Dr. Ulf Böge

President of the Bundeskartellamt

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Ladies and Gentlemen,

During the last decade competition issues relating to network and infrastructure-based service sectors such as the network-based energy industry, post and telecommunications and the transport sector, have gained more and more importance. The Bundeskartellamt and sector-specific regulatory authorities such as the Regulatory Authority for Telecommunications and Posts and the Federal Railways Office apply general competition law or sector-specific regulatory law with the aim to improve the conditions of competition in these economic sectors.

Each of the economic sectors mentioned has its own specific characteristics resulting from the respective technology used. It is, however, an open question whether this fact alone requires specific regulations under competition law for each sector or whether these should not rather be incorporated into the general application of competition law.

With regard to the substantial competition issues basic similarities can be identified in all the sectors.

In the following I would like to briefly illustrate the similarities of the different infrastructure markets, firstly from a regulatory-policy point of view and secondly from the economic perspective. As a third point I will discuss the German liberalisation concepts and their significance for the Bundeskartellamt's activities, after which point four will deal with the consistency of the chosen system of market liberalisation and some crucial requirements for sector-specific regulation. Finally I will briefly address merger control as a further competition issue in infrastructure markets.

1. The regulatory policy perspective

From a regulatory-policy perspective a paradigm shift has taken place in all the infrastructure markets after decades of debate.

Most network-based services are still associated with the concepts of a “natural monopoly” and “services of general interest”. However, this no longer leads to the rash conclusion in regulatory policy that the service concerned should for this reason be offered by a (if possible public) monopoly enterprise. It was due to this conception that over several decades any reform debate was nipped in the bud.

Today we have come to realise that also in markets with a “natural” monopoly infrastucture competition leads to better results for the economy as a whole. The superiority of competition as a steering instrument is no longer called into question, except by those who constantly live in the past.

The scientific and political discussion today does not focus on the question of whether or not to enforce the principle of competition in monopoly infrastructures, but rather on how, i.e. by which means and instruments this can be best achieved.

From the overall economic perspective this paradigm shift, which is above all to the advantage of the consumer, marks a progress in regulatory policy which simply cannot be overestimated.

Despite numerous problems regarding detail the greatest progress has been made in opening up the markets in the **telecommunications** sector where consumers can actually feel positive lasting effects. Just think of the considerable reduction in telephone charges, particularly for international calls, and the development of the Internet market. It is impossible to imagine that in today’s Germany we could still be using the grey telephone set with a dial disk!

But nonetheless, despite the sector-specific regulator, the degree of market dominance enjoyed by Deutsche Telekom AG in the sectors of telephony and fast Internet access still constitutes a substantial barrier to competition.

Generally the **network-based energy sector** has a lot to catch up on in terms of competition.

With the amendment to the Energy Industry Act the Federal Ministry of Economics and Labour has introduced a new legal framework. However, there is no political consensus yet as the Bundesrat's recent rejection has shown.

In the **railway sector** the national legislative process for major elements of a competition-oriented regulatory framework has not been concluded yet either.

Due to merely hesitant liberalisation in the **postal sector** competition has only been able to develop its positive effects to a very limited extent.

And the discussion on a reform of the legal framework conditions for **local public transport** is still in the process of getting off the ground.

2. The economic perspective

In economic terms the possible common ground between the above-mentioned network and infrastructure based services markets is reflected in the form of the market opening model chosen.

Here the possible forms of competition which come into consideration are competition "within" the market and competition "for" the market.

"Franchise bidding" appropriately describes the concept of competition "for" the market. This aims at eliminating the disadvantages created by well-established supply monopolies through the regular and competitive award of exclusive rights for limited periods.

The concept of competition "within" the market, on the other hand, does not rely on the contest between rival suppliers for monopoly rights. Rather, it is based on the competitive use of and therefore non-discriminatory access to the substantial monopoly infrastructure. The alternatives of regulated and negotiated network access are always at the centre of discussion in this context.

At the same time the following should not be overlooked: Even a market opening which is basically far-reaching in its approach can in no way provide a quasi-automatic solution to the problem of the existence and abuse of market power. Ultimately game theory and the economic theory of auctions have heightened the awareness of this problem. The liberalized electricity markets in the United States, in particular in California, and the electricity pool model in England and Wales have become a favourite object of study in this connection.

Even if **political** decision-makers welcome the aim of opening up network-based service markets either with or without regard to economic competition analyses, it should be borne in mind that in the legislative drafting of the legal framework “the devil’s in the details”.

In the view of a **competition authority** the political decision for one of the forms of competition in a “natural” infrastructure monopoly environment is always a fixed date. It is the lawmaker who with the regulatory framework lays down the rules of the market. Consequently it determines the competition issues a competition authority has to deal with.

In implementing the concept of competition “within” the market by means of a **negotiated** network access system the emphasis in the **application of competition law** is on ensuring non-discriminatory access to infrastructure and therefore in the area of abuse control.

The more the chosen liberalisation concept relies on the instruments of competitive award and auction procedures, i.e. competition “for” the market, the more the emphasis in the application of competition law shifts to the guarantee of undistorted and competitive bidding and consequently, inter alia, the effective enforcement of the ban on cartels.

