

## **The influence of competition law on the changing of the role of State in telecommunication markets**

### **1. Introduction**

The European telecommunications markets are determined by the changing role of State, which has considerably been influenced by European competition law. This article will show a picture about how the competition law promotes the regulatory process of liberalization. From this point of view the liberalisation entails the changing of the two main roles of a State concerning the markets: ownership and regulation.

Both of these has changed in the telecommunication markets throughout the last decades but only in respect of the ownership it might be seen as decreasing because the regulatory part of the state rather transformed than changed.

### **2. The decreasing of State ownership in telecommunications**

It could be mentioned two reasons why were often imposed direct ownership of telecommunication enterprises by the State. Firstly the strategic and security concerns dictated it; secondly regulatory controls upon quality and price of telecommunication services at welfare maximising level indicated the ownership of State.<sup>1</sup>

#### **2.1. Global tendencies in changing of State ownership**

The chart below shows the composition of the ownership in telecommunication companies. In the beginning of the 90's the size of State ownership was nearly 60 per cent, while nowadays it is negligible and the degree of private ownership is the determinative. At the end of the 80's the EU telecommunications markets were still characterised by the presence of state-owned monopoly operators in all Member States with the exemption of the UK, Spain and Italy, where mixed public-private firms offered the incumbent services.

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<sup>1</sup> Damien Geradin/Michel Kerf: Controlling Market Powe in Telecommunications, Antitrust vs Sector-specific Regulation, Oxford University Press, 2003. p. 6.

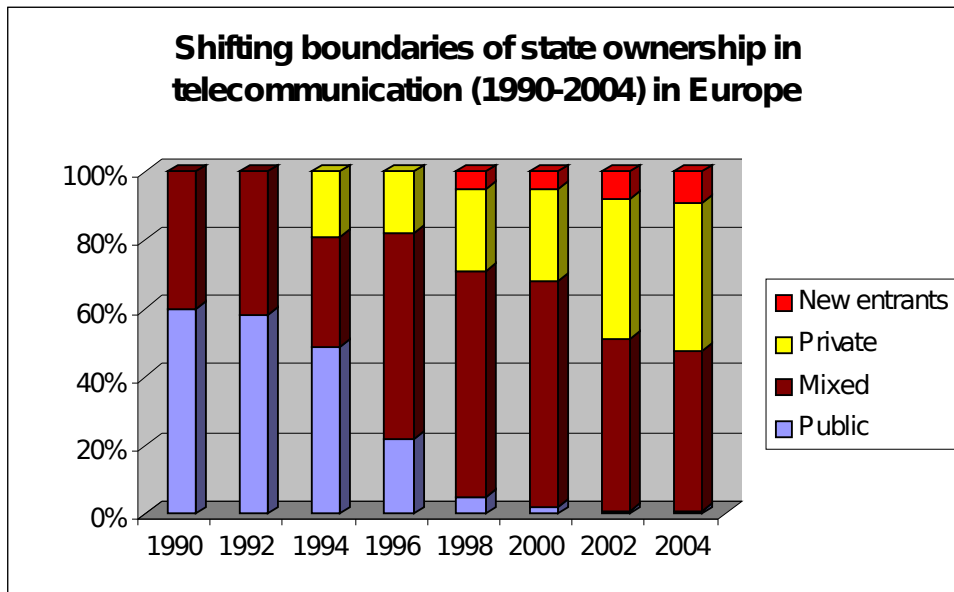


Figure 1<sup>2</sup>

The next chart shows the radical decrease of State ownership as well as the unbreakable increase of the importance of private ownership and new entrants.

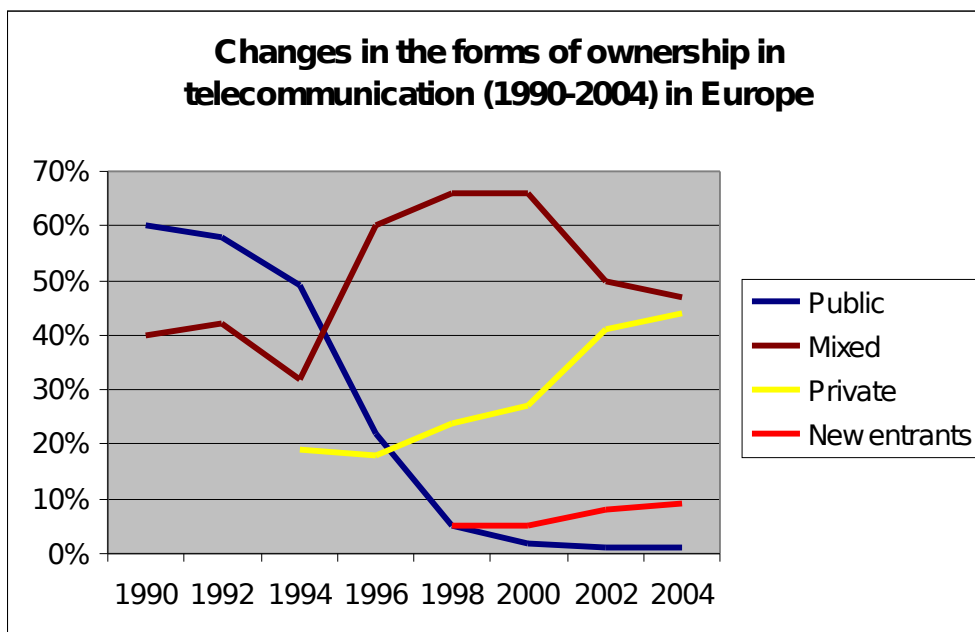


Figure 2<sup>3</sup>

## 2.2. Forms of the privatisation

The global wave of telecom reforms began in the 1980s. These reforms have included privatisation of national companies and liberalisation of entry into the market. The reform was triggered by technological changes and growing of the demand for telecommunication

<sup>2</sup> OECD, Communication Outlook, 1999., Paris. This chart is based on the calculation of Johannes M. Bauer: Regulation and State Ownership – Conflicts and Complementarities in EU Telecommunications, Annals of Public and Cooperative Economics, 76:2, 2005, p. 161.

<sup>3</sup> OECD 1999. and J. M. Bauer 2005., See fn. 2.

services provided on global level.<sup>4</sup> Both of them require massive investment, which seemed to be served by private companies because the governments have other social and development programs. So the privatisation of the national carrier was often the only solution to develop the telecom industries. The privatisation can refer not just to the sale of a national company, but also to the removal of restrictions against private sector participation in the industry.<sup>5</sup>

There are nearly as many approaches to privatisation as there are countries. Privatisation and the liberalisation infrequently are closely linked, but not always in the same way. Four common models are emerged according to *Piscotta*<sup>6</sup>:

1. Privatisation with full competition:

New Zealand presents the case of contemporaneous privatisation, liberalisation and deregulation. In New Zealand at the same time as the privatisation, the government implemented a policy of full and open competition. All restriction on entry into all segments of the market was removed. There is no regulatory authority this resulted in problems e.g. in connection with interconnection fees.

