

ESSAY

Six Principles for Limiting Government-Facilitated Restraints on Competition

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We would like to thank Martin Hellwig, John Temple Lang, Bruno Lassarre, Xavier Lewis, Petros Mavroidis, Menachem Perlman, Michael J. Trebilcock and Richard Whish for their most thoughtful and helpful comments in earlier drafts. All errors and omissions remain, of course, the authors'.

SIX PRINCIPLES

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SIX PRINCIPLES

1

INTRODUCTION

Competition is the corner-stone of our laissez-faire society. The free market economy is based on the assumption that the market's invisible hand is generally a far more powerful guardian of social welfare than any other form of regulation. Competition not only promotes economic efficiency, but also promotes non-purely economic goals such as dispersion of economic opportunity, limitation of undue influences on the political system and strengthening the freedom of speech.

Yet for competition to achieve these goals, certain market conditions must exist. Due to market imperfections, some markets will provide suboptimal levels of service or production absent outside intervention. In such situations direct regulation (hereafter: "regulation") is a better tool than competition to discipline market players and to achieve social goals.

Regulation might, however, sometimes go beyond what is socially justified and create undue restraints on competition. Whereas private restraints on competition can generally be combated by enforcing the competition laws, regulatory schemes are generally legal, if adopted and applied in line with the relevant procedure, and create a potential for harm that should be addressed.¹ The problem of social engineering is thus to devise a system that will ensure that the optimum combination of competition and regulation is achieved. The need for realizing welfare-enhancing synergies among regulatory regimes is increased by globalization, which sharpened the competitive climate.

This essay addresses this challenge by focusing on the tools available to competition authorities and courts to ensure that the regulatory scheme is socially beneficial. It proposes six general principles that are aimed at creating a system of "checks and balances" which maintains adequate safeguards to ensure that competition will be limited only where socially warranted. Whereas much has been written about where to draw the line between regulation and

¹ Advocacy and Competition Policy- Report prepared by the Advocacy Working Group (International Competition Network, 2002), pp i-iii. (available online: <http://www.internationalcompetitionnetwork.org/advocacyfinal.pdf>) (hereinafter: "ICN advocacy report").

competition, the question of what *institutional role* competition authorities and courts can play to ensure that these boundaries are not overstepped has generally received little attention.² This question will be the focus of this essay.

The first part of the article provides a basis for the discussion by surveying possible justifications and motivations for government-facilitated or imposed restrictions on competition. A dichotomy between two main types of restraints is suggested, based on their effects on social welfare. This dichotomy then serves as the basis for the discussion in the second part of the article, which focuses on the tools available to competition authorities and courts to combat welfare-reducing restraints on competition.³ Six general principles to achieve this goal are proposed. Some of these principles suggest that competition authorities should be allowed to venture outside their traditional confines and build upon their institutional comparative advantages in order to ensure that regulation increases social welfare. The third part of the article analyzes the existing EU law to evaluate whether, and to what extent, the proposed principles currently apply. It suggests several changes to the current system that have the potential to limit the existence of welfare-reducing restraints.

PART I: JUSTIFICATIONS AND MOTIVATIONS FOR GOVERNMENT-FACILITATED RESTRICTIONS ON COMPETITION

To determine how government-facilitated restrictions on competition should be dealt with, one must first understand the justifications and motivations for imposing such restrictions. Such motivations are as diverse and numerous as the restraints themselves. Yet they can be grouped into two main categories in accordance with their ability to further social welfare.

² The US *Trinko* case (*Verizon Communications Inc. v. Law offices of Curtis V. Trinko*, (2004) 540 U.S. 398, 124 S. Ct. 872)(Hereinafter: "**Trinko**"), elaborated below, generated some debate in the US regarding the question of who should draw the line between regulation and antitrust. In the EU context there has been very little written on the subject. The relevant literature is surveyed below.

³ Of course, other tools are also available, such as punishing public servants that do not serve the public interest. Analysis of such complementary tools falls outside the scope of this article.

I.1 WELFARE-ENHANCING JUSTIFICATIONS FOR GOVERNMENT-FACILITATED RESTRAINTS

Government-facilitated restraints on competition are often justified by the existence of an endemic market failure, that is, a situation in which there exists a physical or technological condition which prevents the market from performing efficiently and in which unrestricted competition would achieve inefficient welfare outcomes. In such situations regulation might be necessary to enhance social welfare.⁴ The classic market failure is natural monopoly, which arises when market demand cannot support more than one firm, as costs of production would increase substantially if demand was divided among two or more firms. Under such conditions supporting competition *in* the market (as distinguished from competition *for* the market) is not socially desirable. Instead, direct regulation of the firm's prices and other trading conditions might increase allocative and productive efficiency by controlling market power.⁵

Market failures that justify regulation can be of many other kinds. Significant information asymmetries among economic agents, for example, might also justify regulation. Such asymmetries limit, *inter alia*, the ability of consumers to make informed decisions that would create motivations for providers to compete over price and quality. In such situations regulation might be needed to guarantee minimum quality or to ensure that consumers are informed about harm or benefits associated with consumption. Much of health and safety regulation fall into this category.

⁴ For a survey of the Normative Analysis as a Positive Theory of Regulation Theory (NPT) which views the correction of market failures as the main goal of regulation see, e.g., W. Kip Viscusi, John M. Vernon and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* 3rd ed. (MIT Press, 2000), pp. 314-317.

⁵ For an overview of regulation of natural monopolies see, e.g. Michal S. Gal and Michael J. Trebilcock, "Traditional Natural Monopolies in Transition: The Comparative Roles of Structural Changes, Competition Policy and Economic Regulation in Preventing the Leveraging of Monopoly Power in Network Industries", in *Competition Law for the 21st Century* (James Musgrove, ed., Juris Publishing, 1998) (Hereinafter: "**Gal and Trebilcock**"), p. 197. See also Martin Hellwig, "Competition Policy and Sector-Specific Regulation for Network Industries" paper presented to the Swedish Competition Authority (November 2004). For a recent example of regulation which seeks to overcome the limits of competition see the new EU proposal for mobile phone roaming charges regulation: http://europa.eu.int/information_society/activities/roaming/index_en.htm

Regulation might also address externalities: spill-over effects on third parties which are not properly compensated for. It may limit such externalities, *inter alia*, by setting quality and technological standards. Regulation of pollution levels and licensing zones fall within this category.

Accordingly, where there is a market failure, regulation has the potential to increase social welfare. In such cases regulation serves as an alternative to competition law, as both aim to increase social welfare but seek to increase it by other means.

In addition, regulation may also address distributional issues or other broad social goals.⁶ For example, where competition will not ensure universal service, and such service is considered to be in the public interest, regulatory intervention may be warranted. Regulation thus often enables the reconciliation of efficiency and equity considerations.

In most cases regulation and competition law enforcement are complementary: they affect non-clashing aspects of business conduct. Labeling of foods to ensure that consumers are aware of their content, for example, does not clash with prohibitions of cartels among food manufacturers. Rather, regulation might increase competition, for example by addressing informational asymmetries, facilitating market entry, or promoting network competition.

In some cases, nonetheless, regulation and competition might clash due to the different ways each attempts to enhance social welfare. Zoning restrictions for gas stations, for example, limit competition by reducing the number and proximity of competing gas stations. Intellectual property rights limit competition in the provision of the protected right until its exclusivity expires. Yet such limitations might serve social welfare better than if competition was given free reign without restrictions.

⁶ See, for example, John Temple Lang, "European Competition Policy and Regulation: Differences, Overlaps and Constraints", lecture at Ecole des Mines, Paris 2006 (on file with authors)(Hereinafter: "**Temple Lang, "Policy and Regulation"**"), p. 11.

It is useful to view regulation in a historical context. Regulation was, and still is, an important part of industrial policy. It was not long ago that competition took a back seat to other social objectives, including the stability of markets, the creation of strong international competitors and distributional goals, which were achieved by way of direct regulation. Since before the Middle Ages, economic policy in western society has gone through cycles of greater and lesser confidence in markets. When confidence was low, the government intervened more, and *vice versa*.⁷ The recent history of Western European countries is a telling example.⁸ In Post-WWII decades most western-European jurisdictions were characterized by a high degree of state control and a limited sphere for competition. Many countries regarded their industries as lacking the capital, size, or technical and managerial skills necessary to compete with their international competitors. This led to the employment of regulatory measures designed to support and protect national industries against their foreign competitors, which of course limited potential competition. Governmental protection was also tied to economic justice theories that focused on wealth dispersion among members of society. Western Europe is not a sporadic example. Many other jurisdictions were characterized by direct government guidance of economic activity in times when the belief in the market system was not strong. This does not imply that competition should necessarily take a back seat to regulation, but it does suggest that regulation is, in some cases, a legitimate and even a welfare-enhancing policy tool.

I.2 WELFARE-REDUCING STATE- FACILITATED RESTRAINTS

In reality, regulatory policy may differ quite starkly from the ideal mixture of regulation and competition that best serves the public interest. Such substantial regulatory imperfections exist, that some observers claim that government failure may be of the same magnitude as market failure.⁹ This section elaborates on some of the

⁷ Herbert Hovenkamp, "2003 Milton Handler Antitrust Review: Antitrust and the Regulatory Enterprise," (2004) *Colum. Bus. L. Rev.* 335.

