or because the universal provider would not be in a position to satisfy the demand for value-added services (Hofner v Macrotron, supra).

It is clearly necessary to balance the need to ensure universal supply and an effective national network with the need to encourage the development of new technologies and new services through effective competition. This necessity to find a balance is recognised in Article 90(2) which provides that "undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly" are subject to the EC competition rules "only 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."

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19 These issues are also adumbrated in the Court's judgment in Gemeente Almelo, case C-393/92, Judgment of 27 April 1994, not yet reported.
The application of Article 90(2) in the context of value-added services was considered by the Court in Corbeau (supra). The Court held (in paragraphs 17 and 18) that the obligation of universal supply imposed on the Régie des postes presupposed that it should be able to subsidise its less-profitable activities with returns gained from profitable activities ("cross-subsidisation"). This in turn implied that a Member State might be justified in limiting competition in respect of profitable activities in order to prevent creaming-off. However, the Court continued (at paragraphs 19-20) as follows:

"L'exclusion de la concurrence ne se justifie cependant pas dès lors que sont en cause des services spécifiques, dissociables du service d'intérêt général, qui répondent à des besoins particuliers d'opérateurs économiques et qui exigent certaines prestations supplémentaires que le service postal traditionnel n'offre pas, telles que la collecte à domicile, une plus grande rapidité ou fiabilité dans la distribution ou encore la possibilité de modifier la destination en cours d'acheminement, et dans la mesure où ces services, de par leur nature et les conditions dans lesquelles ils sont offerts, telles que le secteur géographique dans lequel ils interviennent, ne mettent pas en cause l'équilibre économique du service d'intérêt économique général assumé par le titulaire du droit exclusif.

Il appartient à la juridiction de renvoi d'examiner si les services qui sont en cause dans le litige dont elle est saisie répondent à ces critères."

This part of the judgment in Corbeau raises a number of questions concerning value-added services, creaming-off and cross-subsidisation.

Creaming-off

There will not be many cases in which a universal provider will be able to establish that the effect of the activities of any particular value-added service provider will threaten its economic stability. For example, it is hard to imagine that the financial stability of the whole Régie des postes was imperilled by the activities of Mr Corbeau in and around Liège. However, there is a danger in looking at each case in isolation. Even if the activities of each individual value-added service provider are relatively unimportant, the combined effect of all their activities may have serious repercussions on the economic stability of the universal provider. It may be necessary to consider the overall effect of competition in all geographical areas and in many types of value-added services. This represents a very onerous task for any court and, indeed, it may be that the process of litigation is really inappropriate to deal with such wide-ranging economic analyses.
Cross-subsidisation

The Court assumed that the Règle des postes should be permitted to use profitable activities to subsidise less profitable activities. However, in future cases, it will be necessary to examine further the situations in which cross-subsidisation are compatible with EC competition law.

"Cross-subsidisation means that an undertaking allocates all or part of the costs of its activity in one product or geographic market to its activity in another product or geographic market" (Commission's Guidelines on the Application of EEC Competition Rules in the Telecommunications Sector, OJ 1991, C 233, p. 2, paragraph 102). Cross-subsidisation may lead to a distortion in competition as it enables an undertaking to provide goods or services at a price lower than their true market price or even lower than their production cost.

The issues raised by cross-subsidisation in the context of universal providers and legal monopolies are complex. The question was considered by the Commission in its Telecommunications Guidelines (supra, at paragraphs 102-104):

"Cross-subsidisation does not lead to predatory pricing and does not restrict competition when it is the costs of reserved activities which are subsidised by the revenue generated by other reserved activities. This form of subsidisation is even necessary, as it enables the TO's [Telecommunications Organisation] holders of exclusive rights to perform their obligation to provide a public service universally and on the same conditions to everybody. For instance, telephone provision in unprofitable rural areas is subsidised through revenues from telephone provision in profitable urban areas or long-distance calls."

The Commission stated that the same reasoning could be applied to the subsidising of reserved services by means of activities which are subject to competition. However, it is very important to ensure access to the network on equitable terms, since there will be an incentive for the universal provider to try to improve its competitive position in respect of value-added services by imposing detrimental conditions of access to the network on its competitors.

The Commission also considered that subsidisation of activities which are subject to competition by activities which are subject to a monopoly was likely to distort competition in violation of Article 86.
It is often very difficult to identify whether there has in fact been any cross-subsidisation. This is because subsidies can be provided in a number of ways. For example, in setting the price to be charged for a value-added service, the universal provider may not take full account of the actual cost of access to the network. Any shortfall can be absorbed by increasing the price of the monopoly services. Furthermore, a universal provider may be able to obtain loan capital at a lower rate than normal private undertakings due to the financial security which it enjoys as a result of its legal monopoly. If such capital is then used to subsidise activities which are not covered by its legal monopoly, this may give the universal provider an unfair advantage over its competitors, for whom borrowing money is more expensive. The existence of cross-subsidisation can be controlled to a certain extent by ensuring that universal providers use transparent accounting techniques which take full account of true cost allocations.

The jurisprudence of the Court of Justice in relation to value-added services, creaming-off and cross-subsidisation is at a very early stage of development. It is important to note that, although the cases decided so far have been concerned with relatively "intangible" networks, the same considerations will apply to access to physical networks for water, electricity and gas supply and rail transport.

A coherent approach to the development of the law needs to be worked out and can usefully be discussed in Rome.