2. Privatisation with Phased-in Competition in case of Hungary:

In this model, privatisation of national company is accompanied by a sustained period of exclusivity rights. Hungary – similar to UK and other European country – pursued this model because wanted to maximise the value of the sale of the national incumbents, and believed that a private monopoly is the best way to build-out the infrastructure.

The requirement of establishment competition on telecommunications markets arose already before change of political regime because the telecommunications infrastructures and services were underdeveloped (8 line per 1000 inhabitants) in Hungary.

The Hungarian Post (Magyar Posta) offered the telecommunications services before 1990, which the tasks of regulatory authority carried out too.

The developments of telecommunications infrastructures and services could start due to credit agreement with EBRD and World Bank. The abandonment of cross subsidization between postal and telecommunications services was the condition of this credit financing. So the Hungarian Post was divided into three parts in 1990 and the Hungarian Telecommunication Company (Matáv, now Magyar Telekom), the Hungarian Broadcasting Company (Antenna Hungária), and the Hungarian Post (Magyar Posta) were established.

After the structural changing could start the regulatory reform, whose three main goals were in the light of the development of effective competition on telecommunication markets:

- the basic telecommunications services would be available for most consumers and in a short time (there were more than 700.000 on the waiting list for telephone);
- maximize the foreign capital investment and increasing its speed of inflow;
- increasing of efficiency of Hungarian telecommunication.

In regard with these requirements was created the Act 72 of 1992 on Telecommunication (Tt.), which was aimed at assuring of the appropriate function of new monopolistic Hungarian telecommunication market. I.e. the performance of aforementioned objects required the “model of temporary maintained monopoly” beyond the privatisation.

On the one hand the rush technical development only had been assured by the inflow of foreign capital investment through privatisation. The engine of technical development was the technology transfer because of small scare and underdevelopment of telecommunication market in Hungary. On the other hand it was needed for guarantee of refunding of

<sup>4</sup> Holzhäuser: Essential Facilities in der Telekommunikation, 2001., 15. o. és Eisenblätter: Regulierung in der Telekommunikation, 2000., p. 288.

<sup>5</sup> Aileen A. Piscotta: Global Trends in Privatisation and Liberalisation In.: Telecom Reform, Principles, Policies and Regulatory Practices, Edited by William H. Melody, Den Private Ingenifond, Technical University of Denmark, Lyngby, 1997, p. 339.

<sup>6</sup> A.A. Piscotta 1997., p. 340-345., See fn. 5.

investments, which was assured by the “model of temporary maintained monopoly”. The Tt. regulated the operation the monopoly system while the Act 16 of 1991 on Concession ordered its development. The instrument of concession made it possible that only one undertaking carries on activity in certain geographical area. (According to the Act on Concession the telecommunications services were provided by concession too.)

In compliance with the above-mentioned objects the Ministry of Transport and Communication invited tenders for privatisation of Matáv and concession of providing long-distance, international call services in Hungary and local call services in 29 dialling area. Prior to inviting tenders the Ministry divided Hungary 54 dialling area from numbering point of view. According to the Tt, if the majority of local governments of certain dialling area requested it, the Ministry had to invite tenders separately regarding local call services. So happened that from 54 dialling area only 29 local governments wanted to be service provider Matáv. The Ministry invited the tenders for other 25 dialling area in September 1993.

But we remain at national concession. The winner of international tender for privatisation of Matáv and providing long-distance, international call services in Hungary and local call services in 29 dialling area was the MagyarCom, which belonged to the Deutsche Telekom A.G. (DT) and Ameritech Inc. 50-50% (now only to the DT). According to the Act on Concession the winner would have had to establish concessions company in Hungary but due to privatisation the winner received 30,1% market shares in Matáv. So the MagyarCom as winner assigned the all right and obligations arising from concession to the Matáv. The concessions agreement was already signed with Matáv as the entitled of concession in end of 1993. According to the concessions agreement the Matáv received 8 years exclusive right for providing long-distance international call services in Hungary and local call services in 29 dialling area.

After the tender for national concession and privatisation of Matáv the Ministry invited other tender for rest 25 dialling area to provide local phone services. 12 several companies won in 15 areas. Matáv won in 5 areas, and Emitel, which was a joint venture of Matáv, won in 3. The further 2 areas was received the Matáv according to the Concession Agreement because for these areas was not candidate. These winners received 8 years exclusive right for providing local call services in their areas too.

### Fix local telephone operators in Hungary

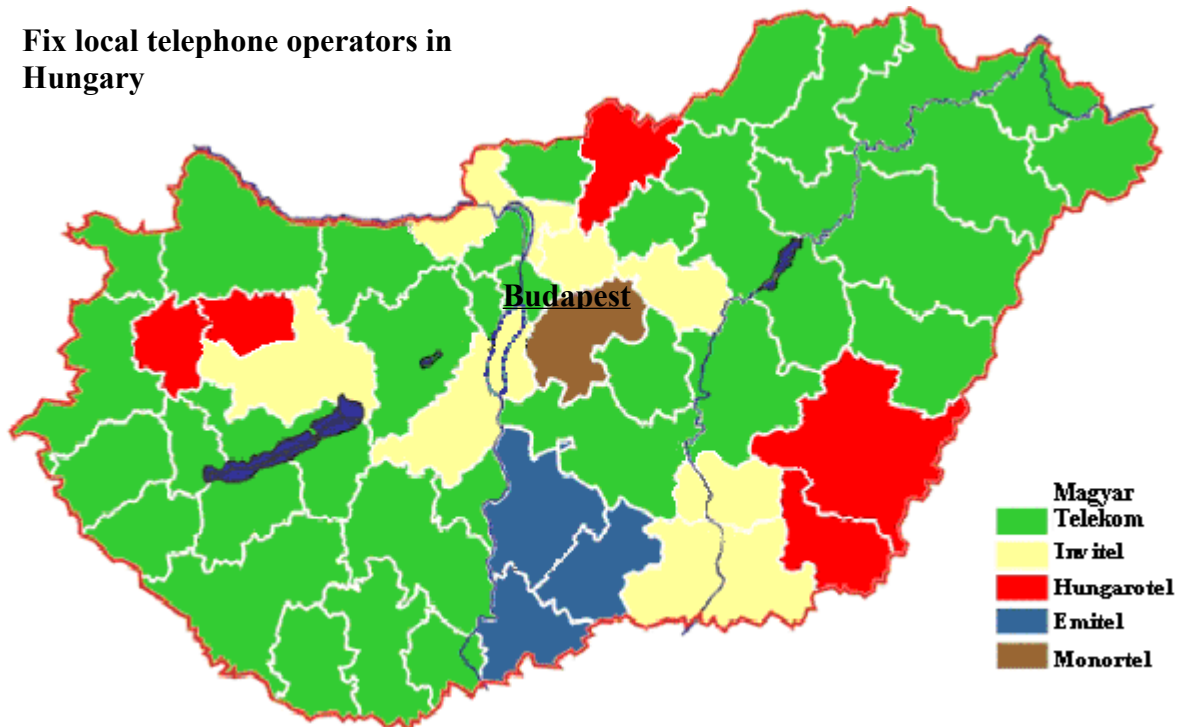
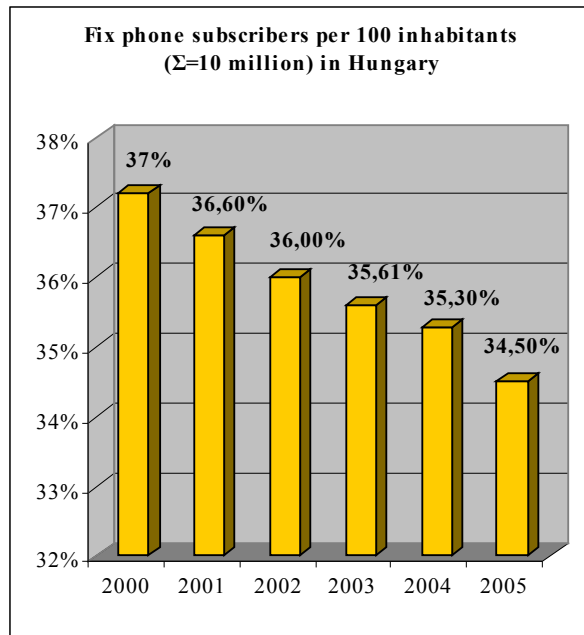
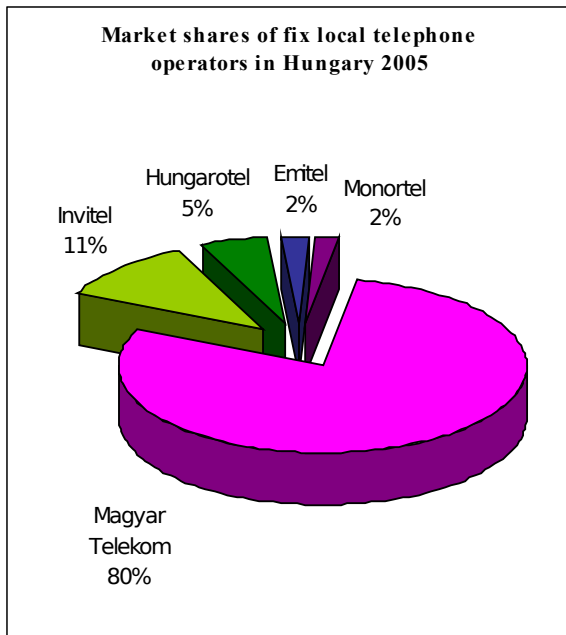