⁸ David J. Gerber, *Law and Competition in Twentieth Century Europe- Protecting Prometheus* (Oxford University Press, 1998).

⁹ Charles Wolf, *A Theory of Non-Market Failure: Framework for Implementation Analysis* (University of Chicago Press, 1978).

reasons why regulation *does* occur despite the fact that it *should not* occur from a social welfare point of view.¹⁰

One of the main reasons for the adoption of welfare-reducing regulation is political pressures on legislatures and regulators that cause them to redistribute wealth from other parts of society to interest groups (regulatory capture).¹¹ Political considerations may affect all stages of regulation- from the adoption of regulatory principles to their application in practice.

Why are such pressures a real threat to social welfare? The reason is that social or economic groups might have strong private motivations to affect the legislative and regulatory mechanisms and distort them to their own benefit and to the detriment of society. Regulation is usually adopted for the benefits it promises. Yet these benefits are generally *non-sector-specific* in their distribution and often look at the *long run horizon*. For example, reduction of electricity costs may benefit large parts of society and may require lengthy structural changes of the regulated entity. Accordingly, regulation usually spells out a broad and long-term vision for society, beyond the immediate pain of the adjustment in specific industries. Yet it is exactly these two traits- non-sector specific gains and its long-term horizon- that create political pressures to modify their application in practice.

The achievement of long-term goals usually requires political fortitude that is sometimes in short supply among political figures, given that elections are often relatively frequent.¹² But more

¹⁰ For criticism of the NPT theory of regulation see, e.g., Richard A. Posner, "Theories of Economic Regulation" 5 *Bell Journal of Economics and Management Science* (1974) 335.

¹¹ For the seminal articles on this subject see James Buchanan & Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962); Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965); George Stigler, "The Theory of Economic Regulation", 2 *Bell Journal of Economics and Management Science* 3 (1971); Sam Pelzman, "Toward a More General Theory of Regulation", 19 *Journal of Law and Economics* 21 (1976). For an analysis of this issue in the context of antitrust see, e.g., Michal S. Gal, "Reality Bites (or Bits): The Political Economy of Competition Policy in Small Economies" in Barry Hawk (ed.) *International Antitrust Law and Policy* (Juris Publishing, 2002), 605.

¹² Kenneth A. Shepsle, "The Political Economy of State Reform- Political to the Core" presented as the Centennial Lecture at the London School of Economics and

importantly, politicians might sacrifice the significance of general welfare in favour of the interests of specific sectors in the economy. Small, homogenous and well-organized groups with large per capita stakes in a policy might cause the government to legislate or to regulate in ways that are against the public interest and usually against consumers, who are poorly organized and have small personal stakes in the specific regulation. As the electoral connection is never far from the politicians' minds, interest groups might influence their considerations by ensuring their reelection. This effect is exacerbated where the ultimate policy decision lies in the hands of one politician (e.g. a minister) rather than the government as a whole. According to some scholars, such groups would invest in securing a policy that favors them up to the total expected profits they stand to gain from it.¹³ Political influences might, therefore, result in welfare-reducing regulatory regimes and a waste of resources in rent-seeking activities. Public choice arguments explain not only harmful regulation, but also socially-harmful decisions not to regulate.

Welfare-reducing regulation might also result from the fact that regulation often tends to be conservative and does not respond optimally to market dynamics, due to several reasons.¹⁴ First, the regulator might be so involved in its regulatory role that he identifies with the interests of the regulated firms and shares a similar perspective.¹⁵ Second, regulation is often biased toward maintaining the status quo, as it requires an administrative decision, made in due process, to change current regulatory decisions.¹⁶ Third, regulation is more likely to adopt policies that assure fair sharing among existing parties rather than leave its determination to the competitive contest.¹⁷

Political Science, February 1999. This should be discounted by the fact that the interests of whom they are beholden for their political survival and the political parties to which they attach themselves may be long-lived.

¹³ Richard A. Posner, *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976), pp. 8-18.

¹⁴ Mark Armstrong, Simon Cowan and John Vickers, *Regulatory Reform: Economic Analysis and British Experience* (London: The MIT Press, 1994), ch. 4.

¹⁵ For an overview see Kip Viscusi, John Vernon and Joseph Harrington Jr., *Economics of Regulation and Antitrust* (Cambridge: MIT Press, 3rd ed., 2000), pp. 317-8.

¹⁶ *Ibid.*, at 312.

¹⁷ Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* (New York: John Wiley and Sons, Inc., 1970), vol. II, p. 13.

Finally, the regulator might have limited tolerance towards unpredictable, competitive rivalry which makes short-term outcomes uncertain. The concern that regulation will limit the incentives and ability of firms to deploy new technologies that will challenge incumbent firms is, perhaps, the most disconcerting.¹⁸

Welfare-reducing regulation might also result from a regulator's narrow focus on certain goals without balancing such interests against wider ones that might better serve social welfare. Such situations are most common where several regulatory goals exist, only one of which might be the furtherance of competition. Assume, for example, that the regulator focuses on ensuring financial stability or creating transparency in the market. If taken to the extreme, competitive considerations might be given no weight at all.

Finally, such restraints can simply result from erroneous assessment of a welfare-seeking legislator or regulator of the impact of the regulation on market conditions. Such assessment might result from information asymmetries between the regulator and the regulated entity.¹⁹ Alternatively, it might result from the regulator's lack of expertise in analyzing dynamic changes in the market.

For these reasons, it is important to create tools that limit regulation to what is strictly necessary in order to maximize social welfare.

PART II: NAVIGATING THE INTERFACE BETWEEN COMPETITION AUTHORITIES AND REGULATORS

In a perfect world, the government's actions would have been harmoniously orchestrated. A restriction on competition would have limited competition only to the degree necessary to maximize overall welfare. If that were the case, then competition authorities would, justifiably, take a back seat when other types of regulation were applied. In practice, however, this is not the case. As elaborated above, government-facilitated restraints on competition might sometimes be welfare-reducing. How, then, can the advantages of

¹⁸ Harold Demsetz, *The Economics of the Business Firms: Seven Critical Commentaries* (Cambridge: Cambridge University Press, 1995) (Hereinafter: "Demsetz").

¹⁹ ICN advocacy report, *supra*, note 1, p. 28.

competition authorities be harnessed in order to limit welfare-reducing restrictions? This question is the focus of this part.

The analysis will first focus on some of the inherent costs and benefits of giving competition authorities an institutional role in all competition matters. This will serve as a basis for our proposal of six principles that should govern the relationship between the regulatory bodies.

II.1. INSTITUTIONAL COMPETENCE OF COMPETITION AUTHORITIES

What might be the possible justifications for giving competition authorities an institutional role in cases which raise competitive concerns? Competition authorities have two main comparative advantages over sector-specific regulators. First and foremost, the authority has (or at least should have) significant expertise and experience in analyzing the competitive impact of many types of conduct. Such expertise is often lacking, or at least is not so pronounced, in other regulatory bodies. Often the regulator might not even be aware of the extent of the anti-competitive effects created by his decision on the regulated market as well as on related markets. Although regulators should presumably be able to hire appropriate experts, the experience and institutional culture differences between regulators and competition authorities are not so quickly and easily eradicated. For example, regulators are often charged with attenuating the effects of market power, whereas competition agencies basically focus on limiting the creation or the strengthening of such power. This tends to produce quite different views on the extent to which market power can be managed for the public good.²⁰

Second, the authority may play an important role in limiting political pressures on legislatures and regulators.²¹ The reason is that it is not as prone to regulatory capture or to a limited and short-sighted view as a sector-specific regulator or a legislator. Since competition law is not sector-specific, it is not so closely linked to specific industries that

²⁰ Relationship Between Regulators and Competition Authorities (OECD, 1999) (Available online: <http://www.oecd.org/dataoecd/35/37/1920556.pdf> (hereinafter: "OECD Regulation"), pp. 8-9.

²¹ Demsetz, *supra*, note 18, p. 222.

its future is dependent on their continued support.²² Additionally, competition authorities are oftentimes more independent from the executive branch of government and thus less susceptible to political pressures.²³ This is not to say that they are completely shielded from political pressures. Yet they often exhibit a lower likelihood of yielding to them.

Giving competition law enforcement institutions precedence is, however, problematic. First and foremost, in areas in which highly specialized and on-going knowledge of an industry is necessary in order to ensure the existence of conditions that increase welfare, such institutions might not be suited to achieve stated goals. Rather, such regulation is better performed by a specialized agency that has competence in such matters, especially where it should be employed *ex ante*.²⁴ This concern is especially significant where competition law is administered by courts- rather than by a professional agency- and where dynamic and complex technological changes are involved.²⁵ Applying general competition law principles in such settings might be problematic.²⁶ This concern can be partly overcome by endowing the authority with the power and resources required to achieve the necessary level of specialized expertise. Yet this solution creates a duplication of regulatory resources and a risk that firms will be subject to inconsistent regulatory demands. In addition, regulators can employ wider regulatory tools than competition authorities to achieve regulatory goals. They may, for example, be authorised to fix amortisation rates, or to set price ceilings and profit margins.²⁷

The authority might also not be the appropriate vehicle to balance competing considerations. It does not possess the knowledge and the tools to evaluate all the implications of a social policy. While it

²² Gal and Trebilcock, *supra* note 5.

