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PRINCIPLES OF GOOD MARKET GOVERNANCE

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INTRODUCTION

One could be forgiven for thinking that economic regulation happens in a haphazard fashion. In recent years, on every occasion where one of a number of sectors – including telecommunications, broadcasting, energy, post and transport by rail – was liberalized, a complete set of economic regulation was produced. Very often, a new regulatory authority was set up, which took up its work with a determination to be active in discharging its mission. Ironically, all of this occurred despite the "deregulation" mantra. The same process could be observed in all Western jurisdictions, with few exceptions.

It would be wrong, however, to think that the wheel is constantly being re-invented. In most instances of economic regulation, a number of basic principles are at stake. The evidence from preparatory materials is that lawmakers and regulatory decision-makers do pay attention to precedents from other sectors and from other jurisdictions, so that some learning process is taking place.

Indeed, there is a sprawling body of literature on what has become known as "good governance", i.e. the search for the best set of all laws, regulations, processes and practices that affect the functioning of a regulatory framework and the market.[1] The main pieces of literature have tended to come from governmental or para-governmental bodies, including:

- the OECD Council Recommendation on improving the quality of government regulation;[2]
- the European Commission White Paper on European governance;[3]
- the report of the UK Better regulation task force, "Principles of Good Regulation";[4] and
- the report of the Australian Utility Regulators Forum, "Best practice utility regulation".[5]

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[***] Lecturer and researcher in European and national competition law and Member of TILEC, Tilburg University. This paper is part of a project of the Dutch Ministry of Economic Affairs, which analyses in which way the scientific approaches from different disciplines can contribute to achieving a certain market order.
[1] In this paper, we will be using "good economic governance" in order to indicate that we are looking at the area of economic regulation only, since the term "governance" is also used with reference to the structure and functioning of firms (corporate governance) and now even in the context of the discussion on the proper working of the public administration in general.
[2] OECD/GD 95 (95).
[3] COM (2001) 428 final.
[4] Better Regulation Task Force, 2000, www.cabinet-office.gov.uk.regulation/Taskforce/Index.htm.
[5] Paper prepared for the Utility Regulators Forum, http://www.accc.gov.au/utipubreg/pubreg.htm

All those documents seek to formulate principles for good regulation. Although the principles are not identical, the purpose behind the exercise is the same, making it worthwhile to compare and classify the principles of the different documents.[6]

In the Netherlands, the Dutch government already took several initiatives related to good economic governance. For one, the programme on the "Functioning of Markets, Deregulation and Legislative Quality" (MDW) aimed to improve the functioning of markets by (i) strengthening competition through regulatory reform, (ii) abolishing or streamlining regulations to "return to what is strictly necessary" and (iii) improving the quality of legislation and regulation through a better *ex ante* analysis of likely effects.[7] Although we will take account of the results of this project, this paper is not restricted to the drafting of parliamentarian bills and ministerial orders. It also examines how quality can be ensured when administrative agencies formulate policies, regulations and decisions.[8] Indeed, these agencies play an important role in making regulation work. Good market governance can only be achieved if the quality standards applicable to lawmaking find their match at the level of administrative action.

In the discussion of good economic governance, legal scholarship is lagging somewhat behind economics and political science. This paper seeks to address that deficiency by taking a more legal approach. It analyses which principles should form the basis of market legislation and supervision and how these principles should be incorporated in the legal order. It examines to what extent law can contribute to a certain order in the market.

The principles of good market governance should enable the legislature, the government and the administrative authorities to formulate laws, policies, regulations and decisions of a high quality. A good-functioning regulatory framework is likely to enhance business confidence and produce the kind of stability required for long-term investment to take place. As a consequence, the interests of the customers/users are likely to be better served, with appropriate supply and a dynamic market.[9] It must be emphasized, however, that good governance is not the only – and probably not even the main – determinant of economic performance, although it has a significant impact.[10]

[6] While the first three documents deal with regulation in general, the last one touches more specifically on the regulation of utilities. This explains why it contains a longer list of principles, many of which are of particular relevance for network industries.
[7] OECD, *Regulatory reform in The Netherlands, Government capacity to assure high quality regulation*, 1999, p. 8.
[8] Several new agencies that have the power to supervise competition and to regulate the markets were established in the Netherlands in the 1990s. We can, for instance, refer to the Netherlands Competition Authority (NMa), the Independent Telecommunications and Postal Authority (OPTA) and the Energy Authority (DTe). See for an overview and analysis of all Dutch market authorities, B.M.J. van der Meulen, 'Marktautoriteiten, aanzet tot een interne rechtsvergelijking', in: B.M.J. van der Meulen en A.T. Ottow, *Toezicht op markten*, Den Haag, Boom Juridische Uitgevers, 2003, p. 19 t/m 20.
[9] S. Berg, 'Infrastructure regulation – Risk, return and performance', *Global utilities*, 2001, p. 3 to 10.
[10] Ibid. at 8.

In the past decade, the attention of regulation scholars was focused mostly on the liberalization movement, which led to a restructuring of network industries, from monopolies (in most cases) to regulated markets. Accordingly, it will come as no surprise that this paper mainly focuses on the experience of network industries. Nevertheless, the legal principles discussed here are for the most part of such fundamental nature that they should also play a role in an assessment of the regulation of other markets.[11]

In this paper, we begin by setting out the substance of the principles of good market governance (I). Afterwards, we analyse how these principles have played, or could have played, a role in the Netherlands: through several case studies, we illustrate that a patchy record as regards those principles has often prevented policy objectives from being realized (II). We conclude with some suggestions on how to improve the quality of the substance of market regulation and the quality of the processes that lead to its adoption (III).

PART I: THE SUBSTANCE OF THE PRINCIPLES

From a survey of the literature, it appears that a consensus is emerging in Western countries on the following set of principles of good market governance: transparency, accountability, proportionality, consistency, predictability, flexible powers, clear legal mandate, independence and respect for competition law and policy. We can add to this specific EU principles, namely respect for EC law and effective cooperation with and within the EU.

Transparency

Transparency is a broad principle that is mentioned throughout the literature as a fundamental basis for good regulation. It applies to all public actors, including the legislature, the executive and the administrative agencies. It protects the interests of all affected parties.