Figure 3

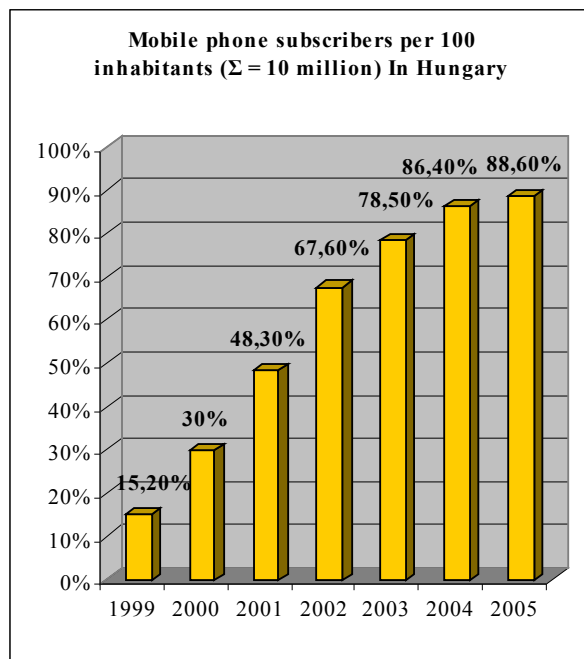
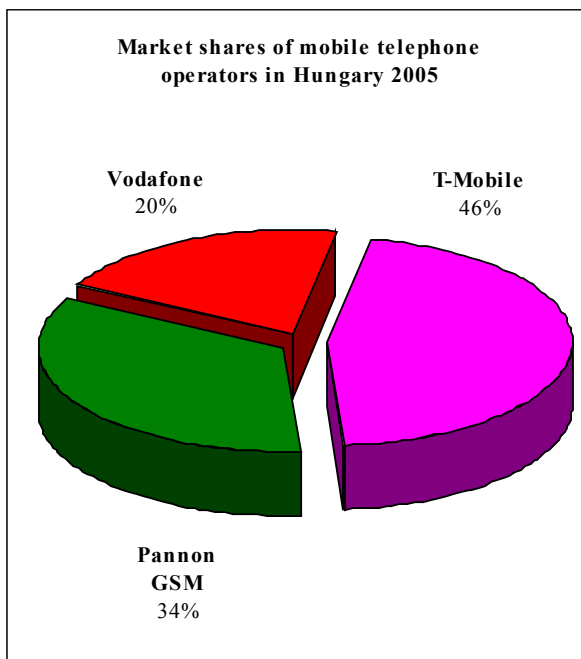
The regulator judged so – in the light of model of temporary maintained monopoly – in 1993 that 8 years exclusive right is needed in order that the telecommunications infrastructures would be liberalized in the future. This model was successful in middle distance but the 8 years exclusivity was source of social deficits in the case of national concession in long distance. The increasing disadvantages of monopoly already surpassed its decreasing advantages in end of the 8 years period.

But the case of local telephone operators (LTO) was other than the Matáv's from two respects. On the one hand the LTOs could provide only local calls in their small dialling area because the national and the international call services fallen under the monopoly of Matáv. So the LTOs were obliged to build the local loop – the most costly part of telecommunications infrastructures – while their possibilities for finance were limited compared with the Matáv LTOs. On the other hand the Matav LTOs were in more favourable situation in the interconnection respects than the other LTOs. According to the Act on Concession the winners of tender for rest 25 local dialling areas were obliged to establish separated concession company. But Matáv did not do it. So the no Matav LTOs were at more disadvantages compared with the Matáv LTOs, which were not obliged to conclude interconnection agreement for termination of national and international calls.



Figures 3-4.<sup>7</sup>

But was not only due to 8 years exclusivity and the aforementioned disadvantages of no Matáv LTOs that the first liberalisations law – Act 40 of 2001 on Communication (Hkt.) – was not able to fulfil the expectations. It seems to be cliché but it is truth that with the help of separated privatisation of the network and the service providing division of Matáv would have solved a lot of problems, which arise from fact of vertical integration. Now these problems require detailed sectors-specific regulation in Europe and in Hungary too. But the liberalisation's circumstances of fix market in Hungary were differing from Europe's market environment from two aspects. On the one hand the liberalisation of fix market started in 2002 under higher penetration of mobile phone than in Europe, on the other hand the telecommunication sector was characterised in the world by recession because of UMTS tenders.