²³ ICN advocacy report, *supra*, note 1, p. 34.

²⁴ OECD Regulation, *supra*, note 20, pp. 8-9.

²⁵ See, e.g., Phillip J. Weiser, "The Relationship of Antitrust and Regulation in a Deregulatory Era" 20 *Antitrust Bulletin* 1 (2005); John Thorne, "A Categorical Rule Limiting Section 2 of the Sherman Act: Verizon v Trinko" 72 *U. Chi. L. Rev.* 289 (2005).

²⁶ This concern was recently echoed by the U.S. Supreme Court in *Trinko*, *supra* note 2, at 414. For the seminal article on this issue see Frank Easterbrook, "The Limits of Antitrust," 63 *Tex. L. Rev.* 1 (1984).

²⁷ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 12.

specializes in analyzing one point of view, it does not have expertise in analyzing and balancing all competing considerations. Since it is exclusively oriented towards prohibiting anti-competitive behavior, it might also not be able to objectively evaluate the importance of non-economic goals. In comparison, regulators may become adept at trading off conflicting goals as they are typically assigned a considerably broader range of goals than competition agencies are asked to pursue.²⁸ Finally, making broad policy decisions that might carry social, political or cultural consequences is not within the mandate of the competition authority and may even impair democratic values. Distributional issues are inherently more political than might be considered optimal for a body that needs to be regarded as an impartial overseer devoted to advancing the general public welfare.²⁹

Building on the above, competition authorities should not be given precedence in all cases involving competition. Democratic values mandate that legislatures should be given the final word as to which markets should be regulated, and how, and that regulators be allowed to carry out such decisions in practice. This does not mean, however, that competition authorities should not play any role in legislative and regulatory processes. Rather, their strengths should be built upon so that at least some checks and balances are put into place to ensure that welfare-reducing government-facilitated restraints are minimized.

II. 2. SIX BASIC PRINCIPLES FOR CREATING A SYSTEM OF CHECKS AND BALANCES

To achieve this balance, we propose the following six general principles, which require the competition authorities to venture outside their conventional confines and serve as guardians of competition in broader settings than traditionally envisioned. While such actions are not costless- most importantly they require the competition authorities to spend resources on studying the existing or proposed regulatory scheme and evaluating its effects and merits- such costs are generally justified as they serve to limit the existence or the effects of welfare-reducing regulation, which might be very costly. We then survey the prerequisites for the principles' application.

²⁸ *Ibid.*

²⁹ *Ibid.*, p. 21, 28. See also Michael Trebilcock, "Regulated Conduct and the Competition Act" 41 *Canadian Bus. L. J.* 492 (2005).

2.1 THE PROPOSED PRINCIPLES

Principle 1: Competition Advocacy at the Legislative Stage

While it is not the competition authority's role to determine whether regulatory schemes adopted by the legislator are valid, the authority has an important competition advocacy and consumer protection role in the legislative process to ensure that the legislator is aware of all relevant competitive considerations when it formulates the regulatory scheme. Consultation in legislative procedures may have a direct impact on the normative environment by limiting unnecessary barriers to competition. If made public, the consultation process may also create a basis for a public debate regarding competition considerations. Such a debate will limit the incentives and ability of legislators to make decisions against the public interest.

This consultative role is important both when a new regulatory regime is established and when deregulation is considered. In the latter it may serve to limit the persistence of welfare-reducing regulation, resulting from the fact that regulators may resist giving up their sources of influence and power. It may also serve to ensure that the new normative environment does not simply convert former state-owned entities into private monopolies, thereby losing much of the potential gains from the change.

The effectiveness of advocacy at the legislative stage depends on a mix of four main conditions: the timing of consultation, the compulsory or non-compulsory status of the consultation, the degree of bindingness of the recommendation and the strength of the existing competition culture.³⁰ Accordingly, several conditions should be met for effective competition advocacy.

First, a procedure should be set to ensure that the authority is informed, in a timely and comprehensive manner, of all legislative initiatives that might significantly affect competition.³¹ Otherwise, the

³⁰ ICN advocacy report, *supra*, note 1, p. 59.

³¹ A study undertaken in 2002 indicated that the moment when a competition authority is consulted varies considerably. Only 65% are consulted at an early stage. ICN advocacy report, *supra*, note 1, p. 60.

main decisions regarding the normative environment might have already been made and will be more difficult to change.

The second condition requires that the authority be granted a compulsory status in the legislative process, at least when the effect on competition might be significant.³² In a somewhat ironic manner, authorities which are relatively independent may generally be relatively removed from the legislative process and might have a weaker stance in it. To remedy this problem, it is essential to grant the authority standing in all legislative deliberations that involve significant implications for competition unless the legislator specifically decides otherwise, rather than grant it standing on an occasional basis, upon invitation to pronounce its view on a specific project. Such systematic consultation ensures that the authority has an institutionally-protected ability to make its observations known to the legislator. An additional method includes the establishment of inter-departmental working groups at the early stages of drafting new projects, which would provide for institutional representation in the formulation of public policy.

In addition, the authority should be empowered to undertake advocacy activities, such as conducting and publishing studies and making recommendations on its own initiative,³³ and should be granted an appropriate budget. It is also suggested, following Lassarre, that a competitive-impact assessment be included in relevant legislative proposals, side by side with assessments of the legislations' environmental and financial implications.³⁴ These methods would

³² In more than 40% the authority is only occasionally consulted and informed. *Ibid.*, p. 63. The French law, for example, provides that the authority "may be consulted on any issue concerning competition" French Commercial Code, Title VI, Chapter II, Article L462-1. By contrast, Latvia empowers the authority to provide opinions in respect of draft legislation. The Competition Law of Latvia, Article 7. The Hungarian law adopts a middle road by empowering the President of the Hungarian Competition Authority to take part in the sessions of Parliament, but enables him to give expert advice only when requested. Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices, Sec. 36.

³³ The Australian law, for example, specifically empowers the authority to do so. Trade Practices Act 1974, sec. 28(1)c.

³⁴ Bruno Lassarre, "State Facilitated or Imposed Restrictions on Competition," presentation made at the US ABA Antitrust Section Spring Meeting (March 8, 2006).

increase public awareness of potential harm and would, in turn, reduce public interest politics.

In our view, the authority's recommendations should not be binding, as otherwise the government would not be able to balance competing policies. Yet the authority should be allowed to make its views and recommendations public, to create a basis for an informed public debate. Public and governmental receptiveness of such recommendations is positively related to the strength of the competition culture. The creation of such a culture is less process-specific and requires the authority to generally engage in the establishment and the strengthening of such a culture. Still, the strength of the competitive culture often is the most important condition of all to limit welfare-reducing legislative proposals.

Where there exists a multi-tiered government, as in the EU and the US, the issue of what degree of scrutiny the higher tier imposes on the lower one arises. We suggest that the above recommendations also apply to the lower tiered legislative process, either by general or by state competition authorities. It should be accompanied, nonetheless, by complementary rules which limit the ability of the lower tier to impose restraints on competition that clash with the overall normative framework. The importance of such limitations arises from the fact that in a multi-tiered environment in which at least one of the levels is comprised from several players, each player has incentives to free ride on the efforts of others to increase competition.

Principle 2: Mandatory Role in Regulatory Proceedings

Competition law should not be granted primacy over the regulatory scheme, where the latter has resulted from a legally valid legislative proceeding. Yet competition institutions have an important role to play in ensuring that the regulatory scheme- once put into place- does not extend beyond its stated mandate and that competitive considerations are given sufficient weight. Such a role would serve to reduce all the motivations for adopting welfare-reducing regulatory decisions, including regulatory capture and the regulator's tendency to limit changes which create uncertainty.

The four conditions that affect the ability of the competition agency to achieve its role in the legislative process are relevant here as well, yet the different nature of the legislative and regulatory proceedings leads to a different set of recommendations. As in the legislative process, the authority should be informed in a timely and comprehensive manner of any regulatory issue which might significantly affect competition, and should be granted mandatory standing in such regulatory proceedings.³⁵ Whereas in many jurisdictions the authority is required to issue opinions upon the request of a minister or the regulator, we suggest a broader rule under which the authority should have automatic standing that is statutorily protected, which will empower it to intervene in any regulatory proceeding that it deems might harm competition unnecessarily, except where specifically provided otherwise in the relevant legislation.³⁶ Of course, the authority should use discretion and intervene only if it deems that competitive considerations will not be given sufficient weight in the regulatory process. In addition, the authority should be explicitly empowered to publish its opinions and recommendations.

The views of the competition authority should not be binding and it should not be allowed to determine the final balance of competing interests, as an equilibrium must often be reached between competition and other justifiable public interest objectives. Yet, as the regulatory agency is often left with considerable discretion as to how to regulate the industry and might often overlook competitive considerations, it should be mandated to justify its decisions which clash with competitive principles, where such a clash was not specifically mandated by the controlling legislation.³⁷ In addition, a dispute resolution process should be established at a higher level of

³⁵ In the U.S., for example, the Assistant Attorney General Antitrust Division is empowered to intervene or participate before administrative agencies which consider competition policies. U.S. Code of Federal Regulations, Title 28, Chapter 1, Part O, Subpart H. Yet in many other jurisdictions the Authority is authorized to give advice only at the request of a regulated body. See. e.g., United Kingdom Enterprise Act, Sec. 7.