Irrespective of the market opening model chosen, merger control always remains a core competition issue in infrastructure markets. I will deal in more depth with the significance of merger control at the end of my speech.

3. Liberalisation concepts in Germany and their significance for the Bundeskartellamt's work

3.1. What is the current situation in Germany?

In nearly all service sectors characterized by a physical network connection the German legislator has decided in favour of the "within" the market competition concept on the basis of EU provisions. This applies in particular to the network-based energy sector, railway network and post and telecommunications.

In implementing the "within" the market concept of competition the legislator originally differentiated between regulated and negotiated network access. In the post and telecommunications sector the regulated network access model was given preference right from the start. However, the opening of markets in the railway and network-based energy sector was to be accomplished by applying the negotiated network access concept.

Competition "for" the market is being discussed as a model for opening markets solely in the road public transport sector, due to, in my view, inadequate liberalisation initiatives at EU level. Here the existing regulatory framework, which is based on state approval and the awarding of limited concessions, is basically open to competition in the form of competing applications for licences. However, the positive potential of competition could be tapped more effectively by making the public tendering of concessions for regular services obligatory. This realization is now also gaining ground in politics.

3.2. What is the cause of this dominance of the regulated or negotiated network access model?

One of the major causes may lie in corporate structures. In the classical network-based service markets in Germany the companies are vertically integrated from production through to network structure and distribution.

In principle alternative models of competition “within” the market would also be possible via ownership unbundling. However, ownership “unbundling“ cannot be enforced in Germany for political reasons, least of all in the short term. The debate which flares up again and again about detaching the railway network from the Deutsche Bahn AG corporation and if necessary “nationalising” it, is a clear example. But this also applies to the gas and electricity sector.

3.3. What consequences does the lawmaker’s decision in favour of the concept of competition “within” the market have for the Bundeskartellamt as regards areas of emphasis in the application of competition law?

The answer is almost inevitable: The areas of emphasis lie in abuse control and ensuring non-discriminatory network access.

3.3.1. In the **railway sector** the Bundeskartellamt, for example, in 2000 examined the route pricing system of DB Netz AG, the network infrastructure company of the Deutsch Bahn group in abuse proceedings.

The Bundeskartellamt criticized the two-tier structure of the pricing system then in place in light of the principle of non-discriminatory network access. This system was two-tier in that in addition to a relatively low price per train kilometre covered every network user had to pay a relatively high **basic fee** to use the rail network. Due to the comparably high mileage covered by DB subsidiaries active in the transportation of passengers and goods this resulted in considerable cost benefits for these companies.

Here the Bundeskartellamt’s threat to prohibit such behaviour was enough to improve the situation. The two-tiered system was replaced by a one-tier linear price structure which merely provided various prices per mileage covered for different standards of network quality.

Here market developments since the outcome of this proceeding have shown that with the help of competition law an effective competitive restraint can be removed. At the same time numerous competitors have complained that discrimination in network access has shifted to other areas, e.g. technical details for the provision of access.

Not least for this reason the legislator has recently extended the competences of the Federal Railway Authority. However there are no plans for a comprehensive ex-ante regulation of network access. In this respect the Federal Railway Authority is restricted to the instruments of ex-post abuse control.

3.3.2. With regard to the **network-based energy industry** the Bundeskartellamt during the past two years has plumbed the depths of the legal framework available for creating more competition in the sector of abuse control. However, the authority has always made it clear that it considered the legal instruments available as not sufficiently effective. There was no legal unbundling of the network. Immediate enforceability of decisions under competition law was not provided for.

For instance the Bundeskartellamt had to suffer setbacks in court with regard to the neuralgic issue of non-abusive levels of fees for network use. Several Bundeskartellamt decisions which were meant to enforce a significant reduction of the fees charged for network use were revoked.

The decisive factor in this process was basically a regulatory-policy decision of principle which may best be described by the ‘self-regulating approach’ concept. The political decision-makers counted on the interest groups concerned agreeing on a basis for calculating fees for network use which is in line with the principles of competition. The results of these negotiations, the so-called Associations’ Agreements, were ‘juridified’ in 2003, i.e. they were granted the seal of ‘good professional practice’ although they substantially

restricted the principle of competition in several major points relating to cost allocation.

For the competition authorities' examination of the level of fees for network use based on ex-post abuse control this juridification and its interpretation by the courts had the effect of de facto blocking the competition law provisions.

4. Consistency of the chosen market liberalisation model, essential requirements for a sector-specific regulation

These developments in the network-based energy sector directly lead me to another aspect which applies equally to all different infrastructure markets. It is the call for a consistent concept for market liberalisation and a regulatory framework.

The way the German regulatory framework for the network-based energy industry has developed in recent years provides in my opinion a telling example for an insufficiently consistent market liberalisation approach.