Figures 5-6.<sup>8</sup>

<sup>7</sup> Monthly Reports of National Communications Authority, <http://www.nhh.hu/index1.html>

<sup>8</sup> Monthly Reports of National Communications Authority, <http://www.nhh.hu/index1.html>

Although the cable television networks would have reduced these harmful effects because approximately 55% of viewers are their subscribers consequently the cable networks in Hungary would have been able to create competition widely on voice market. But it did not happen that. The Hungarian cable television market is very fragmented: 4 undertakings have 60% market shares, and approximately 500 companies share in the rest. These small undertakings have not had financial possibilities to develop their networks and services for call services. Whereas the biggest companies were busy with their expansions. Matáv recognized the importance of cable networks (it started buying and building cable networks) that is way the Tt. was modified in order that fix telephone operators (mainly Matáv) did not obtain parallel cable television networks. Although the Hkt. adopted and applied this restriction until end of 2003, this rule remained ineffective and the cable networks were not able to competitive pressure on fix telephone operators. Beyond these reasons the Hkt. did not ensure the National Regulatory Authority (Hírközlési Felügyelet, now Nemzeti Hírközlési Hatóság) effective intervention tools. These gaps of Hkt. manifested itself in price squeeze cases and carrier selection, which was excluded in the tariff packages of fix operators in spite of rules.

So the Hkt. was the first liberalisation regulation in Hungary but next to several market circumstances it was not able to trigger effective competition.

3. Liberalisation without Privatisation

The reason for pursuing this approach is to gain the advantages of competition without suffering political disadvantages. (E.g.: Finland, Sweden, Germany, and France.) The independence of the regulatory authority must be ensured in these countries in order to protect the competitors from unfair competition due to special link between the state-owned company and the regulatory function of the State.

4. Private sector Participation without privatisation or liberalisation

As I mentioned above the privatisation can refer to the removal of restrictions against private sector participation in the industry as well. Thailand and Saudi Arabia are examples of this approach where the private industry has concession to build or operate specific facilities or services. The private sector participation in telecom is not permitted in China where two telecom operators controlled by two ministries compete.

**2.3. Pros and cons analysis of the privatisation**

While the below-mentioned liberalisations measures are binding to the member states, the EU do not stipulate any particular ownership regime but left the choice to national governments. There are pros and cons of the public and mixed ownership according to Bauer<sup>9</sup>:

Advantages	Disadvantages
1. could mitigate asymmetric information problems 2. utilize social objectives (universal services, stabilization of employment) 3. can stabilize investor expectations after privatisation	1. may put a pressure on the regulator to adopt regulations favourable to the mixed firms 2. such an abuse is more difficult to detect

Figure 7.

**3. Changing of the regulative intervention of the State on telecommunication markets**

<sup>9</sup> J. M. Bauer 2005., See fn. 2.

The regulation constitutes the other main dimension role of State on the markets. This chart shows the changes of the degree of regulation and its prospective development in the future in Europe.

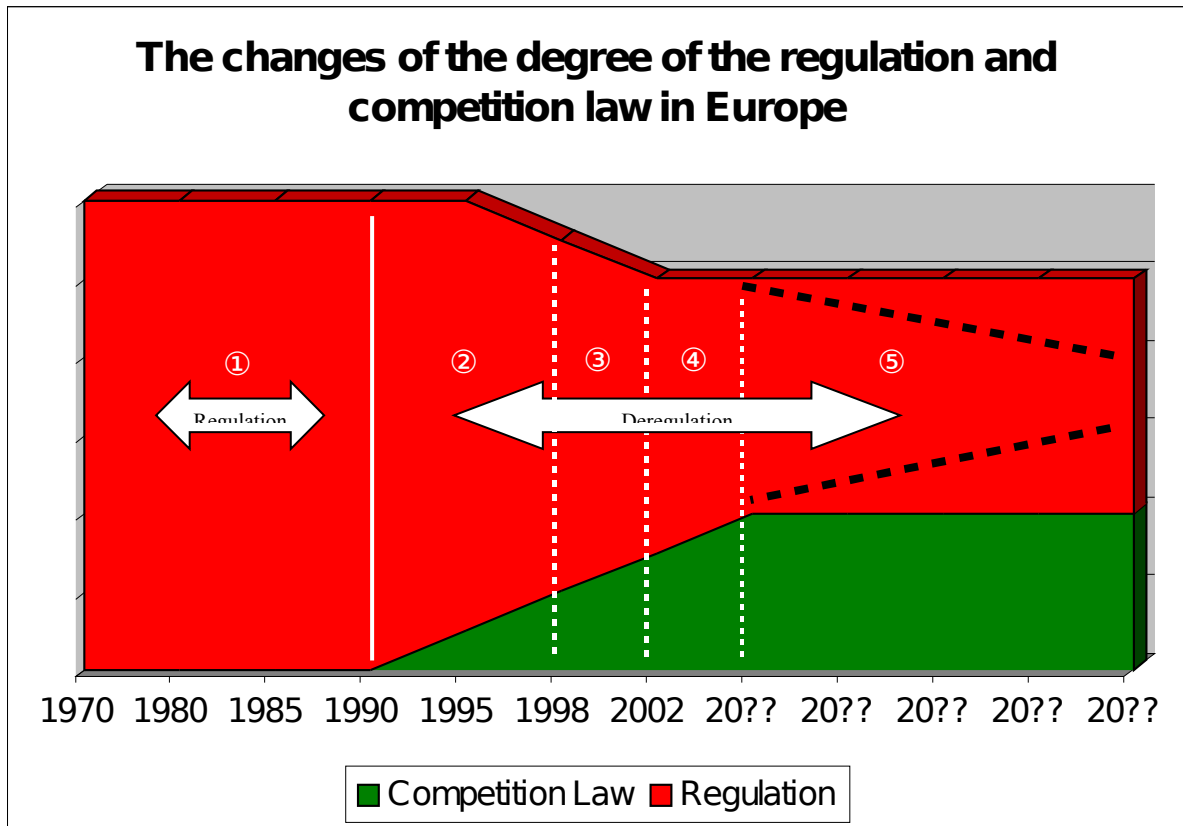


Figure 8.

The regulatory intervention of the State on telecommunications markets could be divided into two main elements. The first one is the period of the regulation the second one is the deregulation. The regulation lasted until 90's in Europe, so the deregulation process began in 10 years later than in other developed countries. The deregulation period could be divided further into three subparts. Both of them are characterised by re-regulation, which means regulation for successful liberalisation. The European re-regulation started in 90's with the liberalisation of non-voice telecommunication services. The liberalisation of voice telecommunication services constitutes the second part of the European re-regulation, which was renewed in 2002 based on principles of competition law. These forms of re-regulation developed some competition on the markets but did not result in decreasing of regulation intensity. Moreover, doubtful whether the regulation would be able to phase out. On it depends the growing of the competition in the future.

### 3.1. Regulation

In a modern market economy there are several State policies for welfare. One of these is competition policy with the main purpose of protecting effective competition. Competition should be able to function without any restriction because it so could maximize the welfare of consumers. Accordingly the competition law ensures this function of the competition. But the ability of the competition law to carry out this requirement depends on the competition environment. Therefore the tools of the competition law are not sufficient on all markets. This could be traced back to the character of the norm of competition law.