³⁶ Such powers exist, for example, in Canada. Competition Act 1985, sec. 125.

³⁷ The U.S. Deep Seabed Hard Minerals Act requires the administrative body to not take action on matters that affect competition until he has received the recommendations of the Federal Trade Commission, "and if he chooses to act in a fashion inconsistent with those recommendations, he must notify the agencies of his reasons before doing so." 30 U.S.C, sec. 1413(d).

government, once the authority determines that the regulator did not meet the onus of proof that the harm to competition was justified.³⁸

To be effective, the authority's recommendations should, of course, be professional and factually-based. Yet competition authorities often lack the sector-specific expertise regulators have. To overcome this problem, it is suggested that procedures be developed to facilitate sharing of information and to encourage exchange of staff among agencies.

These procedural safeguards that serve to formalize and strengthen the consultation procedure will provide for a more transparent decision-making process, which would create a sounder basis for a public debate on the methods employed to achieve regulatory goals and may also serve to restore the balance between interest groups and consumers.³⁹

The consultative role is especially important whenever the principal task is to manage an evolution towards greater reliance on competition, through designing or administering existing sun-setting provisions. As noted above, in such settings a regulator might have overt or covert incentives to limit or stall the deregulatory process in order to preserve his self-interest. He might also not possess the expertise necessary to analyze the extent to which competition can increase social welfare under future market conditions. In comparison, competition agencies have several institutional advantages: they are more attuned to pursuing static and dynamic efficiency; are motivated to demonstrate that competition might produce significant benefits; are familiar with what constitutes a competitive market and what threatens it; are willing to wind down access and economic regulations when competition becomes

³⁸ In Hungary, for example, where the Authority "finds that any public administrative decision violates the freedom of economic competition, it shall request the institution to amend or revoke the decision. Where [it] fails to comply...the [authority] may seek a court review." Hungarian Competition Act, Sec. 85.

³⁹ To some extent, the risks of regulatory capture can also be reduced by involving affected third parties (consumers or competitors) in regulatory decision-making, preferably backed up with formal rights of appeal. Here, as well, competition advocacy by the antitrust authority is important.

sufficiently strong; and are more able to persuade prospective investors that the government is committed to making the transition.⁴⁰

In order to create a stronger basis for understanding the merits of competition, as well as its limitations and the conditions necessary for its application, it is also suggested that competition authorities take some general, pro-active steps even before specific regulatory questions arise. The authority might, for example, conduct seminars to educate legislators and regulators in the relative merits, costs and conditions for competition and for regulation. It might propose general guidelines for analyzing when and to what extent competition is limited by regulation and how such limitations are best dealt with. It might also join forces with other authorities to create international best practices on such issues and, if necessary, actively enlist the support of other competition authorities for its own activities. It might also conduct in-depth studies on the effects of governmental restrictions on competitive conditions in specific industries, in which it considers competition to be limited beyond what serves the public good.⁴¹ Of course, such activities could not be performed without sufficient resources and an acknowledgement by the government of the importance of such functions. Yet the sequence of events does not necessarily have to follow this pattern. The authority can initiate such activities and generate the necessary public and governmental support as it goes along, based on the apparent positive effects of such activities on social welfare.

Principle 3: Ensuring Optimal Scope of General Doctrines

The competition authority has an important role in limiting the scope of any general doctrine which immunizes regulatory processes from competition law scrutiny, beyond the scope that best serves social welfare. Even if the authority cannot, by itself, narrow the scope of such a doctrine, it has an important role in advocating a necessary change, for example by publishing reports or by filing *amicus briefs* in courts to this effect. The U.S. Federal Trade Commission, for

⁴⁰ OECD Regulation, *supra*, note 20, p. 9.

⁴¹ Such market studies are conducted, for example, by the UK Office of Fair trade and by the Netherlands competition authority. For reports of the former see <https://www.offt.gov.uk/News/Annual+report/index.htm>

example, studied the justifications for the State Action Doctrine, which immunizes certain regulatory arrangements created by the States, and published a report criticizing its wide scope.⁴² It has also taken some positive steps to apply a narrower interpretation of the doctrine in several of its decisions.⁴³

Principle 4: Institutional Standing in Judicial proceedings

In most cases the decisions of a regulatory body are subject to judicial scrutiny. In some jurisdictions courts play an even more important role, as in some cases they are the only instance that can determine the legality of a conduct and impose remedies. As a result, many of the rules and doctrines that govern the normative environment are created by courts. This institutional structure has many advantages. Most importantly, it reduces political influences of interest groups, as the judiciary is generally not susceptible to their influence. At the same time, however, the judiciary may often lack the necessary expertise that is needed in order to analyze the implications of its decision on the competitive environment. In addition, because a regulatory measure is likely to be based more on policy considerations than on strictly competition considerations, it is likely to be subject to less stringent judicial review.⁴⁴ This, in turn, might lead to a more lenient approach toward the regulator than is socially beneficial.

To limit this problem, the authority should be granted standing in judicial review proceedings and be allowed to submit its comments to the courts in order to protect the public interest ("amicus curiae").⁴⁵ Courts should also be allowed to consult with the competition authority in matters which might negatively affect competition.⁴⁶ As experience has shown, participation in the judicial proceeding can

⁴² See: <http://www.ftc.gov/os/2003/09/stateactionreport.pdf>

⁴³ See, e.g., *Kentucky Households Goods Carriers Association, Inc* (Docket no. 9309, decoded June 2005) can be found at <http://www.ftc.gov/opa/2005/06/kentuckymovers.htm>

⁴⁴ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 16.

⁴⁵ In Belgium, for example, the Competition Council may submit its written comments to the Court of Appeals. Article 42 bis sec. 4 of the Belgian Act on the Protection of Competition.

⁴⁶ The French law, for example, includes such a provision. See French Act, *supra*, note 32, Article L462-3.

provide substantial contribution: competition authorities provide economic analysis and other informed guidance to help courts better understand the impact of their decisions in creating and maintaining competitive markets.⁴⁷

Principle 5: Ensuring Regulatory Oversight

As elaborated above, granting the regulatory regime precedence over competition law, where such precedence is authorized or compelled by validly enacted legislation, is a direct result of the legislator's democratic mandate. Yet such immunity is not a *carte-blanc* for all regulatory activities. Rather, it should be ensured that adequate government oversight is exercised over competitive harm, to guarantee that social goals are not frustrated by way of oversight. The relevant question thus becomes whether a regulatory regime is in place that either has, or is likely to, review and control the challenged conduct while taking into account all relevant considerations. No immunity from competition law scrutiny should be granted if the regulatory agency lacks jurisdiction over the specific practice, or has jurisdiction but simply rubber-stamps what the private firms want without reviewing and approving the conduct. The competition authority has an important role in identifying those cases in which regulatory oversight is not exercised in actuality.

Principle 6: Harmonization of Regulatory Regimes

Let us now turn to substantive rules, which are also affected by institutional competence. Where an activity is authorized or compelled by a validly enacted legislation, it should be afforded immunity from the application of competition law. Such activity cannot be taken to offend competition law and the public interest is deemed to be protected by it. This rule results from the legislator's democratic mandate to design regulatory regimes. At the same time, however, the sector-specific regulatory regime and competition law should be harmonized to the extent possible. This may require interpreting the regulatory regime in a way that does not clash with competition rules, or applying competition laws in parallel, where such an interpretation does not clash with the legislative framework.

⁴⁷ ICN advocacy report, *supra*, note 1, pp. 15-16, 25.

This rule results from the general assumption that competition law is the main tool to regulate market activity, unless specifically mandated otherwise. It also serves to limit the harm to one of the basic economic liberties: free access to markets and the possibility of competing in them.

An important debate, which is most relevant to our analysis, surrounds the question of whether the parallel application of competition law must be attuned to the degree of competence of the regulatory regime in taking competitive considerations into account. In other words, does harmonization imply that unless specifically mandated, regulation and competition law should be parallelly applied in all cases, or should it imply a more nuanced application, that each must recognize and reflect the institutional competence and regulatory tools at the disposal of the other. The US Supreme Court's *Trinko* decision⁴⁸ seems to suggest that in cases in which both competition law and other regulatory rules may apply cumulatively, it might still make sense to apply a cost-benefit test to ensure that their parallel application furthers the public interest. The Court held that the value of adding antitrust to a regulatory enterprise must be determined by asking two questions. First, how well is the regulatory enterprise itself doing its job of identifying and controlling competitive harms? The better it is doing, the less incremental value antitrust will provide. Second, how much confidence do we have that application of the antitrust laws will improve competition in the situation at hand. If competition law will be particularly difficult to apply and prone to error, then it might do more harm than good to apply it in a well-regulated regime. This formulation is thus based on a careful examination of the regulatory reality rather than a more formal black-or-white rule that would be based on the mere existence of a regulatory regime.