Like many of the principles discussed here, transparency is multi-faceted. Prior to decision-making, it entails that the rules governing decision-making are open and publicized, and that the agenda (both substantive and procedural) is known. In the course of decision-making, it implies that the decision-maker will not operate behind closed doors, will disclose the record on which the decision is to be based and will issue reasons for the decision. Following decision-making, transparency requires the decision to be made easily accessible. Of course, transparency applies to a different extent depending on the type of decision – a piece of legislation and a decision in an individual case being the two extremes – but nevertheless it is one and the same principle,[12] based as it is on the idea that the State must act in the open, so that citizens can be

[11] We can refer, for instance, to the principles of transparency, accountability and proportionality.
[12] The case-law of the ECJ on the requirement to give reasons, set out in Article 295 EC, illustrates this point very well, starting from a single principle and giving it a different colour depending on the type of act at stake.

aware and safeguard their rights, and that the State can be put under pressure to act in a way that is openly defensible.

At the legislative level, the principle of transparency requires that legislation be easily accessible. The addressees of legislation (those whose legal position is affected) should be made aware of their obligations and given time to comply by the enforcing authorities. Furthermore, when legislation entrusts certain tasks to an authority, then it must also contain a clear formulation of the authority's powers and their relation to the purposes of the law, to carry transparency onwards to the next stage. Moreover, when responsibilities are shared between authorities or between the executive and an authority, the legislation should also clearly indicate who is responsible for what.

For instance, in the UK the Utilities Act 2000 blurred the responsibilities between the economic regulators and government.[13] According to the Act, the primary duty of the regulator is to protect the interests of consumers, wherever appropriate by promoting effective competition. But the regulators must also have regard to the interests of individuals who are disabled, chronically sick, of pensionable age, have low incomes or live in rural areas. All the parties involved in the utilities market – with the exception of consumers – felt that the addition of these new social and environmental duties actually complicated the task of the regulators, because it was no longer clear who is responsible for the policy decisions. A clear delineation would probably have meant that since the executive is accountable to the legislature, the government should spell out policy objectives on environmental and social issues which it expects the regulators to implement.[14]

The principle of transparency is not only directed at the legislature and the executive, but also at the authorities who are required to implement the law. Transparency requires these authorities to be open with stakeholders about their objectives, processes, record and decisions. Moreover, authorities should explain to the citizens and the regulated firms the rationales of their decisions. Given that authorities are liable to be "captured" (at least as far as their attention and their information is concerned) by the regulated firms, the principle of transparency could even go as far as to require authorities actively to seek the involvement of other interests, in particular customers and citizens, in their activities.

When transparency is respected, both the regulated firms and citizens are able to understand – and thus more likely to accept – the decisions made by legislatures, ministries and agencies. Therefore, transparency will contribute to the legitimacy of the legal framework and the agencies' actions.

Independent supervision of the market

Independent supervision of the market is of particular significance for network industries,[15] but it also plays an important role for the financial sector, for instance. The OECD has made clear in several documents that good market governance requires that supervisory or regulatory agencies be independent, first, from the stakeholders and secondly, to some extent, from politics.[16]

[13] Better Regulation Task Force, *Economic regulators*, July 2001, p. 16.
[14] Ibid. at p. 18.
[15] Accordingly, this principle is only mentioned by the Best Practice Document and not by the other documents.
[16] OECD, *Regulatory reform in The Netherlands*, *Regulatory reform in the Electricity industry*, 1999, p. 35.

The first part is uncontroversial. In order to ensure that fair competition between market players is maintained, it is important that stakeholders cannot unduly influence the outcome of regulatory procedures. According to the Australian Utility Regulators Forum the principle of independence is a necessary element in providing stakeholders with confidence in the regulatory system and is linked to the principles of consistency and predictability.[17] EC directives on the liberalization of the utility sectors recognize the importance of the independence of the regulatory function from the market players.[18]

The second part is less well entrenched. Within OECD countries, independence usually does not mean complete autonomy from government policy.[19] It rather means that the agency is independent in implementing regulations and policies without intrusion from the executive, while it must still heed general government policy. Several arguments can be put forward in support of that position. First and foremost, the consistency of economic regulation, in particular as regards innovation and efficiency incentives for regulated firms, is endangered by undue political interference.[20] Economic regulation may not become an instrument of macro-economic policies, like inflation control. If investors are to make long-term commitments in networks and other capital-intensive industries, they need guarantees of a stable regulatory regime that is not subject to sudden changes.[21]

Another argument stems from the technical nature of the decisions that have to be taken by administrative agencies. These decisions are often based not on political choices, like decisions on how to distribute wealth, but on expertise[22]. In principle, it stems from the democratic principle that political choices are supposed to be made by the lawmakers, and the agencies only make economic decisions on how to give

[17]Utility Regulators Forum, *supra*, note 5, p. 7.

[18] According to Article 12 of Directive 97/67/CE (the Postal Directive) [1997] OJ L 15/14, each Member State shall designate one or more national regulatory authorities for the postal sector that are legally separate from and operationally independent of the postal operators. According to Article 3 of the Directive 2002/21/CE (the "Framework Directive" for electronic communications) [2002] OJ L 108/33, Member States shall guarantee the independence of national regulatory authorities by ensuring that they are legally distinct from and functionally independent of all organisations providing electronic communications networks, equipment or services. Member States that retain ownership or control of undertakings providing electronic communications networks and/or services shall ensure structural separation of the regulatory function from activities associated with ownership or control. According to Article 23 of Directive 2203/54/CE (the new "Electricity Directive") [2003] OJ L 176/37, Member States shall designate one or more competent bodies with the function of regulatory authorities. These authorities shall be wholly independent from the interests of the electricity industry (see also Article 25 of Directive 2003/55 (the new "Gas Directive") [2003] OJ L 176/57).

[19] OECD, *Telecommunications Regulations: Institutional structures and responsibilities*, DSTI/ICCP (99) 15/FINAL, p. 14.

[20] P. Vass, 'The principles of better regulation-separating roles and responsibility', in P. Vass (ed), *Regulated Industries - The Governance contract*, Centre for Regulated Industries, Bath, 2002, p. 29.

[21] D. Edmonds, 'Independent economic regulators-defining the role in practice', in Vass, ibid., p. 43.

[22] In principle, it is the Dutch government's policy not to give independent administrative agencies any powers to formulate legislative rules, with the exception of organisational or technical subjects or in special instances provided that the formulation of the rules is subject to Ministerial approval (Aanwijzing 124F of the Directives for drafting legislation, *Staatscourant* 1996 number 177), The UK Utilities Act 2000 is also based on the assumption that it is up to politics to establish the non-economic goals that should be respected by the independent regulators. The Utilities Act attributes to the Secretary of State the power to issue guidance on social and environmental powers to which the independent regulators should have regard. See T. Prosser, Memorandum to the House of Lord's Select Committee on Constitution, February 2003.

effect to these political choices. Although those decisions require some discretion, that discretion is restricted by the goals of the legal framework within which the agency operates.