The abstraction of the norms of competition law is on a high level because of the unforeseeable and huge variety of the behaviours. Moreover the enforcement of the competition law does not depend on the actions of authorities but of the market players, who pursue the aim of the competition law voluntarily. This dual character of the competition law (the abstraction on a high level and the voluntary obedience to the law) could result in uncertainty. The case law by specifying the abstraction can reduce this uncertainty. However this crystallisation procedure is quite slow because of the burden of proof and the appeal process. Moreover the detailed legal principles are applicable in a certain context for only the parties, who are involved in the case and the enforcement and the monitoring of the remedies is also difficult and slow.

Due to the above-mentioned characteristics of these norms, competition law may be applied successfully to such markets where in case of infringement:

- the legal consequences and the sanctions are very likely to follow the illegal conducts, and this probability of the legal consequences constitutes sufficient preventing power from the infringement, and
- the intervention of the authority is able to restore the market place effectively before the infringement.

These market conditions are given in effective competition where there is no market player with dominant position. But this does not indicate that the competition law would be unable to prevent the abusive conducts. It could be concluded only if

- the market is very fragmented geographically and there are lots of market players with dominant position, who realize abusive behaviours often, or
- the number of market players are not so much but these abuse their dominant position in several forms and often, and
- the frequent infringements involve slow and difficult proving procedures, and
- the ex-post intervention is not able to reinstate effectively the status quo before the infringement.

These factors could emerge in case of market failure triggered by a natural monopoly. The natural monopoly is due to the large fixed costs and in certain cases it may be attributed to the economies of scale. This was the situation in telecommunication services, where the economies of scale evolved from the fact that where a network was already built it was not worth building other parallel networks. It was strengthened by the network externalities from users point view, because the value of a network increases with the number of network subscribers.<sup>10</sup> This economic model based on natural monopoly determined the regulation of the telecommunication services until the beginning of the 80's and some other segments (e.g. local loop) so far. In this regulatory environment the task of the regulation was to simulate the outputs of the competition mainly with regard to price and quality. Five characteristics of this regulation can be identified according to *Eisenblätter*<sup>11</sup>, which described the regulation of telecommunication as well:

- permanent competition simulating;
- market players of a certain sector are concerned;
- regulation instruments affect in particularly terms of price, quality, market entry;
- there is a single act, and
- authority.

As it was mentioned above these regulatory controls were often assumed direct ownership of telecommunications enterprises by the State.

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<sup>10</sup> Geradin/Kerf, 2003., p. 6., See fn. 1.

<sup>11</sup> Tanja Eisenblätter: *Regulierung in der Telekommunikation*, Peter Lang GmbH Europäischer Verlag der Wissenschaften, Frankfurt am Main 2000., p. 28.

### 3.2. Deregulation

The erosion of the reason for regulation in the most segments of the telecommunications market was due to the dynamic factor of the natural monopoly in 1980's. The regulation of a natural monopoly is only based on the actual situation of the technical development therefore the natural monopoly is a static conception, a "snapshot".<sup>12</sup> (It can be defined only by present economic situations.) As in case of other innovative markets, the elements of the dynamic factor emerged from telecommunication as well. So the increasing international trade and the technical development boomed the demand for telecommunication services<sup>13</sup> on global and also on national level. The arising scarcity of capacity abolished the economies of scale in most segments together with it the reason for regulation as well. The most developed countries (USA, Canada, Japan, New-Zealand, Australia) recognised this phenomenon on time and began creating the conditions of effective competition on telecommunication market, which also is the engines of development of other sectors. Such launched deregulation aimed at decreasing the role of State in terms of economic regulation and the ownership.

According to *Eisenblätter*<sup>14</sup> the deregulation means the abolishing of regulation, State intervention, which constitutes barriers of freedom of market players and consumers as well. This deregulation constitutes the second main part of the regulation life-curve of the telecommunication.

But as it was recognised in the case of light-handed regulation in New Zealand, the single liberalization is not able to trigger effective competition. The light-handed regulation, according to regulation instances of *Lagenfurth*<sup>15</sup>, does not require regulatory authority because it assumes that the market players could find better solution for the market failures. Competition office and the court carry out the task of regulatory authority in this regulatory environment. The national incumbent was fully privatised in 1987 and all sector specific regulation was withdrawn in New Zealand. But the market players were not able to effectively solve the market problems by negotiation.<sup>16</sup>

The liberalization is the main factor of deregulation, which requires the erosion of exclusive and special rights in the market. Of course, some segments of the telecommunication sector will be untouched by liberalisation (e.g. local loop) because of its natural monopoly character. But liberalization isn't expected to trigger effective competition especially not in rest segments where there are significant market shares of incumbents. This fact doesn't result in dominant position if there are no barriers and risks in terms of market entry. But the barriers are very high in the case of telecommunication e.g. because of (sunk) investment costs. The competition law is not able to demolish these significant market entry<sup>17</sup> barriers. As it could be seen above,

- if the incumbent abuse their dominant position in several forms and often, and
- the frequent infringements involve slow and difficult proving procedures, and
- the ex-post intervention is not able to reinstate effectively the status quo before the infringement,

then the competition law does not achieve its target. So the creation of effective competition requires asymmetrical applied ex-ante remedies to prevent the abuses of incumbent operator, which are able to jeopardize the success of liberalization and market entry of newcomers. The

<sup>12</sup> . Holzhäuser 2001., p. 14., See fn. 4.

<sup>13</sup> M. Holzhäuser 2001., p. 15., See fn. 4., and T. Eisenblätter 2000., p. 288., See fn. 11.

<sup>14</sup> T. Eisenblätter 2000., p. 53., See fn. 10.

<sup>15</sup> Markus Lagenfurth: Der globale Telekommunikationsmarkt, Peter Lang GmbH Europäischer Verlag der Wissenschaften, Frankfurt am Main 2000., p. 127.

<sup>16</sup> Martin Gebbert - Ernst-Olav Ruhle - Fabian Schuster: Handbuch Recht und Praxis der Telekommunikation, Verlag Österreich, 2002., p. 786-787.

<sup>17</sup> Holzhäuser, 2001., p. 25., See fn. 4.

ex-ante character of norm means that rules are enforced through authority, which imposes the remedies previously. These remedies require such regulatory tools, which ensuring supply-side substitutability (e.g. carrier selection, unbundling) as well as the conditions of interconnection and interoperability according to *Larouche*.<sup>18</sup>

So it is necessity to support the deregulation by positive formation of regulation, which constitutes the re-regulation.<sup>19</sup> Although the features of the re-regulation are very similar to regulation as its rules are laid down in a single act, applied to a certain sector's market players, and are controlled by an independent authority. But it is not permanent therefore it cannot be regarded as a formal regulation. According to *Eisenblätter* the market failure is not due to the dysfunctions of the market operation but the lack of regulation could result in the missing of its.<sup>20</sup>

The re-regulation is different from the regulation firstly in terms of purpose, which don't constitute the simulation of the competition but the development of effective competition and the application of competition law. Accordingly, the present European telecommunications regulation in the light of liberalization

- has ex-ante instruments to prevent conducts, which may jeopardize the successful liberalization,
- therefore it is asymmetric, in a way opposes incumbents and favours newcomers,
- temporary because its frame will stay till crystallization of effective competition.