This suggestion is theoretically valid. It limits duplication of resources while at the same time not sacrificing regulatory competence issues: where the regulatory regime is reasonably effective in addressing the relevant anticompetitive concern, competition law should not apply cumulatively. Yet this suggestion suffers from significant practical drawbacks. Most importantly, the

⁴⁸ *Trinko*, *supra* note 2.

courts that will be asked to determine the degree of competence of the regulator will often lack the necessary information to make an informed decision. Also, the rule will create uncertainty, as not only the set of rules which apply will not be clear, but it will also not be clear which regulator is empowered to regulate the industry until a court will determine the issue of competence. This, in turn, will reduce the incentives of both the competition authority as well as private parties to spend resources in applying competition law principles to the industry. Thus, where the two regulatory regimes can be harmonized, so that both apply in parallel, this is the preferred solution.⁴⁹

Our conclusion implies that the two regulatory authorities will have parallel jurisdiction. Yet this does not imply that the competition authority should apply the competition law as if it were operating alone. Rather, it should take into account the relative competence and actual regulatory steps taken by the other regulator, in determining whether to spend its resources on regulating the industry. In addition, it might rely on a regulator to perform regulatory functions in which the regulator enjoys a comparative advantage. For example, it may rely on the regulator to determine access rates, after an essential facility has been found to exist. Such co-existence will reduce duplication of resources while ensuring that competitive considerations are not disregarded.

2.2 PREREQUISITES FOR APPLICATION

The above principles are based on the assumption that the designated regulatory authorities, including the competition authority, have the resources- human, financial and political- to carry out their regulatory tasks. Once this assumption changes, the distribution of tasks should also change.⁵⁰ For example, where a sector-specific regulator is weak (as measured by his ability to carry out his regulatory tasks to the

⁴⁹ For a similar conclusion in the merger review context see Margaret Sanderson and Michael Trebilcock, "Merger Review in Regulated Industries" 42 *Canadian Bus. L. J.* 157 (2005).

⁵⁰ For the importance of institutional features of an antitrust authority see, e.g., Michal S. Gal "The Ecology of Antitrust: Preconditions for antitrust Enforcement in Developing Countries" in *Competition, Competitiveness and Development: Lessons from Developing Countries* (UN, 2004), 22.

public benefit), it might be wise to give the competition authority more power to overrule his decisions.

Accordingly, the distribution of regulatory tasks should change when a significant change in the overall regulatory environment is deemed necessary. This might be the case in transition economies, in which traditional sector-specific regulators are not prone to take account of competitive considerations. In such cases, the authority can act as a top-down force to change long-entrenched regulatory methods and ideologies that distort competition without serving social welfare. It is not surprising, therefore, that in many countries in Eastern Europe the authority is given a strong and mandatory role in the decision-making processes of legislative and other regulatory bodies.⁵¹

It is noteworthy that a well-established competition tradition might limit the need for a formal establishment of the proposed principles.⁵² Yet, as institutional economics has long shown, institutions and procedures do matter- as they may be used as a positive force to overcome obstacles to achieving stated goals, or they may create obstacles to achieving opposing goals, for example, by creating an informed public debate. It is thus recommended that the above principles be legally formalized, even when the competition culture is relatively strong.

III. ANALYSIS OF EU DOCTRINES IN LIGHT OF PROPOSED PRINCIPLES

This part seeks to analyze the applicability of the proposed principles in EU law and proposes several ways to strengthen their application, where it is relevant.

⁵¹ International Competition Network, *Competition Advocacy in Regulated Sectors: Examples of Success* (2004) (available online: http://www.internationalcompetitionnetwork.org/capacitybuild_sg4_seoul.pdf). A study conducted by the ICN indicated that in 58% of developing countries a representative of the competition authority is represented in the Cabinet of the national government, while in developed countries such percentage is 16%. See also: ICN advocacy report, *supra*, note 1, pp. 48-9.

⁵² Advocacy Provisions (International Competition Network Advocacy Working Group, June 2003) additional information available at <http://www.internationalcompetitionnetwork.org/cpi.html>

One of the basic goals of the EU is to create an economically integrated market. Competition policy has played, and is still playing, a pivotal role in the development of the EU by helping to facilitate market integration. The Treaty of Rome (hereafter: "the Treaty") contains several provisions which protect competition.⁵³ It specifically states that one of the main goals of the Treaty is the creation of "a system ensuring that competition in the internal market is not distorted."⁵⁴ The EU administrative governing body has a Directorate General for Competition (hereafter: "DG Competition"), directed by a Commissioner for Competition, which is an integral part of the EU Commission. Due to its importance, competition law has achieved a quasi-constitutional status.⁵⁵ This status is relevant both to the horizontal relationship between competition law and other regulatory regimes set up at the EU level and to the vertical relationship, between the EU competition law regime and national regulatory regimes. The analysis will therefore address both levels, where relevant.

At the horizontal level, the EU Commission and Council may set up regulatory regimes that are necessary in order to achieve Community goals. The Telecommunications Directive, for example, seeks *inter alia* to increase competition in order to increase market integration at the European Level.⁵⁶ Such measures are generally implemented by national regulatory authorities. Determining the optimal method to regulate markets often requires the Commission and the Council to trade-off competing considerations. This can be illustrated by the recent debate over the REACH proposal, which requires the testing and authorization of certain chemicals before they are marketed.⁵⁷ Such regulation is intended to reduce harm from hazardous chemicals. At the same time, such testing is costly and might affect competitive

⁵³ The most relevant are sections 3(g), 5, 81 and 82 of the Treaty of Rome, but many other provisions indirectly protect competition (e.g., sections 87-89 that deal with state aid).

⁵⁴ Section 3(g) of the Treaty.

⁵⁵ Competition Law and Policy in The European Union (OECD, 2005) (Hereinafter: "**OECD EU report**"), p. 59.

⁵⁶ See principally Commission Dir. 90/388 [1990] OJ L192/10, Commission Dir. 94/46 [1994] OJ L268/15, and Commission Dir. 96/2 [1996] OJ L20/59 Commission Dir. 96/19 [1996] OJ L74/13. Richard Whish, *Competition Law* (Bath: Butterworths, 2003, 5th ed.), chapter 23.

⁵⁷ Reach - Registration, Evaluation and Authorisation of Chemicals

conditions as smaller firms might not be able to afford it. The balancing of such considerations has led the EU Environmental Committee to approve different requirements of such testing, which are dependent, *inter alia*, on the volume of production of the chemical.

At the vertical level, the Treaty recognizes the right of Member States to regulate their internal markets, at least to some extent. Yet such regulation constitutes the single most important obstacle to the establishment of a functioning common market in Europe, as it carries the danger of maintaining the compartmentalization of markets. It also raises the concern that some Members will free-ride on the enforcement efforts of others. This danger was increased by the recent modernization process of EU competition law, which decentralized some of the decision on competition matters.⁵⁸ Additionally, it interferes with the uniform application of competition law principles. The framers of the Treaty, recognizing these dangers, included in it several provisions that seek to contend with this delicate balance and to limit State measures that have a direct impact on competition between undertakings. In the European level, such clashes may appear between different interests. In general, Member States may not adopt or maintain any measures contrary to the Treaty rules relating to competition and trade.⁵⁹ Yet, as elaborated below, several exceptions exist that aim to protect national preferences and institutional arrangements against negative integration.

Given this general framework, we now turn to analyze the applicability of the proposed principles in the EU.

Principle 1 suggests that the competition authority be specifically empowered to play an advocacy role in the legislative process. In EU-level legislative proceedings such a role is somewhat built-in into the institutional framework. The EU Commission has an exclusive right

⁵⁸ See, e.g., Petros C. Mavroidis and Damien J. Neven, "The Modernization of EU Competition Policy: Making the Network Operate" (Lausanne, July 2000) pp. 4, 17, 21-22. Mavroidis and Neven argue that the de-centralization of competition law would create significant externality problems in which one state would not generally consider the effects of its policies on other states. Some of the principles we suggest would serve to reduce such problems.

⁵⁹ This results, *inter alia*, from a combination of Articles 3(1)(g), 10, 81 and 82 of the Treaty of Rome.

to propose community-wide legislation.⁶⁰ DG Competition is an integral part of the Commission, and contributes to the promotion of competition, *inter alia*, through screening proposals from other quarters of the Commission and by analyzing market problems and advocating reforms in Community and Member State laws and regulations. The importance of such actions was recently recognized by the Commissioner for Competition, who stated that "proactive competition advocacy... is essentially a toolkit which can improve the overall quality of legislation, and help make it more sensitive to competition concerns".⁶¹

To increase its role in Community legislation and policy guidance and to assist the other Directorates-Generals in evaluating the competitive impact of their proposals, DG Competition recently published guidelines for impact analysis for hypothetical reforms of regulations and has prepared guidelines for competition screening.⁶² The guidelines encourage competitive considerations by pointing to kinds of proposals that are most likely to have a competitive impact - liberalization, industrial policy, grants of exclusive commercial rights and exempting activities from competition rules.⁶³ Yet currently DG Competition does not have a separate unit responsible for advocacy and screening, so projects are allocated to its members on a case-by-case basis, taking relevant proficiencies in consideration.⁶⁴

On balance, the *de facto* prerogative of the Commissioner for Competition has increased in recent years. Still her impact on

⁶⁰ John Temple Lang, "Checks and balances in the European Union: The institutional structure and the "Community Method"", in Patrick Birkinshaw (ed.) *European Public Law* (forthcoming) (Hereinafter: "**Temple Lang, "Checks and Balances"**"), pp. 7-8.