The question then arises where to draw the line between the decisions which properly belong to the legislature or executive and those which should be entrusted to an independent authority. In our view, harking back to concepts such as "the primacy of politics" does not help very much, since it simply sends the discussion in a circle. Similarly, using traditional distinctions such as that between "policy making" and "policy implementation" does not bring one very far. In the matters covered by economic regulation, there are many decision layers, and the middle ones in particular do not neatly fit into one or the other category.[23] In the end, perhaps it could be useful to consider leaving squarely in the political realm only those decisions which lie at such a level of generality that they are unlikely to give rise to significant controversy among the stakeholders. As soon as such controversy is to be expected, it seems advisable to leave the matter in the hands of an independent agency, which if it operates well is less prone to allegations of partiality and arbitrariness.

In any event, independence from the executive must be at its widest when the State also holds a significant stake in one of the players on the market, as is very often the case in liberalized sectors. On this point, some EC directives do require Member States to ensure a measure of independence towards the executive (structural separation).[24]

Clear legislative mandate

This principle is strongly related to the principle of transparency and it is not always mentioned as a separate principle by the different documents. Nevertheless, we agree with Baldwin and Cave that this principle deserves separate attention.[25] Regulatory agencies fulfil an important role in carrying out the will of Parliament as it is expressed in legislation. It is accordingly of the utmost importance that the mandate of the agency be laid out clearly in legislation. Here clarity goes beyond mere semantic quality, which any good piece of legislation is expected to achieve. It entails a number of substantive elements as well, concerning what should figure in the legislation. The US Telecommunications Act of 1996[26] presents us with a worst-case scenario; commenting upon it, the US Supreme Court wrote:[27]

[23] For instance, in the case of interconnection, one finds – from the most general to the most specific – (i) the decision that interconnection is so important that it should under certain conditions be imposed in the absence of agreement between parties, (ii) the decision as to what these conditions are (SMP, etc.), (iii) the decision on the parameters of regulated interconnection (location, price, etc.), (iv) the decision as to which standards to use to determine the interconnection price and (v) the actual decision in an individual dispute. It is not obvious which ones of these are "policy making" or "policy implementation". Therefore, the distinction between policy making and policy implementation should be seen as a sliding scale. Eventually it is up to the legislator and the executive to decide where to draw the line.
[24] See Directive 2002/21, *supra*, note 18, Art. 3(2).
[25] Baldwin and Cave, *Understanding regulation, theory, strategy and practice*, Oxford University Press, 1999, p. 78.
[26] Pub. L. no. 104-104, 110 Stat. 56 (96).
[27] *AT&T Corp.* v. *Iowa Utilities Board*, 525 US 366 at 399 (1999).

> "It would be gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. That is most unfortunate for a piece of legislation that profoundly affects a crucial segment of the economy..."

There is a risk indeed that legislation becomes bogged down in minute detail, attempting to sort out complex situations in the abstract, and handing out a set of fairly specific tasks to the authorities in charge of carrying out the legislation.

In this respect the recent practice at the European level appears to provide better guidance. European legislation traditionally contains recitals (sometimes even too many of them) explaining the purpose of the legislation. The recent Framework Directive on electronic communications[28] goes further by including, at Article 8, a statement of the purposes and objectives which regulatory authorities must pursue in their activities. Indeed, in order to enable the agency to adopt its policy to changing economic and technological circumstances, it appears preferable to formulate the legislative mandate not so much as a static allocation of tasks, but rather as a set of objectives against which the agency should test the exercise of its powers. Furthermore, the Directive also contains provisions on the independence of the authority, coordination with competition authorities, transparency, appeals and consultations with interested parties, to name but the main ones.[29] This can be considered as a good example of how legislation can provide clear guidance to the authority mandated to implement it, without going into too much detail about the substance of the actual issues which the authority is expected to tackle.

Flexible powers

This principle might appear somewhat to contradict the previous one, but in truth it builds upon it. While it is desirable that the legislative framework give the agency clear guidance as to what it is supposed to do, at the same time the agency must not be put in a straightjacket by receiving only well-delineated and limited powers. The practice of Anglo-American jurisdictions on this point is enlightening. For instance, Ofcom, the new UK regulatory agency for communications, has been entrusted with the function "to do such things as [it] consider[s] appropriate for facilitating the implementation of, or for securing the modification of, any relevant proposals [from the Secretary of State] about the regulation of communications."[30] For that purpose, it received the power "to do such things as appear to [it] to be incidental or conducive to the carrying out of that function."[31]

Broad and flexible powers appear especially called for when they touch upon a dynamic sector, where it is likely that the situation will evolve more quickly than the Legislature can act, for instance in sectors where monopoly rights are removed and competition is introduced, or in technology sectors. In such cases, as

[28] *Supra*, note 18.
[29] Ibid., Art. 3, 4 and 6.
[30] Office of Communications Act 2002, art. 2(1).
[31] Ibid, art. 2(4).

evidenced by the new EC framework for electronic communications, legislation can be framed in clear terms, while avoiding to couch it in such a way that it is bound to the structure of the market at a certain point in time (the so-called "technological neutrality" principle). Whether this automatically means that "general" competition law concepts should be used for regulation remains an open issue; it can be argued that a legislative framework based on functional-economic concepts should stand the test of time as well.[32]

It might be feared that giving broad and flexible powers to a regulatory authority creates an accountability problem, with the risk that the authority would go off on a direction of its own, without means of control (political or judicial). Indeed such a risk would exist if the authority were given these powers without any further guidance. The combination of a clear mandate – including provisions on objectives, matters to be considered, procedural guarantees, etc. – with broad powers would seem to ward off against that concern. Moreover, as will be discussed hereafter, recent changes in European competition law, telecommunications law and energy law have made the national authorities applying national law or European competition law subject to various supervisory powers on the part of the European Commission, which enable the latter to ensure a consistent application of European law or national laws that are based on European directives.[33] In such a case, it will always be possible to argue that the authority failed to discharge its mandate appropriately. Such an approach may well lead to a pattern of "marginal" review (mostly judicial, but also political) where the authority will enjoy breathing space but will be sanctioned for grave mistakes in substance. In contrast, an authority with narrowly-defined powers is more likely to get embroiled in constant litigation over the limits of its powers, without regard to the substance of its actions.

Proportionality

The principle of proportionality entails that regulatory action is only taken when really necessary, that the measures chosen are appropriate to achieve their goals and that the measures chosen are proportionate to the objectives. The principle mainly protects the regulated firms, in a sense that the interference through regulation is kept to a minimum. Here as well, this general principle knows of a large number of variants, some of which encompass only part of it.