Although the re-regulation is not considered as regulation from formal point of view but the same risks also could emerge in case of this. Because there is information asymmetry between the regulator and the market player in case of re-regulation as well as capture of the regulator<sup>21</sup> rooted in personal relationships and existential questions. The latter arise from the temporary character of the re-regulation according to which the regulation has to demolish itself with parallel of the development of competition. Eventually the regulatory authority has to work for abolishment of its job. Therefore is not foreseeable the future outcome of the re-regulation in EU.

#### **4. Role of the competition law in the changing of the regulation on telecommunications markets in EU**

As it was mentioned above, at the end of the 80's the EU telecommunications markets were still characterised by the presence of state-owned monopoly operators in all Member States with the exception of some countries where mixed public-private firms offered services. These operators did not face competition in their mainstream activities. The technological development of the sector dramatically and very rapidly changed the sector's economic context. It became apparent that unless markets were deregulated and new competitive forces were introduced on the market, the required investment to develop the technology would not be made. Consumers would not benefit to the fullest extent from this technological revolution. The Commission also considered – relatively late – that, unless it had adopted an adequate regulatory framework at the EU level to support the development of the telecommunications market, Europe would have been left behind its trading partners in the US and Japan.

In order to create a more competitive environment for telecommunication services and equipments, the Commission disclosed its first concept about the European liberalisation in a Green Paper in 1987. This Green Paper proposed three-pronged action:

- i) the liberalisation of the supply of telecommunications services and equipment;

<sup>18</sup> Pierre Larouche: *Competition Law and Regulation in European Telecommunications*, Hart Publishing, Oxford and Portland Oregon, 2000., p. 323-358.

<sup>19</sup> M. Holzhäuser, 2001., p. 28. See fn. 4.

<sup>20</sup> T. Eisenblätter, 2000., p. 91., See fn. 11.

<sup>21</sup> T. Eisenblätter, 2000., p. 44., See fn. 11.

- ii) the establishment of harmonised and open access conditions to telecommunications networks;
- iii) the application of the EC Treaty's competition rules to incumbent telecommunications operators.

Liberalisation, harmonisation and application of competition rules constitute the three pillars of the liberalisation of European telecommunications sector. At the same time this three pillars decreased and changed the role of the state, which is significantly influenced by the European competition law, because

- the engine of the liberalisation was the Commission with its directives based on Article 86 (3) of the EC Treaty, in frame of this the state-owned firms lost their exclusivity;
- the content of harmonisation directives are characterised by the competition principles in order for the rules to be able to react flexibly on the dynamic development of the market, therefore the regulatory intervention is no so strict;
- the re-regulation and the competition law are applicable in parallel, whereby the two regulation complement each other, therefore the competition law obtain more area at the expense of the regulation.

#### **4.1. The role of the competition law in liberalisation process**

The liberalisation is a key element of the deregulation process in telecommunication markets, which is restricted by the exclusive and special rights. The Commission declared that these in the telecommunications markets are incompatible with the EC Treaty.

The exclusive rights awarded to the dominant telecommunications operators was due to the fact that monopolistic structures were deemed necessary to enable cross-subsidies between different services or users. Opening the market to competition would prompt entry into the segments where excess profits are made (cream-skimming effect).<sup>22</sup>

The Commission recognised that the creation of effective competition in the telecommunications markets is essential for the EU to be able to keep up with the most developed countries. From this point of view it was necessary to abolish any restrictions on the markets with special regard to the exclusive rights. The aim was that the establishment of the common internal market based on competition would develop the whole sector.

As it was already mentioned the Commission applied Article 86 (3) to abolish the restrictions on the telecommunication markets. It is useful to recall the text of Article 86 EC:

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 12 and Articles 81 to 89.
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, insofar 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.

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<sup>22</sup> Geradin/Kerf, 2003., p. 6., See fn. 1.

Accordingly, Article 86 (3) entrusts the Commission with power to adopt generally applicable instruments such as a directives. This power is the only law-making tool in the hand of the Commission, which is independent from both the Council and the Parliament. But the application of this article assumes the applicability of the competition law on the European telecommunication services.

In the *British Telecom* (BT) case<sup>23</sup> the European Court of Justice (ECJ) first clarified that the competition rules were applicable to the sector. In this case the Commission found that the BT abused its dominant position when prohibited for the message forwarding agencies to transit the telex messages from outside the UK. These agencies wanted to take advantage of the lower telex rate between the UK and USA compared to the rates between other Member States and USA. The Commission found that the application of the competition rules does not hinder the performance of BT's duties in an efficient and economic way pursuant to Article 86 (2). This declaration opened the way to a wider liberalisation process. The Italian Government argued that BT was exempt from the competition rules by virtue of being entrusted with the provision of services of 'general economic interest', under Article 86 (2), which could be threatened by the loss of revenue resulting from the provision of private message-forwarding services.<sup>24</sup> The Court noted that BT's monopoly only extend to the provision and operation of telecommunication networks, not the supply of services over such networks. The ECJ confirmed the decision of the Commission concerning the applicability of the competition law in telecommunications market because there was no evidence that it would be detrimental to the tasks assigned to BT.

On this background the Commission took the first step towards the liberalisation in connection with the market of the terminal equipments. Based on its power in Article 86 (3), the Commission adopted the Directive on terminal equipments (1988/301/ECC)<sup>25</sup>, which opened the market of terminal equipments where until then the national incumbents enjoyed exclusive rights. The Commission went further and not only investigated the exercise of these rights but challenged the existence of them.<sup>26</sup> At the same time several Member States (France, Italy, Germany, Belgium, Greece) disagreed with the legal basis of the Directive. Indeed the Member States were afraid of the loss of the control over the process of liberalisation process in EU. Therefore France appealed<sup>27</sup> the Commission's decision arguing that the Commission should have applied Article 226 instead of Article 86 (3), moreover the Commission had no other duty but to ensure the exercise of the exclusive rights is compatible with the Treaty based on Article 86. The ECJ uphold the Commission's Directive and found that powers of the Commission under Article 86 (3) were not limited to ensuring that exclusive rights are exercised in compliance with the rules of the Treaty. On the basis of that article the Commission could go further and require the Member States to remove all the exclusive and special rights, if they were not compatible with the Treaty.

The *RTT* case<sup>28</sup> also absolutely promoted the Commission's effort to abolish the exclusive rights in the European telecommunication markets. The Belgian court asked the opinion of the ECJ (within the meaning of Article 234, the preliminary ruling procedure) in a case before it, where a Belgian terminal equipment distributor challenged the practice of the Belgian incumbent operator, who refused to distribute the equipment of the competitors on the basis of an exclusive right granted by law. The ECJ found that the exclusive rights on the market of

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<sup>23</sup> 82/861/EEC, OJ L 360/36, 21. Dec. 1982

<sup>24</sup> Telecommunications Law and Regulation, Edited by Ian Waldan and John Angel, 2nd Edition, Oxford University Press, 2005., p. 114.

<sup>25</sup> OJ L 131 1988.05.27.

<sup>26</sup> Telecommunications Law and Regulation, 2005. p. 115. See fn. 24.

<sup>27</sup> C-202/88, 1991 ECR. p. I-1223.