⁶¹ Neelie Kroes, "The Competition Principle as a Guideline for Legislation and State Action – the Responsibility of Politicians and the Role of Competition Authorities", speech given at the 12th International Conference on Competition (Bonn, 6th June 2005) (available online: <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/324&format=HTML&aged=1&language=EN&guiLanguage=en>)

⁶² Revised Impact Assessment Guidelines Better Regulation: A Guide to Competition Screening (DG Comp, 2005) available online: http://europa.eu.int/comm/competition/publications/advocacy/legis_test.pdf

⁶³ OECD EU report, *supra* note 55, p. 57.

⁶⁴ *Ibid.*

legislative proposals is relatively limited and depends, to a large degree, on the existing competition culture.

Accordingly, we suggest that the Commissioner for Competition's consultative role in legislative proceedings initiated by other quarters of the Commission be strengthened. The importance of such a role at a Community level stems from the fact that there is no general principle in the Treaties on how to deal with a conflict between the demands of competition law and those of other Community-level laws or official actions. Many passages in the Treaty that promote other policies and goals include provisos to ensure consistency with the goals of open markets and free competition. The omission of such a proviso in other passages might imply greater leeway about those topics in the event of conflict.⁶⁵

With regard to national level legislative proceedings, DG Competition and national competition authorities do not have an institutional role in such proceedings to ensure *ex ante* that EU principles are not breached or that competition is not harmed beyond what is necessary. DG Competition has, nonetheless, taken active steps in order to highlight the impact of Member States' legislation on Community competition interests. For example, it has recently sponsored a thorough study and report of National-Level Regulation of Professional Services.⁶⁶ The report indicates that serious restrictions of competition are still too common in many countries. This has been followed by a combination of admonition and encouragement, seeking to form a consensus about change.⁶⁷ Yet this initiative indicates the limits of the current system, as it "is hampered by a lack of national political support for reform and little appetite for reform from the professions themselves."⁶⁸ Of relevance are the Commission's powers to bring Member States to court for breaching EU principles and the fact that national competition authorities have a duty to disregard national legislation or other measures restricting

⁶⁵ *Ibid.*

⁶⁶ "Professional Services – Scope for more reform" (Directorate-General for Competition, September 2005).

⁶⁷ OECD EU report, *supra*, note 55, p. 69

⁶⁸ *Ibid.*, at 58. for further information see:

<http://europa.eu.int/comm/competition/liberalization/conference/libprofconference.html>

competition beyond what is legally permitted.⁶⁹ Yet such remedies are seldom used. Also, they are applied *ex post*.

It is noteworthy that DG Competition is specifically empowered to enact implementing legislation which protects competition. Under Article 86(3) of the Treaty, DG Competition can adopt preventive measures to ensure that Member States comply with the requirement that they do not grant undertakings special or exclusive rights that infringe Treaty principles.⁷⁰ This is an implementive power, which can be used to clarify and to make precise the practical consequences of existing legal obligations stated in the Treaties.⁷¹ This power, however, is seldom used.⁷² One rare example is the adoption of the Transparency Directive, which requires Member States to use transparent accounting systems that can help the detection of the grant of state aids.⁷³ Nevertheless, the potential for its use has been utilized in several occasions, most notably in the air transport and telecommunications market, in order to induce Member states to agree to EU directives liberalizing the relevant markets.⁷⁴ DG Competition is also empowered to decide that a particular Member State had breached this obligation, and what measures should the State take to remedy this infringement.⁷⁵ Yet such power is relatively weak, as Member States have some discretion for determining the pace of adjustment needed.⁷⁶

Accordingly, DG Competition should be granted a mandatory right to review and have standing in all legislative endeavors by Member States that might infringe EU competition principles. In addition,

⁶⁹ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 16.

⁷⁰ Article 86(3) of the Treaty of Rome; C. Bellamy and G. Child, *European Community Law of Competition* (5th ed., London, 2001, Sweet & Maxwell) (Hereinafter: "**Bellamy & Child**"), para. 13-031; Cases 188/80 etc., *France, Italy and United Kingdom v. Commission* [1982] ECR 2545, [1982] 3 CMLR 144.

⁷¹ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 6.

⁷² Paul Craig and Grainne De Burca, *EU Law* (3rd Ed., Oxford Press, 2002) (Hereinafter: "**Craig and De-Burca**"), p. 1134.

⁷³ Jonathan Faull and Ali Nikpay, *The EC Law of Competition*, (Oxford University Press, 1999) (Hereinafter: "Faull and Nikpay"), para. 5.174, p. 327

⁷⁴ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 6

⁷⁵ *Ibid*; Craig and De-Burca, *supra*, note 72, p. 1134.

⁷⁶ Faull and Nikpay, *supra* note 73, para. 5.101, p. 307.

national competition authorities should also be granted mandatory consultative rights in their respective countries.

It is also suggested that all legislators be required to add a competitive impact assessment to their legislative proposals, where relevant. This is not a big change from the existing situation. Every measure adopted by the EU must include a statement for the reasons for its adoption- it should be shown, *inter alia*, that it complies with the principle of proportionality in that it does not exceed what is necessary to achieve its objective.⁷⁷ Adding a competitive impact analysis will simply provide a sounder basis for meeting this requirement.

In addition, as Temple Lang suggests, in order to enhance the acceptance and understanding of EU policies, including competition, and to ensure that Member states do not enact or maintain regulatory regimes that do not comply with EU principles and policies, "[i]ndividual members of the Commission could...come to national capitals regularly to discuss their current proposals and policies... It would be more worthwhile for [the Commissioners] to discuss policies with legislators, and it would be helpful to both parties for this to be done regularly, as a matter of routine, and not only when some particularly controversial or difficult problem arises. This would also enable Commission representatives to sound out national political opinion, and would provide legislators with another source of information on Commission activities and thinking."⁷⁸

Principle 2 suggested that the competition authority, as well as the relevant national competition authorities, be granted a mandatory role in regulatory proceedings which might significantly harm competition and that the regulator be required to justify any significant harm to competition. This role is especially important in the EU, in which regulatory authorities are national.

Currently, the role of the Commission, DG Competition or national competition authorities in regulatory proceedings is generally not

⁷⁷ Article 253 of the Treaty of Rome; Temple Lang, "Checks and Balances," *supra*, note 60, p. 2.

⁷⁸ Temple Lang, *ibid.*, p. 22

legally established, although some exceptions apply.⁷⁹ Further, national regulatory authorities are not obliged to notify the Commission or national competition authorities of decisions which they intend to adopt that might harm competition, or to stop a procedure if the Commission takes up the same case.⁸⁰ Regulators are also not specifically obliged to provide reasons for rejecting competitive concerns. We recommend that the law be changed in these respects.

The existing safeguards against harmful regulatory decisions focus largely on general *ex ante* prohibitions coupled with *ex post* judicial review. As further elaborated in principle 6 below, the Treaty mandates Member States not to approve or apply any practice which is contrary to Community competition law, except in specific circumstances.⁸¹ Moreover, Community case law generally prohibits restrictions on freedom of establishment or services unless such restrictions are in the public interest and meet the requirement of proportionality.⁸² These duties limit the Member State's ability to apply competition-reducing regulation. In addition, the *Ahmed Saeed* case stands for the principle that a regulator must not approve under national law any practice which is contrary to EU competition principles.⁸³ Where such regulation is nonetheless applied, it is the primary responsibility of the Commission to bring Member States before Community Courts. Such regulatory decisions can also be challenged before national administrative courts and may even be disregarded by national competition authorities. Yet such review is costly and applied *ex post*, and thus is limited in its practical effectiveness.

⁷⁹ For example, the Commission has a fairly established role in the regulation of telecommunications markets.

⁸⁰ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 26

⁸¹ See Case C-163/96, *Silvano Raso*, [1998] ECR I 533, at p. 579; Case C-258/98, *Carra*, [2000] ECR I 4217, as brought in John Temple Lang, "European Union law rules on State measures restricting competition," 2(4) *Europarattslig Tidskrift* (2001) pp. 206-223 (Hereinafter: "**Temple Lang, 'State Measures'**"). See discussion on Principle 6 which elaborated on this doctrine.

⁸² Temple Lang, "Policy and Regulation," *supra*, note 6, p.36

⁸³ Case 66/86 *Ahmed Saeed* [1989] ECR 803; Temple Lang, "Policy and Regulation," *supra*, note 6, p. 43.

It should be noted that during the last two decades, a liberalization and de-monopolization process took place in industrial sectors which had been state-owned for many years.⁸⁴ The liberalization process commenced in several sectors, including energy, postal services, telecommunications, and transport. DG Competition assisted the process by applying competition law principles to these sectors, and by challenging the justification for state monopolies and exclusionary rights.⁸⁵ It also reviewed, in some cases, the agreements between competitors, to ensure that competition is protected.⁸⁶ Yet such interventions are the exception and not the rule and have been operational only in several specific sectors. They also operate *ex post* to change existing regulatory regimes, rather than ensure *ex ante* that regulatory decisions do not infringe competition rules.

Principle 3 suggests that DG Competition take an active role in limiting the scope of any general doctrine which immunizes regulatory processes from competition law scrutiny, beyond the scope that best serves social welfare. Indeed, the Commission has been a driving force behind limiting exceptions to the general rules on the applicability of Community competition law.