The OECD recommendation states that governments should correctly define the regulatory problems, that regulatory actions should represent the best form of government action and that the benefits of regulation should justify the costs. In the White Paper on European Governance the European Commission states that

[32] Indeed while the discussions leading up to the Directives making up the new EC framework for electronic communications pointed to a strong desire to align it with competition law, the practical implementation of that new framework (see the Commission Recommendation of 11 February 2003 on relevant product markets [2003] OJ L 114/45) appears to point in the direction of a specific functional-economic analysis while still paying lip-service to competition law. By way of a concrete example, it is possible to tackle a problem such as the tariffs for call termination on mobile networks either with competition law tools – by defining a relevant market, assessing market power and taking the appropriate measures – or with functional-economic concepts – where the legislation would identify bottlenecks (means of exerting exclusive control over access to the end-user) as a serious economic problem worthy of regulatory attention.

[33] See *infra*, note 45.

policies must be effective and timely, delivering what is needed on the basis of clear objectives, an evaluation of future impact and, where available, of past experience. Effectiveness also depends on implementing EU policies in a proportionate manner and on taking decisions at the most appropriate level.[34] The UK principles of good regulation state that regulation should be proportionate. This means that government should fully consider alternatives to state regulation, as they might be more effective and cheaper to apply. Moreover compliance should be affordable to those regulated – "regulators should think small first". In order to ensure proportionality, the motivation of new major rules should be based on an adequate cost-benefit analysis.[35] In addition to proportionality as such, the UK principles of good regulation also list "targeting" as a separate principle, but it remains strongly related to proportionality. The targeting principle implies that regulation should be aimed at the actual problem and avoid a scattergun approach. Moreover, whenever possible, regulation should use a goals-based approach, with enforcers and those being regulated given flexibility in deciding how best to achieve clear, unambiguous targets. Finally, the Australian Best Practice Document makes clear that all regulatory action should be effective and efficient. According to the report all regulatory proposals should include an assessment of cost-effectiveness and of possible alternatives. In order to achieve efficiency, the information requirements imposed on the regulated firms should be limited to what is required for carrying out the regulatory objectives. A balance must be found between the disclosure of information required for regulation and the confidentiality of commercial information. Moreover, decision-making processes should be well-defined and structured to eliminate unnecessary delays. They should also minimise waste and duplication and operate quickly and easily for all parties.

Although the documents use different terms, the idea behind them is the same: ensuring that all governmental action is proportionate to its goals. It follows that proportionality has both a substantive and a procedural element. Not only does it place a limit on the substance and scope of regulatory measures, it also forces executives and agencies to follow transparent and efficient procedures.

We prefer to refer to proportionality instead of more economic notions, like efficiency and cost-effectiveness. Proportionality leaves ample room to take account of efficiency arguments, when it is assessed whether the envisaged course of action requires the least amount of inputs and leads to the least cost. Beyond that, however, proportionality will also help the authority to choose the appropriate course of action when the legal mandate does not allow it to pursue economic objectives or when it must give precedence or at least due weight to non-economic as well as economic goals. Moreover, the principle of proportionality is well developed in the case law of the European Court of Justice, for the review of community and national measures. Therefore, it has become a legally binding benchmark.

[34] White Paper, *supra*, note 3, p. 10.
[35] Better Regulation Task Force, 2001, *supra*, note 13, p. 15 and 30.

Regulatory Impact Assessments (RIAs) are useful instruments that are applied by national governments, administrative agencies and the European Commission to assess the effects of regulatory measures.[36] On the basis of a RIA a regulator can structure the process of establishing whether there is a need to regulate a harm and what is the most proportional response to a certain harm.

The RIA should be released together with regulatory proposals, thereby enabling the regulated firms and other interested parties to engage the authority on that point in the course of the consultation procedure leading to the measure. The RIA practice of the governmental departments and agencies in the UK can be put forward as a good example.[37]

The RIA forces the authority to indicate ahead of time to all interested parties (i) the scientific basis of economic regulatory measures, which comprises a quantification of the costs of the harm, (ii) the reasons why the agency prefers a given regulatory alternative to another one (for instance, it would set out why the ex ante regulation of tariffs will be more cost effective to remedy the harm than the ex post application of general competition law), (iii) the compliance costs of the measures and (iv) the benefits to be expected from the measures. In short, by virtue of being forced to prepare a RIA, the regulatory authority will be able to comply with its duty to take proportionate regulatory measures.

The principle of proportionality is strongly related to the principles of flexible powers, consistency and predictability. When the agency is obliged to exercise its flexible powers in a proportionate way, its policies are likely to be consistent and predictable. Moreover, the operation of the principle of proportionality through an RIA process improves transparency and accountability, since it helps the agency to explain the rationale of its regulatory measures. Furthermore, proportionality enables the agency to value conflicting policy objectives and to reconcile those objectives through the selection of the most appropriate policy option.

Consistency

The Australian Utility Regulators Forum stresses the key importance of consistency of treatment, across the different utility sectors, and over time as a means of improving confidence in the regulatory regime. This principle is linked to the provision of consistent and fair rules that do not adversely affect the business performance of a specific participant. Within Europe and at national level, it may not always be difficult to honour this principle, given the increasing distinctions in regulatory treatment of those parties deemed to have 'significant market power' or not. Therefore, the legislature, the executive and administrative agencies generally should not make distinctions between different market parties but for compelling reasons. Key mechanisms for achieving consistency are the formulation of clear substantive rules and

[36] Action Plan on Simplifying and improving the regulatory environment, COM (2002) 278 Final.
[37] Cabinet Office, Regulatory Impact Unit, January 2003, *Good policy-making, A guide to regulatory impact assessment*, August 2003.

transparent procedures. Moreover, the administrative agencies need some flexibility to adapt economic regulation to the dynamics of the market in order to ensure that economic regulation remains consistent with the goals of the legal framework.[38]

Predictability

Predictability of regulation is an essential requirement for regulated companies to be able to plan with confidence for the future and to be assured that their investments, many of which require long time horizons, will not be generally threatened by unexpected changes in the regulatory environment. This is not just a matter of ensuring that tariff or pricing regulation is predictable: there should be predictability with respect to government policies on externalities which are likely to have an impact on utility pricing and investment, such as environment, technical, safety and related social policies. Key mechanisms for providing predictability in regulation include the establishment of decision-making criteria that are well defined, the provision of clear timetables for the review of standards and regulations and transparent decision-making procedures.