<sup>28</sup> RTT/GB-Inno-BM SA, C-18/188, 1991 ECR p. I-05941.

terminal equipments were incompatible with the Article 28 of EC Treaty because these hinder the trade between member states.

It is very interesting that the trigger of the liberalisation process was the competition law in US as well. In the 1970's MCI challenged the behaviour of AT&T in the court because the incumbent operator refused to interconnect with MCI's networks on local level hindering the providing of long distance telecommunication services of MCI. The court judged the case<sup>29</sup> based on the essential facilities doctrine and declared that the refusal to deal was illegal because the incumbent controlled over essential facilities so it would be leverage onto other market. The case was terminated by settlement between Department of Justice and AT&T, which established the basis of the liberalisation in USA.

#### **4.2. The role of the competition law in the harmonisation procedure**

Although neither the Council nor the European Parliament has any explicit role in the lawmaking process under Article 86 (6), from political standpoint, it would not be desirable for the Commission to ignore the view of the council or the parliament because of the other legal action where these institutions have the final say.<sup>30</sup> This fact resulted in a political compromise between the Commission and the Council in 1989. According to this settlement the voice telephone services remained under exclusive rights, while other telecommunication services would be liberalised, further the Council will adopt the harmonisation directives based on the Article 95 of EC Treaty, which abolish barriers resulting from a divergence of national regulations.

This compromise resulted in a two-pronged approach in terms of liberalisation and harmonisation. The harmonisation directives are determined by the recognition according to which the liberalisation directives of the Commission will not result in effective competition because of the high barriers of market entry and the high market share of the incumbents. In this situation the newcomers have to rely on the infrastructures of the incumbents. So the harmonisation directives had to ensure not only the unifying of the nation regulation but also the eliminating this dependency from the incumbents mainly from access point of view and creating level playing field.<sup>31</sup> Therefore the harmonisation directives established several open, fair, and effective ex-ante obligations for the incumbent operators, which were able to jeopardize the success of liberalization. These terms constitute the basic elements of the concept the Open Network Provision (ONP), which was incorporated firstly in the directive 90/387/EEC.<sup>32</sup> The 1<sup>st</sup> ONP framework ensured that the incumbent's behaviour on the monopolised segments does not influence harmful the development of competition on liberalised markets.

Although the ONP remedies are imposed only on the incumbents, so these are asymmetrical, it must be avoided the overloading of the incumbents in favour of protection of the investment especially in case of the full-liberalised markets. Therefore when the Commission disclosed the directive on full liberalisation<sup>33</sup> in 1996, which order the markets opening for the Member States by 1998, in order to protect this process – in accordance the above-mentioned two-prolonged approach – the Council and the Parliament adopted the 2<sup>nd</sup> ONP directives<sup>34</sup>.

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<sup>29</sup> 708 F 2d 1081 (7<sup>th</sup> Circ. 1983)

<sup>30</sup> Larouche, 2000., p. 38., See fn. 18.

<sup>31</sup> Larouche, 2000., p. 326., See fn. 18.

<sup>32</sup> OJ L 192 1990.07.24

<sup>33</sup> 1996/19/EC, OJ L 047 1996.03.22.

<sup>34</sup> The 2nd ONP directives were constituted: directive 1997/51/EC on Framework of regulation, OJ L 295 1997.10.29.; directive 1997/33/EC on Interconnection, OJ L 199 1997.07.26.; directive 1998/10/EC on 2nd telecommunication, OJ L 101 1998.04.01.; directive 1999/5/EC on radio and telecommunications equipment, OJ L 91 1999.04.07.

Because the regulation has to ensure the proportionality, namely the remedies should reflect the competition concerns in the new regulatory environment. This requirement assumes proper flexibility of the regulation to be imposed remedies in proportion to the certain market failure. This ability distinguishes the re-regulation from the regulation because the former is able to phase out itself in light of the development of the competition. The trigger of the regulation on the full-liberalised telecommunications markets in Europe is the concept of significant market power (SMP) based on 2<sup>nd</sup> ONP directives as well, which indicates of the necessity of the regulation. The operation of this mechanism has increasingly become accurate to detect the market failure and impose the proper remedy.

The remedies of 2<sup>nd</sup> ONP directives were addressed to market players with significant market power on the relevant market, namely which had 25 % market share based on Article 4(3) of directive on Interconnection directive.<sup>35</sup> The directive on interconnection itself identified these relevant markets. So the remedies on 2<sup>nd</sup> ONP regime were applied by formal regulatory basis in Europe from 1998 to 2002 because the markets and the main element of the SMP were defined by directive. Nevertheless, the regulatory authority could take into consideration other factors as the financial power, controls of essential facilities, turnover. Theoretically the regulatory authority could have determined that an operator with 25% market share was not SMP. Consequently these additional factors showed the early convergence between the SPM concept and the dominant position according to competition law, which orders taking into account more factors of the markets based on supply-demand substitution.

This convergence between the SPM and dominant position happened in the new regulatory framework for the electronic communication in 2002<sup>36</sup> in favour of the support the effective competition. In light of this convergence the trigger of the regulation, namely the concept of SMP needs to be adapted to suit more complex and dynamic markets. For this reason, the definition of SMP is equivalent to the concept of dominance as defined in the case law of the Court of Justice and the Court of First Instance according to recital 25 of Framework Directive.<sup>37</sup> The recital 27 of Framework Directive declares that it is essential that *ex ante* regulatory obligations should only be imposed where there is not effective competition, i.e. in markets where there are one or more undertakings with significant market power, and where national and Community competition law remedies are not sufficient to address the problem. The Commission adopted the Recommendation on Relevant Markets<sup>38</sup> based on 15 Article of Framework Directive, which identify those product and service markets within the electronic communications sector in accordance with the principles of competition law, the characteristics of which may be such as to justify the imposition of regulatory obligations set out in the Specific Directives, without prejudice to markets that may be defined in specific cases under competition law. The Commission identified such markets based on competition law principles in the Recommendation recital 9., which has fulfilled the following three criteria:

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<sup>35</sup> See. fn. 34.

<sup>36</sup> Directive (2002/21/EC) on a common regulatory framework; Directive (2002/19/EC) on access and interconnection; Directive (2002/20/EC) on the authorisation of electronic communications networks and services; Directive (2002/22/EC) on universal service and users' rights relating to electronic communications networks and services; Directive (97/66/EC) on the processing of personal data and protection of privacy (up to 30/10/2003); OJ L 108, 24.04.2002; Directive (2002/58/EC) on privacy and electronic communications (from 31/10/2003), OJ L 201, 31.07.2002; Directive (2002/77/EC) on competition in the markets for electronic communications services, OJ L 249, 12. 09. 2002

<sup>37</sup> Directive (2002/21/EC) on a common regulatory framework, OJ L 249, 12. 09. 2002

<sup>38</sup> Commission Recommendation On Relevant Product and Service Markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services. C(2003)497, OJ L 114 08.05.2003

- the presence of high and non-transitory entry barriers whether of structural, legal or regulatory nature;
- the structure of markets does not tend towards effective competition within the relevant time horizon;
- application of competition law alone would not adequately address the market failure(s) concerned.