Combining

- a renunciation of effective vertical unbundling,
- a self-regulating approach as regards fees for network use together with a juridification of association agreements and
- a mere *ex post* abuse control by the competition authority

has proved completely insufficient to make full use of the positive potential of competition in the network-based energy industry. The immediate enforceability of abuse decisions of competition authorities as a general rule was introduced far too late; besides, it had little effect due to the juridification of association agreements and their interpretation by the courts. These facts have delayed, if not stopped, an effective market liberalisation.

It is not only the consumers that bear the consequences. The excessive prices for electricity and gas damage the international competitiveness of the German national economy as a whole.

Following the example of the post and telecommunications sector, the main responsibility for liberalising networks in the electricity and gas sector is to be given to a sector-specific regulatory authority.

The time schedule does not allow for a detailed discussion of the bill which is currently being discussed. Therefore I will confine myself to a few aspects which I consider relevant for the discussion about a consistent market liberalisation approach.

The federal government's bill provides for a strictly normative regulation of network access with detailed specifications on how to calculate fees for network use. However, other countries' experience shows that not only competition itself but also the regulation of access to monopolistic infrastructures is a discovery and learning process. Therefore, the regulatory authority requires not only political independence but also a great amount of flexibility and a high level of discretion to effectively implement the model of competition "within" the market. Where the granting of access is subject to provisions which are too detailed and rigid, there is the risk of market developments exposing these provisions as rather presumptuous. In the worst case such provisions require elaborate and protracted legislative adaptation measures.

When drafting provisions on regulated network access, the legislator needs to ensure that the application area of the *ex ante* regulation does not exceed what is absolutely necessary for effective market liberalisation. Sector-specific regulatory approaches tend to gradually extend to complementary areas of the monopolistic infrastructure. In this context, the regulation of access to the infrastructure initiates a "regulation spiral" which bit by bit leads to a comprehensive control of the whole industry.

In addition, it must be taken into account that sector-specific regulatory authorities run a much higher risk than competition authorities of paying too much heed to the

respective interests of the regulated industry (a problem which is referred to as “regulatory capture”).

The “sectoralisation“ of competition law poses a considerable threat in regulatory policy terms, not only due to possible contradictions in the application of competition principles. Although legal provisions on the cooperation between competition and regulatory authorities can countervail this threat, the economy as a whole is affected by continuous sectoralisation.

5. Merger control – another significant competition issue

As announced I would like to end my speech by addressing the core competition issue in the area of network and infrastructure based services: merger control.

Merger control as a means of structural control is of great significance in the liberalisation process of network-based infrastructure markets.

Market liberalisation processes in network-based infrastructure markets are often followed by the increased merger activity of the companies active in the market. Companies strive to avoid the (imminent) greater competitive pressure by securing their market position by means of participations and a concerted improvement of their competitive situation.

It is not the task of merger control to hamper the quest for new optimised company sizes as a reaction to enlarged markets. In fact, mergers can even stimulate competition.

However, the Bundeskartellamt has to ensure that the structural conditions for the envisaged market liberalisation are not considerably weakened by mergers that result in market dominance. Such a result would undermine the objective of effective market liberalisation.

In the course of the wave of mergers that occurred in the late 1990s in the network-based energy industry during the run-up stage of market liberalisation the Bundeskartellamt and the courts developed guidelines in line with this objective: Applying substantive assessment standards merger control examines whether a merger is likely to result in the creation and strengthening of a dominant position. This requires a prediction of market developments. However, in market liberalisation processes no predictions should be made on the possible effects on competition of merely **planned** modifications of the regulatory framework.

Merger control which is based on the “hope that everything will go well” will possibly be particularly counterproductive in infrastructure markets that need to be opened up to effective competition.

The conflict between the aim of companies to increase their competitiveness in preparation for more intense competition and the protective purpose of merger control can be defused in individual cases by imposing adequate conditions and obligations on mergers. Naturally, this will only be possible if assessment under competition law is not overruled by political decisions.

For example, in anticipation of the opening up of the market for **local public transport** to competition, the Bundeskartellamt made the clearance of mergers in this sector in several cases conditional upon the companies issuing Europe-wide public invitations to tender for concessions for regular services on expiry of the current terms of contract.

Experience drawn from the network-based energy industry shows that the monitoring of liberalisation processes also poses specific demands on merger control.

For: a **modified** regulatory framework commits the competition authority to predict competitive developments in the respective industry under the amended framework regulations.

The significance of a market structure approach in merger control can be seen in the current judicial review of a prohibition decision of the Bundeskartellamt in the

network-based energy industry (“E.ON/Stadtwerke Eschwege”). The proceedings focus mainly on the question of whether a joint dominant position of the leading energy suppliers E.ON and RWE can be confirmed under the current market conditions. The answer to this question requires a comprehensive assessment of the specific structural features of the affected industry.

Here, ladies and gentlemen, I reach the threshold that lies between competition issues in infrastructure markets and other interesting topics of competitive and industrial economics, such as the “oligopoly theory” and the theory of “tacit collusion”. To cross this threshold would mean to exceed, both in terms of time and content, the frame allowed for a keynote speech of an expert conference on the different aspects of “Network Economics”. So I’ll spare you the rest.

Thank you for your attention.