Accountability

The principle of accountability should be respected by all governmental actors. It protects the interests of the regulated firms, the citizens as well as those of the legislative (when the decision emanates from the executive or an agency) or the executive (when the decision emanates from an agency). Elements of this principle are included within all the different lists of good governance.

On the basis of the different documents it may be concluded that accountability consists of three processes, namely explanation, participation and control. In other words, regulatory authorities should be accountable to politicians through political control instruments, to the citizens by explaining and publishing policies, to the interested parties through public consultation procedures and to the judiciary through legal procedures. Hence the principle of accountability is strongly related to transparency.

Since the authorities entrusted with market regulation or competition oversight usually are to some extent independent from politics, there is some tension between the principles of accountability, on the one hand, and the principles of independent supervision and regulation of the market and flexibility, on the other hand. The Australian Utility Regulators Forum's Best Practice Document explains very well how accountability should be understood in the context of economic regulation, and how it can be reconciled with the other two principles. Since economic regulators and competition authorities must inevitably enjoy a measure of discretion in the decision-making process, it is important that their actions are controlled in order to ensure that they exercise their powers in a reasonable way and that their actions have the desired

[38] Vass, *supra*, note 20, p. 24.

effects. However, the principle of independence does not allow the executive and the legislature to control the actions of agencies to the fullest extent, in the sense that they would be able to block decision-making. The fact that politics cannot exert full control over decision-making by agencies does not mean that the agencies are no longer accountable to politicians. The executive and the legislature retain the power to examine the performance of the regulatory framework and of the agency against specific objectives, for instance through a periodical review mechanism. On that occasion, the agency would have to explain globally the rationale of their actions and how they fit within the regulatory framework. Should the review find shortcomings, the executive and/or the legislature can then examine which measures should be taken to improve the performance of the regime.[39]

Although the interests of market parties should not unduly influence decision-making, the agency should be able to explain its decisions to the regulated firms and other interested parties. The agency can only do so, however, if all the interested parties have had the opportunity to state their views on the proposed measures. Public participation through public consultation procedures is an important instrument for achieving accountability for the formulation of the regulator's policies and regulations.

Regulators have made considerable efforts to consult widely on their policies and proposals. Finally, judicial review of administrative action is an indispensable element of accountability. The courts can eventually control whether the agency has given all interested parties an opportunity to state their views and whether it acted reasonably within the boundaries of the law.

Respect of general principles of competition policy

Since it is very likely that the actions of agencies that regulate markets will affect competition (as well indeed as the regulatory laws themselves), there is a chance that the substance of regulatory measures could conflict with the general competition law regime. Moreover, if more than one authority has the power to take action against certain private behaviour, it is possible that there is a duplication of procedures and that the authorities are played off against each other. Therefore, it is very important that the sector-specific regulators are obliged to respect general competition law and that they consult competition authorities before taking actions. In this way it might be ensured that general competition law principles are respected in all sectors and that the duplication of procedures and forum shopping are prevented.

The principle of the respect of general competition law is not mentioned as a specific principle in the relevant documents. However, it may be assumed that the principle of proportionality and the principle of consistency and predictability require the legislature, the government and the agencies to take into account

[39] It should be noted that the UK House of Lords recently started an inquiry into the accountability of Government-appointed regulators, which among others deals with the question of how effective the role of Parliament and the public in controlling regulators actually is and how it can be improved. See for more information: www.parliament.uk/parliamentary_committees/lords_constitution_comm/constcfe.cf

how regulatory measures will affect competition. It should be noted here, that the UK Cabinet Office's RIA obliges regulators to make a competition assessment of every proposed measure. Moreover, both OECD and EU reports have pointed out that it is very important that in general regulatory measures are consistent with general competition law and policy.[40] In a 1999 OECD report on regulatory reform in The Netherlands, the OECD makes clear the principles and analysis of competition policy provide a benchmark for assessing the quality of economic and social regulations.[41] Consequently the OECD has recommended that the Dutch government systematically revises the competitive implications of all existing legislation and corrects and identifies all laws that conflict with competition law and that unnecessarily impair competition.

Since competition law issues play such a pivotal role in assessing the framework for the regulation of markets, it makes sense to state the principle of respect of general competition law as a separate principle.

Integration within the European framework

It is trite to say that legislative and regulatory activities at Member State level must comply with EC law. Yet the implications of that proposition are becoming ever larger, bringing it from a prudent obligation to "respect" EC law into a more extensive duty positively to act as part of an integrated European whole.

As a starting point, the EC Treaty as such – especially its provisions concerning the internal market and competition policy – imposes basic constraints on what Member States can do. Moreover, in most areas affected by regulation, the EC has adopted more or less wide-ranging harmonization measures, usually in the form of directives, which the Member States are then under a duty to implement in their national law.

Beyond that, the national authorities in charge of carrying out regulatory schemes are themselves under a duty to avoid conflicts with EC law (if only because of Article 10 EC). [42] This duty has been developed further in more recent enactments: as discussed above, national regulatory authorities must for instance ensure that their actions also comply with EC competition law.[43]

The changes brought to EC competition and telecommunications law in 2002, and to energy law in 2003, bring the matter one step further. In all these cases, the national authorities are meant to play the leading

[40]OECD, *Relationship between regulators and competition authorities*, DAFFE/CLP (99)8.
[41] OECD, *Regulatory reform in The Netherlands, The role of competition policy in regulatory reform*, 1999.
[42] ECJ, Case C-67/97, *Albany* [1999] ECR I-5751.
[43] In the telecommunications sector, the new regulatory scheme introduced with Directive 2002/21, *supra*, note 18, and the other electronic communications directives is premised on an alignment between competition law and regulation. In its Notice on the application of the competition rules to access agreements in the telecommunications sector [1998] OJ C 265/2, the Commission makes it very clear that the national authorities are expected to act so as to comply with EC competition law, and that the Commission might intervene if that were not the case. The same follows implicitly from rec. 41 and Art. 22 of the Postal Directive, *supra*, note 18; see also the Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services [1998] OJ C 39/2.

role in the application of Community law. In order to preserve or ensure consistency, however, the authorities are subject to various supervisory powers on the part of the Commission.[44] What is more, the national authorities are meant to work together in a network,[45] which implies that they must not only look up to the Commission, but also look sideways to their counterparts in other Member States. Ultimately, the national authorities become part of a community of authorities at EC level, and must act accordingly.