National regulatory authorities should define relevant markets appropriate to national circumstances, in particular relevant geographic markets within their territory, in accordance with the principles of competition law based on the identified markets by the Commission in the Recommendation referred to in 15 Article of Framework Directive. National regulatory authorities should analyse the relevant markets in accordance with competition law principles as well taking the utmost account of the Guidelines<sup>39</sup> whether a given product or service market is effectively competitive in a given geographical area referred to in 16 Article of Framework Directive. This market analysis is equal with the SPM-Test according to which there is no effective competition on the relevant market if there is service provider with dominant position.

So the determination of the SPM is totally based on the competition law principle on the regulatory framework for electronic communication in 2002 but there are some differences between the competition law and sectors specific regulation. In case of the regulation the trigger of the market analysis is not market behaviour or restrictive agreement but the relevant markets identified by the Commission. The national regulatory authority has to apply the remedies in forward-looking basis and ex-ante way, prior to the abusive conduct as well as the decision should be permanently reviewed. So the designation of an undertaking as having SMP in a market identified for the purpose of ex-ante regulation does not automatically imply that this undertaking is also dominant for the purpose of Article 82 EC Treaty or similar national provisions according to the recital 30. of the Guidelines. Moreover, the SMP designation has no bearing on whether that undertaking has committed an abuse of a dominant position within the meaning of Article 82 of the EC Treaty or national competition laws.

But it is very important to emphasise that the division of SMP designation process into market definition and market analysis could be interpreted only from sector-specific procedure law point of view. But the national regulatory authority has to designate the SPM based on competition law principle so the process on it could not divide into two or more parts. It constitutes a unilateral procedure from competition law point of view. In *Entreprenørforeningens Affalds*<sup>40</sup> and *GT-Link*<sup>41</sup> the ECJ confirmed that the objective of market definition is not an end in itself, but part of a process, namely assessing the degree of a firm's market power.

So the SPM designated based on principles of competition law could ensure that the remedies are applied only to a certain degree and as long as market power gives reason for them. Namely the flexible reaction on dynamic development of the market is ensured.

### **4.3. Parallel applicability of the competition law and sector-specific regulation**

Article 15 of Framework Directive declares that the identified markets under the European regulation for electronic communication without prejudice to markets that may be defined in

<sup>39</sup> Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03) OJ C 165, 11.07.2002

<sup>40</sup> C-209/98. 2000., ECR p. I-3743.,57.

<sup>41</sup> C-242/95. 1997., ECR p. I-4449., 36.

specific cases under competition law. Moreover, 31. recital of Guidelines emphasise that in practice it cannot be excluded the parallel procedures under ex-ante regulation and competition law. According to *Klotz* this parallel applicability of both regulation constitutes the key to successful liberalisation in Europe.<sup>42</sup> The question arises from this in practice whether the sectors-specific regulation eliminates the applicability of competition law.

The European re-regulation (in contrast with regulation) is a competition motivating temporary regulation. Therefore the re-regulation overlaps with competition law with respect to the purpose of the two regulatory tools. Re-regulation protects the development of competition. Competition law protects the competition regardless the degree of its development. Consequently it is impossible that the re-regulation allows or obliges as conduct, which may be contrary to competition law on European level. But the European regulation for electronic communication mainly built on secondary legislation therefore it could not be excluded collision between the competition law and sector-specific regulation on national level because of the fail to implement the rules of directives correctly. This could imply infringement procedure against the Member State according to Article 226 of EC Treaty. Same collision could arise also from the jurisdiction of national regulatory authority. But in *Ahmed Saeed*<sup>43</sup> and *Van Eycke*<sup>44</sup> the ECJ confirmed that the national regulatory authority must ensure that actions taken by them are consistent with Community competition law. This duty requires them as it expressed in *GB-Inno-BM/ATAB*<sup>45</sup> to refrain from action that would undermine the effective protection of Community law rights under the competition rules. If the national authorities act so as to undermine those rights, the Member State may itself be liable for damages to those harmed by this action based on jurisdiction in *Francovich*.<sup>46</sup>

Consequently it's all the more possible that a concrete market behaviour violates both re-regulation and competition law. In this aspect, the relation between re-regulation and competition law is can be described as parallelism. This parallel applicability of both regulations is the key factor of the European re-regulation because it ensures that the infringements will be remedied in any case. But this parallelism could result in some difficulties in terms of the sphere of authorities because of the regulatory vacuum and concurrent process against same infringement. Therefore the Framework Directive<sup>47</sup> enacts the close collaboration between the competition and regulatory authority. Because of this parallelism the competition authority has to consider whether the procedure of regulatory authority remedies efficiently and completely the violation of competition law. The Commission the Commission therefore takes the view based on its the Notice<sup>48</sup> that a dispute before an national regulatory authority should be resolved within a reasonable period of time, normally speaking not extending beyond six months of the matter first being drawn to the attention of that authority. But the Commission expresses that always will take action if it feels that in a particular case, there is a substantial Community interest affecting, or likely to affect, competition in a number of Member States.<sup>49</sup> These principles would be governing on national level as well.

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<sup>42</sup> Robert Klotz: Wettbewerb in der Telekommunikation: Brauchen wir die ex-ante Regulierung noch?, *ZweR* 3/2003., p. 313.

<sup>43</sup> 66/86.,1989., ECR p. 838

<sup>44</sup> 267/86., 1988., ECR p. 4769

<sup>45</sup> 13/77., 1977., ECR p. 2115

<sup>46</sup> Joined cases C-6/90. and C-9/90., 1991., ECR p. I-5357;

<sup>47</sup> Article 3(4) and 16(1)

<sup>48</sup> Notice on the application of the competition rules to access agreements in the telecommunications sector, OJ C 265 22.08.1998, recital 30.

<sup>49</sup> Recital 31., See fn. 48.

At the same time the competition authority has to keep in mind that a double punishment must be avoided for the same conduct. But if the regulatory authority remedies potential violation of law but it cannot impose as high fines as the competition authority then the market players of other sectors may disapprove the privileged situation of market players of certain regulated sectors. This situation is in Hungary where the National Regulatory authority could impose fine related to 0,25% of revenue based on electronic communication act while the Competition Office could fine up to 10%.

## **5. Conclusion**

The competition law played a very important role by the changing role of State in European telecommunication markets. While the liberalisations and harmonisation measures are binding to the member states, the EU do not stipulate any particular ownership regime but left the choice to national governments. Therefore the European competition law mainly affects the role of EU or Member States in terms of the telecommunication markets across the regulation. The most determinative factor of the market is the liberalisation in last decades, which was triggered by Commission's directives based on its power of Article 86(3). The applicability of European competition law confirmed by ECJ opened the door before the liberalisation process. To promote this is need for additional regulation as well, which is also characterised by competition law because it made more flexible the concept of SMP, which induces the remedies for the providers who are able to jeopardise the successful liberalisation. The SMP is equal with the concept of dominant position created by ECJ's case law in competition in legal framework for electronic communication in Europe. Nevertheless, the competition law remained applicable to the regulated telecommunications markets, which parallelism constitutes the key success factor of the liberalisation. Accordingly the relationship between the sector-specific and competition law could be described as complementary.