The Commission's practice to use its powers to inform an industry that some type of conduct will be considered contrary to EU competition rules, is a good tool to limit harmful regulation *ex ante* by clarifying the scope of legal principles. For example, the notices on competition issues in the telecommunications industry and on access agreements were intended to clarify the legal position in advance, without the need to wait for formal Commission decisions to be adopted and challenged in the courts. Although such notices have no legislative effects, they clarify the position of the Commission and as far as possible resolve doubts about the application of competition principles in practice and bind the Commission itself.⁸⁷

⁸⁴ Richard Whish, *EU Law – Text, Cases and Materials* (Oxford University Press, 2003, 3rd ed.), p. 866.

⁸⁵ 1992 ECR I-5833. A liberalization process has just recently taken place in the German Telecommunication infrastructure market, in which the Commission had an important role. For further details see, e.g.,

<http://www.cbsnews.com/stories/2006/08/21/ap/business/mainD8JKQIT80.shtml>

⁸⁶ Faull and Nikpay, *supra* note 73, para. 10.10.

⁸⁷ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 9, and references therein.

Principle 4 grants the authority institutional standing in judicial proceedings which involve competition issues.

The Commission has a general responsibility to bring Member States before Community Courts if they do not carry out their obligations under EU law.⁸⁸ In such cases, the Commission is a party to the proceedings. It also has a right to intervene in all Community court proceedings, including those that involve competition issues.

In addition, Article 15 of Regulation 1/2003 states that Member States' competition authorities and the Commission are allowed to intervene in court proceedings that consider competition law issues in their country. Such intervention was deemed necessary in order to maintain consistency of interpretation when the application of the rules is decentralized, and to lend support to the national courts in the exercise of their functions.⁸⁹ Also, in the course of proceedings before them courts may address competitive concerns to DG Competition to ask for information of a procedural, legal or economic nature.

Yet there is generally no institutional standing of national competition authorities or of the Commission in judicial proceedings in national courts that do not specifically involve competition law issues.⁹⁰ This lacuna should be remedied.

Principle 5 requires that it be ensured that adequate government oversight is exercised over competitive harm, to guarantee that social goals are not frustrated by way of oversight. This principle is, indeed, applied in the EU. One of the preconditions for granting exemptions under Article 86(2), which will be elaborated in principle 6 below, is that the regulator does not simply rubber-stamp the regulatory scheme. If the relevant act delegates to private economic operators

⁸⁸ Temple Lang, "Checks and Balances," *supra*, note 60, p. 4.

⁸⁹ Commission Programme No 99/027, White Paper on Modernization of the Rules Implementing Articles 85 And 86 Of The EC Treaty (Brussels, 28.04.1999), para. 107.

⁹⁰ Some Member states have enacted provisions that grant the national competition authorities the power to submit written observations in all judicial proceedings. See, e.g., Section 89(h) of the Netherlands Competition Act.

responsibility for taking decisions affecting the economic sphere, then the relevant regulation is deemed to be illegal.

Principle 6 suggests that when the regulatory regimes can be harmonized, without much cost, this should be pursued.

Member states have consistently opposed the idea of European regulators, so that the Commission has only a very limited operational role in regulatory matters. Nonetheless, it has several tools at its disposal in order to set a general regulatory framework, besides competition law principles, including directives and decisions in cases of state-owned monopolies and companies with exclusive rights, sector inquiries and non-binding "soft law" measures designed to clarify its views on a regulatory issue in advance, and ensuring the application of general principles such as the freedom of establishment and the freedom to provide services.⁹¹ Accordingly, European regulatory policies are generally initiated by the Commission but carried out by national regulatory authorities.⁹²

Where there exists a Community regulatory regime, courts try to harmonize it with EU competition law, to the extent possible. Only when a clash is inevitable, is the regulatory system immunized from the application of competition laws, to avoid the possibility of judgments conflicting with a specific Community regulatory scheme. When competition law immunity is express, the role of the court is mainly to ensure that the statute's requirements have been satisfied. Courts have also recognized implied immunity, which applies when immunity seems necessary to avoid conflicts between regulatory and competition law requirements. This set of rules comports with the general principles suggested above.

Rules become more complicated when restraints result from Member-States' regulation. The Treaty's provisions combine to disfavor a

⁹¹ For cases opening up markets to competition based on the freedom of establishment see, e.g., C-243/01 *Piergiorgio Gambelli and Others* (November 6, 2003) ("The restrictions must be justified by imperative requirements in the general interest, be suitable for achieving the objective which they pursue and not go beyond what is necessary in order to attain it. They must in any event be applied without discrimination." Para. 65); C-438/02 *Krister Hanner* (31 May 2005).

⁹² Temple Lang, "Policy and Regulation," *supra*, note 6, p. 4.

broad “state-action” exemption, as exists in the US. The Treaty obliges Member States to take all appropriate measures to fulfill their obligations and to abstain from any measures that could jeopardize the attainment of Treaty objectives. Thus, Member States generally may not enact or maintain any measure which is contrary to the Treaty rules about competition or which would deprive competition law of its effectiveness.⁹³ This basic principle also results from the fact that European competition rules are Treaty rules and in the case of actual conflict override national law.⁹⁴

Article 86(1) is a specific manifestation of the general duty of Community loyalty.⁹⁵ It imposes a duty on Member States not to adopt or maintain in force measures which could deprive the competition provisions of their effectiveness “in the cases of public undertakings and undertakings to which Member States grant special rights.” Yet this article has been interpreted by the courts to prohibit the grant of any right only if the very exercise of the right could not avoid being anticompetitive,⁹⁶ or if it would lead the grantee to an

⁹³ This results, inter alia, from a combination of articles 3(1)(g), 10, 81 and 82 of the Treaty of Rome. Case 13/77 *GB-Inno-BM* [1977] ECR 2115, paragraph 31. This principle was reiterated in later decisions. See, e.g., Case 267/86 *Van Eycke v. ASPA NV* [1988] ECR 4769, [1990] 4 CMLR 330, paragraph 16; Case C-153/93 *Delta Schiffahrts- und Speditionsgesellschaft* [1994] ECR I-2517, paragraph 14; Case C-96/94 *Centro Servizi Spediporto* [1995] ECR I-2883, paragraph 20. In *CIF* the European Court of Justice ruled that where anti-competitive conduct by undertakings is required or facilitated by national legislation, a national competition authority has the duty to disapply the national legislation. See: Case C-198/01 *Consorzio Industrie Fiammiferi (CIF) v Autorità Garante della Concorrenza e del Mercato*. (9 September 2003). For an elaboration on the theoretical basis of such principles see Temple Lang, “State Measures,” *supra*, note 81.

⁹⁴ Temple Lang, “Policy and Regulation,” *supra*, note 6, p. 35.

⁹⁵ Alison Jones and Brenda Sufrin, *EC Competition Law – Text, Cases and Materials* (Oxford Press, 2002) (Hereinafter: “**Jones and Sufrin**”), p. 431; Case 13/77 *NV GB-INNO-BM v. ATAB* [1977] ECR 2115.

⁹⁶ Case c-41/90 *Höfner and Elser v. Macorton GmbH* [1991] ECR I-1979. In *Corbeau* the court went even further, to suggest that the very grant of special or exclusive rights might be contrary to Article 86(1). Case C-320/1991 *P. Procureur de Roi v. Paul Corbeau* [1993] ECR I-2533. Corbeau's importance also stems from the fact that it extended the application of the rule to situations where the competition was restricted because the market itself had changed, and not only when an independent action was taken by the Member State or an undertaking in the regulated industry. The ECJ has later retreated this approach: Case C-323/93 *Societe*

infringement.⁹⁷ This strict interpretation dramatically reduces the scope of the prohibition.⁹⁸

A basic tenet of the EU is that states are entitled to regulate their own internal economies, at least to some degree. Accordingly, Article 86(2), together with the rules governing state aid and agricultural policy, is the principal exception to the general rules on competition.⁹⁹ Article 86(2), known as the public mission exemption, provides that "Undertakings entrusted with the operation of services of general economic interest...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...[and] the development of trade must not be affected to such an extent as would be contrary to the interests of the community." Hence measures that would otherwise be in violation of Treaty rules are permitted under the above *lex specialis* if applying such rules would meet the conditions set out in it, which seek to reconcile the States' interest in using certain undertakings as an instrument of economic policy with Community interests.¹⁰⁰ It is thus clear that Member States do not possess complete sovereignty in relation to national regulation that might obstruct competition. Rather, such regulation should be balanced, *inter alia*, with the principle of competition. Article 86(2) can be applied by Community as well as by National Courts. The question thus becomes how the balance is struck by them.

States are relatively free to define what counts as a service of general economic interest. Member States are also free to define the means for attaining the public mission, even if these clearly distort competition and restrict intra-Community trade. Yet the public service mission should be clearly defined and explicitly and deliberately

Civile agricole du Centre d'Imsemination de la Crespelle v. Cooperative d'évage et d'insemination Artificielle du Department de la Mayenne [1994] ECR I-5077.

⁹⁷ Case c-260/89 *ERT v. DEP and Sotirios Kouvelas* [1991] ECR I-2925, and Case c-190/90 *Merci Convenzionali Porto di Genova SpA v. Siderurgica Gabrielle SpA* [1991] ECR I-5889.

⁹⁸ Faull and Nikpay, *supra* note 73, para. 5.05, pp. 275-276.