PART II: CASE STUDIES ON THE PRINCIPLES OF GOOD MARKET GOVERNANCE

In this section we discuss several case studies concerning core aspects of economic regulation, namely the regulation of network access and cost accounting. Due to an unclear legal mandate, and at the same time inflexible powers, all these cases illustrate that the economic regulators have faced difficulties in carrying out their tasks. The regulators have tried to seek ways to extend their powers (sometimes against the law) and adapt them to the realities of the market. Moreover, they have improved the transparency of the decision-making process by organizing public consultation rounds. However, the courts proved reluctant to approve the regulators' approach, resulting in annulments of the relevant decisions.

For instance, it follows from a recent provisional survey that between 1997 and 2002, OPTA lost about 40% of the challenges to its decisions, before the Rotterdam District Court, on formal grounds. In many of these cases, the Court ruled that OPTA had no power to take the disputed decision under the Telecommunications Act 1998.[46] Although OPTA subsequently won one major case on a further appeal to the Court of Appeal for Trade and Industry,[47] the latter recently confirmed some important judgments of the Rotterdam District Court.[48] Consequently, the goals of the legal framework have not been fully realized or only with much delay.[49]

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[44] In competition law, the Commission is kept informed of the activities of national competition authorities and retains the power to relieve them of their competence, Regulation 1/2003, OJ 2003 L 1/1, Art. 11. As for electronic communications, the fairly complex system put in place by the Framework Directive, *supra*, note 18, at Art. 7, 14 and 15, enables the Commission to monitor the activities of national regulatory authorities and prevent them from adopting decisions if necessary. According to article 23, paragraph 12, of the new Electricity Directive, *supra*, note 18, the national regulatory authorities shall contribute to the development of the internal market and of a level playing field by cooperation with each other and with the Commission in a transparent manner. By virtue of Article 7 of Regulation 1228/2003, OJ 2003 L 176/1, the Commission will have the power to supervise the national authorities' decisions on new interconnectors and if necessary prevent them from adopting these decisions.

[45] The network for electronic communications has now been formally established: see Decision 2002/627 establishing the European Regulators Group for Electronic Communications Networks and Services [2002] OJ L 200/38. As for competition law, the setup of such a network is provided for in Regulation 1/2003, *supra*, note 45, rec. 15. The European Competition Network began its work in 2002, but its modalities are still being discussed at the moment. The same is true for the network that will established pursuant to the New Electricity Directive, *supra*, note 18, rec. 16, and the new Gas directive, *supra*, note 18, rec. 14.

[46] Provisional memorandum by E.J. Dommering, N.A.N.M. van Eijk and A.T. Ottow, IVIR, Amsterdam, 2003.

[47] CBB, 25 April 2001, *KPN* v. *OPTA*, *Mediaforum*, 2001, p. 212- 220, commented by A.T. Ottow.

[48] See the judgement cited at footnote 71 and CBB, 28 May 2003, AWB 02/711, uitspraak op het hoger beroep van OPTA tegen de uitspraak van de Rechtbank Rotterdam van 14 maart 2002 in de gedingen tussen Versatel en KPN (concerning the level of discounts KPN is allowed to give to its end-user).

[49] It should be noted that the Court of Appeals for Trade and Industry (CBB) is competent to review in last instance the judgements of the Rotterdam District Court by virtue of the Telecommunications Act 1998, whereas the Court of Appeals for Trade and Industry is the court of first and last instance to review DTe's decisions by virtue of the Electricity Act 1998.

Electricity: Price cap regulation

Introduction

This case study will illustrate how disrespect for certain principles of good market governance by the legislature and the Energy Authority (DTe) has cast doubts on the legitimacy of the regulatory framework on the electricity sector and the legitimacy of the actions of the DTe. The DTe has the power to regulate and to supervise the access to and the operation of the transmission and distribution grids by virtue of the Electricity Act 1998.[50] The DTe is not an independent regulator; it is a chamber of the Netherlands Competition Authority (NMa), which currently is a supervisory department of the Ministry of Economic Affairs. The Minister has the power to give the DTe directions concerning general and specific matters. Since the Dutch State is also the sole shareholder of the Transmission System Operator (TenneT), the Minister's powers contravene the principle of independent supervision. Moreover, the Ministry of Economic Affairs continues to play an important role in the regulation of the electricity sector. The Minister is responsible for price regulation for protected customers, for the appointment of the independent network operators and the approval of the privatisation of the energy companies. The DTe advises the Minister on all these issues, a role which has become increasingly important. For instance, the Minister requested DTe advice on the security of supply in the electricity sector, the quality of network services and on the future of the structure of the gas sector. The DTe even has the power to regulate supply to the protected customers, in the name of the Minister. Since the DTe has become the minister's most important advisor, there is no clear separation of roles between the Minister and the DTe, threatening an effective system of accountability.

Due to several amendments, the text of the Electricity Act 1998 has become too complex. Moreover, the legal mandate of the DTe is ill-defined, so that the scope and objectives of its powers are unclear. Although the DTe decision-making process has been transparent, the process itself takes too long. Before establishing the appropriate method of economic regulation, the DTe consults the sector extensively through public hearings, workshops and even visits to the firms concerned. In the light thereof, the process of internal administrative review, which interested parties must first go through before they can request review by an independent court, does not bring much added value. Due to a combination of this inefficient decision-making process, an unclear legal mandate and the annulment of the DTe's decisions on formal grounds, a central issue such as the level of the maximum transmission and distribution tariffs in the period 2001-2003 remained in limbo for about two and a half years.[51] Consequently, the legal framework is not predictable, which has negative effects for the level of investment in infrastructure.

[50] *Staatsblad* 1998, nr. 427, as amended by *Staatsblad* 1999, nr. 260, as amended by *Staatsblad* 2000, nr. 305 and as amended by *Staatsblad* 2000 nr. 607.

[51] After the Court of Appeals had annulled DTe's decisions, the DTe started a new consultation round on the establishment of the x-factor. Finally, the DTe and the network operators agreed on how the x-factor should be established between 2001-2006 at the end of the first phase of regulation (2001-2003). The sector and the DTe laid down their commitments in a written agreement that has been signed by all parties.

The power to set the X-factor

The DTe has the power to approve the tariffs that the network operators may charge for the transmission and the distribution of electricity. By virtue of section 41 of the Electricity Act, the DTe director shall determine the tariffs, which may differ for each of the various grid managers. In setting tariffs, the DTe must strive to use market forces to promote efficient operations and cost reductions to the advantage of customers. In doing so, a price-cap formula is to be used, whereby the maximum tariff for a given year is based on the tariff of the preceding year, corrected with the change in the consumer price index (cpi) and with a discount to promote efficiency (the "x-factor"). Section 41 further empowers the DTe to determine the x-factor for a period of at least three and at most five years.

The Electricity Act 1998 does not provide any guidelines on the purposes of the x-factor and how the DTe should establish it. The Minister of Economic Affairs, however, stated during the parliamentary debate on the Electricity Act that the DTe should establish the x-factor on the basis of a benchmark exercise. The Minister made clear that its up to DTe, together with the interested market parties, to establish the performance indicators against which the companies will be benchmarked. The performance level of the most efficient companies would then be a guideline for all network companies. Cost differentials due to historic, inefficient decisions had to be erased as soon as possible, whilst differentials due to objective regional circumstances could continue to exist. According to the Minister, the ultimate goal of the price cap formula was to establish a uniform x-factor, provided that differentiation is allowed between the factor applicable to regional network managers, on the one hand, and to the transmission system operator, on the other hand. An advantage of this regulatory approach is that regulatory intervention is limited to setting in advance goals to be achieved. Regulated firms can then decide themselves how they realize those goals. The regulator intervenes in internal firm processes as little as possible.

However, regulation of network managers through a uniform x-factor (yardstick competition) will only produce fair and efficient results if the network managers are at the same level of efficiency. During the first period of regulation this is usually not the case. If the regulator introduces a system of yardstick competition at a stage when the different firms are at an unequal level of efficiency, the reward goes to inefficient firms for which it is much easier to beat the average efficiency improvement. On the other hand, more efficient firms are punished since they have less room for cost savings. Inefficient companies can thus generate profits at the expense of the efficient companies. Consequently, to make a light-handed system of yardstick competition work, it is necessary to impose heavier regulation during a transitional period prior to yardstick competition. During this transitional period, the performance levels of network managers are made to converge by means of individualized x-factors for each network manager. The establishment of separate x-factors requires an assessment of the relative performance of each firm, meaning that the regulator will have to impose detailed information requirements on market parties. Only with such detailed

information can the regulator establish the best-practice level and accordingly compute separate efficiency discounts that will bring about a convergence in the performance of all operators.

The text of the Electricity Act 1998 was not clear on the power of the DTe to set out differentiated x-factors in a transitional period. During parliamentary debates, however, the Minister had indicated that differentiated x-factors would be allowed for a short period. On that basis, the DTe considered that section 41 gave it the power to set differential x-factors for the first period of regulation (2001-2003).

In the meanwhile, the competent court for judicial review, the Court of Appeal for Trade and Industry (CBB), had concluded, in a ruling concerning another matter (price cap regulation of tariffs for protected customers), that the Electricity Act did not provide a sufficient basis for the DTe to adopt differential x-factors.[52] Following this ruling, the Minister of Economic Affairs filed a bill amending the Electricity Act 1998, so as to clarify the power of the DTe to adopt differential efficiency discounts for the regulation of the networks and the supply to the protected customers.

Finally, the CBB annulled DTe's actual decisions on the network tariffs in its ruling of 13 November 2002.[53] According to the Court, the text of the Electricity Act was clear in that it did not explicitly allow for differentiated x-factors. It should be noted that the Court based its reasoning merely on the fact that the text of the Electricity Act expressly mentioned that the regulated tariffs resulting from the price-cap formula could differ from one grid manager to the other, whereas it did not expressly mention that the x-factor forming part of that formula could also itself differ. Although the Court thought that the legislative history provided some indication that a system of differentiated x-factors would be permissible, the ministerial statements made during parliamentary debate were not unquivocal, according to the Court. It was therefore of the opinion that the DTe could not justify regulatory measures that interfered more deeply with the internal workings of regulated firms than would follow from a literal reading of the Electricity Act. Only an amendment to the Act could allow for differentiated x-factors. Although such an amending bill had been tabled during the court proceedings, the Court did not take it into consideration, as it had not entered into force yet.

It seems that the Court followed quite a formal approach in reviewing DTe's decisions. After having examined the history of the Act and its literal text, one could just as well have argued that DTe's interpretation was justified. Nevertheless, one can understand why the Court concluded as it did. The legislature provided little guidance to the DTe on the goals and methods of the price-cap formula. Since it was not clear against which legal norms and goals DTe's decisions had to be tested, the Court felt justified in taking an approach that would safeguard the rights of regulated firms as much as possible.

[52] CBB, 6 February 2002, AWB 01/623, *Rendo* v. *DTe*.
[53] CBB, 13 November 2002, AWB 01/841, 01/847 t/m 853, 01/955, 01/956, *Netbeheerders* v. *DTe*.

Communications: The regulation of the mta tariffs and the regulation of access to the cable

Introduction

The Telecommunications Act 1998 entered into force in 1998.[54] The goals of the Act are: introducing competition in the telecommunications sector, maintaining an adequate level of universal service and guaranteeing an open telecommunications infrastructure of high quality. The independent telecommunications regulator (OPTA) has the mandate to supervise how telecommunications operators comply with the Act. In addition, it may take regulatory measures to implement the Act. It was the intention of the legislature to frame OPTA's powers as narrowly as possible, so that OPTA would be given neither the power to issue rules of a legislative nature nor broad discretionary powers. The regulatory framework was based on the assumption that the Ministry of Public Transport, Public Works and Water Management would be responsible for the formulation of telecommunications policy, whereas OPTA would take care of implementation. In practice, the underlying assumption, namely that policy formulation can be strictly separated from implementation, proved unworkable. Firstly, OPTA must work with difficult technical and economic concepts, like Significant Market Power (SMP). It cannot use such concepts without an adequate margin of appreciation of the relevant facts. Secondly, telecommunications is a very dynamic sector, in which economic and technological conditions can change quickly, thus requiring flexibility in the regulatory framework.

As a consequence of a strict legal mandate and restricted powers, OPTA has not been able to respond adequately to developments in the market.[55] Consequently, the growth of competition in the Dutch telecommunications sector has been hampered at least in part because of the regulatory framework. The following cases, concerning mobile termination tariffs and access to the cable, show how the lack of a clear legal mandate and the reluctance to grant discretionary powers emasculated OPTA's role. In response, OPTA started searching for ways to extend its powers – often in conflict with the law – leading to inconsistency and unpredictability. Like in the electricity sector the competent court for judicial review, here the Rotterdam District Court, annulled OPTA's decisions on formal grounds, without any thorough review on the merits. Furthermore, because of the overlap between general competition law and the sector-specific regime of the Telecommunications Act, it is a pity that the Court did not consider how OPTA can take into account competition law principles in its decisions. Two recent rulings of the Court even seem to point towards a refusal to allow OPTA to take into account competition law principles in the exercise of its power to settle disputes. These rulings conflict with an earlier ruling of the same Court, where it stated that OPTA should take competition law into consideration when exercising its powers.[56] The more recent rulings pose a threat to the principle of respect for general competition law.