⁹⁹ Other exceptions also exist, such as article 21 of the Council Regulation (EC) No. 139/2004 of 20 January 2004 On the Control of Concentrations Between Undertakings.

¹⁰⁰ Case C-202/88 *France v. Commission* [1991] ECR I-1223, para. 12.

entrusted through an act of public authority. Merely tolerating, approving or endorsing an undertaking's activities is insufficient.¹⁰¹ Also, the exemption has been interpreted narrowly to cover only activities with a direct relationship to the entity's main, permitted statutory function, and only where there is a prospect of inherent conflict between that entrusted task and the Treaty rules at issue.¹⁰² In addition, even if an activity is accepted as a service of general economic interest, the party requesting the immunity has to show that compliance with Treaty rules would obstruct the performance of the particular tasks assigned to the undertaking.¹⁰³ Accordingly, in order for the exemption to apply the national court or the competition authority should be able to determine *first* the exact nature of the needs in question and their impact on the economic activity of the undertakings; *second* that the regulation should be considered in the light of its ability to accomplish the tasks assigned to the regulator. It is not sufficient, for example, that a monopoly would enable the enterprise to be more profitable, or to charge less for some services. The harm to competition must be a necessary element in achieving the task of public interest¹⁰⁴; and *third* that the restriction is necessary to fulfill the duties the regulator was required to perform.¹⁰⁵ This is, in essence, a proportionality test. Finally, for the exemption to apply, it must be proven that derogation from general Treaty rules would not have an effect on trade contrary to the interests of the Community. This tailpiece has not so far been of importance, and it is generally seen as part of the overall proportionality requirement.¹⁰⁶

The cases that have applied those issues exemplified some hostility towards the consequences of statutory state monopoly. However, from the case of *Corbeau* (1993) onwards, the ECJ had been more willing to accept that providers of public services may need to be immunized from competition law and has become more flexible in the

¹⁰¹ Jones and Sufrin, *supra*, note 95, at p. 457; Temple Lang, *State Measures*, *supra* note 81, p. 16.

¹⁰² OECD EU report, *supra*, note 55, p. 52

¹⁰³ See, e.g., Case 157/94 *Commission v. Netherlands (Re Electricity Imports)* [1997] ECR I-5699, para. 52-53 and 58.

¹⁰⁴ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 41.

¹⁰⁵ Craig and De-Burca, *supra* note 72, at 1132-1133. For a recent decision see Case C-438/02 *Krister Hanner* (May 31, 2005).

¹⁰⁶ Jones and Sufrin, *supra*, note 95, p. 469.

way Article 86(2) is applied.¹⁰⁷ In *Deutsche Post*, for example, the exemption was applied quite formally.¹⁰⁸ The focus of the analysis was not on ascertaining the necessary level of the anti-competitive restraint that could be justified as means to meet the regulatory end (i.e., a proportionality test), but rather on the justification for the restrictive measure in a general manner, that is, whether the restriction is justified by "economic general interests".¹⁰⁹ It is possible that the more lenient approach adopted by the courts was affected, *inter alia*, by Article 16 which was added by the Treaty of Amsterdam in 1996, and acknowledges the place occupied by services of general economic interest in the shared values of the Union and their role in promoting social and territorial cohesion.¹¹⁰ Yet DG Competition has stated that it will interpret the exemption quite narrowly to ensure proportionality, that is, that any restrictions on competition are no greater than is necessary to guarantee effective fulfillment of the mission.¹¹¹

Let us also add a few words about the case law regarding state monopolies. Member States are allowed toArticle 31 of the Treaty

Does this exemption comport with the suggested principles? On a theoretical level it does, as it emanates from the first principle suggested above. The exemption is an outcome of the division of tasks, not of general regulatory policy. Its purpose is to give appropriate recognition to state regulatory power, even if it clashes with competition goals, as long as the harm is proportional. The Doctrine's requirements also comport with the sixth principle, which requires that the regulatory authority review and control the anti-competitive conduct in actuality. It might be argued, however, that the way the court applied Article 86 in recent cases does not serve Community goals. In particular, as noted above, the court did not

¹⁰⁷ Faull and Nikpay, *supra*, note 73.

¹⁰⁸ *Deutsche Post AG v GZS für Zahlungssysteme, Citicorp Kartenservice GmbH*, Joined Cases C147 and 148/97, 2000 ECR I-825.

¹⁰⁹ Leonor Moral Soriano, "How Proportionate Should Anti-Competitive State Intervention Be", *E.L. Rev.* 2003, 28(1), 112-123 (Hereinafter: "**Soriano**"), pp. 118-119.

¹¹⁰ Article 16 of the Treaty of Amsterdam.

¹¹¹ OECD EU Report, *supra*, note 55, pp. 50-53.

apply a proportionality test to check the appropriateness of means to ends. Rather, it presupposed that the measure is suitable to guarantee the provision of services of general economic interest.¹¹²

It is interesting to contrast the EU rule with the U.S. "State Action Doctrine".¹¹³ The Doctrine was first articulated by the US Supreme Court in *Parker v. Brown*,¹¹⁴ which held that state-mandated or directed restraints are exempted from antitrust liability. The ruling was based on the States' status as sovereign entities, in light of which Congress did not intend the Sherman Act- a federal Act- to apply to the activities of the states themselves. The doctrine shields private conduct from the antitrust laws when a two-pronged test is satisfied. First, the challenged restraint must be clearly articulated and affirmatively expressed as state policy, and second, the policy must be actively supervised by the state itself, to ensure that the State has exercised sufficient independent judgment and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties.¹¹⁵

The U.S. doctrine is much wider than the EU exemption. Whereas the EU exemption focuses on the means/end relationship and allows the judiciary to strike a balance between competing interests, the U.S. applies a less interventionist rule which focuses on the procedure rather than the degree of harm to competition and applies an either/or test. This disparity stems from a basic difference between the two systems. The U.S. rule is an outcome of federalism, not of federal regulatory policy. Its purpose is not to protect federal regulatory or competition goals, but to give appropriate recognition to state regulatory power. Under the U.S. notion of democratic federalism, states keep all powers that are not expressly granted to the federal government. Among these powers, there is the power to pass anti-

¹¹² Soriano, *supra*, note 109, p. 117, 123.

¹¹³ Several scholars have compared the two. See, e.g. Andrea Filippo Gagliardi, "United States and European Union Antitrust Versus State Regulation of The Economy: Is There A Better Test", 25 *E.L. Rev.* 353 (2000). As argued above, we think that there exists a much more significant difference between the EU and the U.S. tests than the author argues for.

¹¹⁴ *Parker v. Brown*, 317 U.S. 341 (1943).

¹¹⁵ *FTC v. Ticor Title Insurance Co*, 504 U.S. 621 (1992).

competitive regulations since these were not made expressly subject to antitrust law. Thus, when a court applies the State Action Doctrine it must try to avoid making substantive judgments about whether the state regulation at issue is social-welfare enhancing. If courts were given the authority to assess the legitimate interest of every state regulation, this would extensively interfere with a state's power to regulate its economy. It is thus a rather formal rather than a substantive test, focusing on the process rather than on the outcome. The EU rule, on the other hand, is based on the recognition that state regulation might be one of the major obstacles towards an integrated economy, and thus should be limited. State anti-competitive regulations are authorized only if they pursue a legitimate interest and meet a proportionality test.

Where parallel regulatory powers exist, it might be necessary to decide which authority should deal with a particular case. Community law imposes no solutions. As Temple Lang suggests, the regulatory authorities should devise some mechanism for avoiding unnecessary duplication of procedures and conflicting approaches, and for either informal consultation or mutual submission of formal arguments and evidence.¹¹⁶

CONCLUSION

Regulation of markets is multi-faceted and often requires the combined efforts of several types of regulatory regimes in order to achieve social welfare. Regulation might, sometimes, restrain competition. Such restrictions may be necessary to increase social welfare. Indeed, competition policy does not necessarily imply competition law. Rather, competitive conditions might sometimes be better achieved by applying other regulatory mechanisms. At the same time, regulation is riddled with limitations. Most importantly, it is prone to regulatory capture and a conservative view, which might harm social welfare. The problem of social engineering is basically one of incentive mechanism design: how to induce the legislative and regulatory bodies to act in accordance with the public interest.

This article seeks to address this problem through the tools available to competition law enforcers. We propose six basic principles that

¹¹⁶ Temple Lang, "Policy and Regulation," *supra*, note 6, p. 17.

seek to define the possible synergies between competition agencies and regulators. We suggest that where specific regulation exists, competition law should generally take a back seat. Yet competition agencies still have an important watch-dog role to play, to ensure that the road was paved by the government in a clear fashion which reviewed all relevant considerations and that the car's driver is licensed to drive it.

Analysis of the existing rules that govern the interface between competition agencies and other regulatory bodies in the EU has indicated that some of the proposed principles are already applied. Yet in other cases the Commission and the courts adopt a too lenient approach that grants specific regulatory regimes too much leeway. In such cases we suggested a change of approach that would build on the complementarity between competition authorities and specific regulators.

Regulation is as significant a variable as technology in determining the economic performance of an industry. Efficient regulation is crucial to the eventual realization of the potential benefits of an industry. It is thus crucial to ensure that the regulatory system creates checks and balances to ensure that regulation does not spill beyond what is socially beneficial. This article attempted to take a step in this direction.