[54] *Staatsblad* 1998, nr. 610, as amended by *Staatsblad* 2001, nr. 431 and as amended by *Staatsblad* 2001, nr. 55.
[55] A.T. Ottow, 'Over toezicht en rechtsbescherming: de omissies in de Telecommunicatiewet', *Mediaforum* 2002, p. 108-113.
[56] Rechtbank Rotterdam, 16 February 2001, V TELEC 00/2530-SIMO, *MCI Worldcom* v. *KPN Telecom*.

The power to regulate the MTA tariffs

Although the retail market for mobile telecommunications services is competitive, at wholesale level the situation is different when it comes to mobile termination. In brief, under the current technological setup, each number "belongs" to an operator, so that the customer at that number can only be reached via the network of the operator to which this customer is subscribing. Each operator is accordingly placed in a strong position, given that calls made to its subscribers, from wherever they may originate, must be terminated over its network, at the tariff set by the operator in question. The Telecommunications Act 1998 did not provide any basis to designate mobile operators as operators with Significant Market Power (SMP operators) on a hypothetical market for mobile termination.[57] In the absence of *ex ante* instruments, OPTA could only intervene against high mobile terminating access (MTA) tariffs on an *ex post* basis, at the request of market players seeking a settlement of interconnection disputes. Indeed if network operators do not comply with their duty to conclude and perform interconnection agreements with other operators, OPTA may pursuant to section 6.3 of the Telecommunications Act determine the contents of those agreements. In so doing, OPTA must seek to formulate reasonable tariffs and conditions, within the meaning of general Dutch civil law.

After a public consultation, OPTA published policy rules that required mobile operators to make their MTA tariffs cost-oriented by July 2003.[58] OPTA planned to assess costs according to a "forward-looking long-run incremental cost" (FL-LRIC) standard, which would merely allow the mobile operators to recover the costs that would have been made by an efficient operator under competitive conditions. In the meantime, between 1 December 2002 and 1 July 2003, the operators had to decrease the level of their tariffs in two steps to the maximum level established by OPTA by benchmarking the best-performing mobile operators in other EU countries.

OPTA ruled in a number of disputes on the basis of its policy rules, resulting in numerous appeals. Since none of the mobile operators could be designated as SMP operators by virtue of the Telecommunications Act, the operators argued that OPTA did not have the power to base what in fact was an *ex ante* regulation of MTA tariffs on section 6.3. of the Telecommunications Act. Furthermore, it was argued that the costs of OPTA's measures were disproportionate to the expected benefits.

Not only the mobile operators, but also the NMa seemed to disagree with OPTA's approach. Since according to the NMa the mobile operators have a dominant position concerning MTA within the meaning of Section 24 of the Competition Act (prohibition of abuses of a dominant position), both the NMa and OPTA were empowered to take action. Pursuant to a co-operation agreement between OPTA and the NMa,

[57] The Telecommunications Act 1998 implements the old ONP directives. According to these directives operators could only be designed as SMP operators in case they had a market share of at least 25% on a market that was defined in the law. Since, the market of mobile termination was not defined as a relevant market within the ONP directives, the mobile operators could not be designated as SMP operators.
[58] *Staatscourant* 2002, nr. 65, p. 22, as amended by *Staatscourant* 2002, nr. 142, p. 21.

both authorities decided that OPTA would handle the case.[59] To ensure that OPTA would apply competition law in line with the practice of the NMa, the latter had the opportunity to state its views on the policy rules proposed by OPTA for the regulation of MTA tariffs. Although the NMa agreed with OPTA's relevant market definition, namely a separate market for mobile termination, the NMa did not seem to agree with how OPTA proposed to implement cost-orientation. In its non-binding advice of March 2002, the NMa stated that in principle, it would also examine the prices of monopolistic firms according to a cost-orientation principle, yet unlike OPTA, it would allow those firms to recover all their historic costs (as opposed to the FL-LRIC standard advocated by OPTA). Apparently, the NMa thought that OPTA's approach would interfere too much with the internal processes of the regulated firms, since this would require an estimation of the efficient costs of the network operators. Moreover, there would be a risk that the operators could not recover all their costs.

In a provisional ruling, the Rotterdam District Court suspended parts of OPTA's decision.[60] The Court recognized that OPTA may formulate and publish in advance general principles that will be taken into account in deciding individual disputes, in order to ensure a consistent policy. Nevertheless, in these cases, OPTA omitted to take into consideration the specific circumstances of each dispute. According to the Court, Section 6.3. does not provide a solid basis for the establishment of maximum tariffs, based on a relevant market definition and a simulation of competitive outcomes, independently of the specific position of the individual parties. Furthermore, the Court considered that, irrespective of whether the general power to take action against market problems might not preferrably rest with the NMa, Section 6.3. did not endow OPTA with such power. In the view of the Court, the legislature could not have intended to exclude the commercial freedom of the parties in the absence of a request for the settlement of a dispute. Without paying any attention to how the principles of general competition law affect OPTA's powers, the Court found it doubtful that OPTA could eventually implement the cost-orientation for MTA tariffs in a legitimate way. The main reason put forward by the Court for that conclusion was under the system of the Telecommunications Act 1998, mobile operators could not be designated as SMP operators.

In a recent final ruling concerning the dispute between O2 and KPN Mobile, the Court was able to avoid ruling on the legality of the policy rules.[61] It took a very formal stance, stating that in any event OPTA did not have the power to decide the dispute between O2 and KPN Mobile, since the networks of the two parties were not directly interconnected, but rather indirectly through KPN's fixed network. Indeed, in accordance with the Telecommunications Act, OPTA had granted mobile operators an exemption from the legal obligation to connect their networks directly. However, OPTA had granted that exemption in the wake of another ruling from the Rotterdam Court to the effect that OPTA had to grant an exemption as a pre-condition for it to have jurisdiction over disputes concerning indirect interconnection.[62] It is ironic that

[59] *Staatscourant* 2000, nr. 249, p. 75.
[60] Voorzieningenrechter, Rechtbank Rotterdam, 29 November 2002, V TELEC 02/2675 RIP, *Dutchtone* v. *OPTA*.
[61] Rechtbank Rotterdam, 25 April 2003, TELEC 02/2156 GERR, *O2* v. *OPTA*.
[62] Voorzieningen rechter, Rechtbank Rotterdam, 1 May 2002, V TELEC 02/900 RIP, *Telfort* v. *OPTA*.

the same court decided one year later that, because of that exemption, OPTA was no longer empowered to settle the dispute between the parties.

According to the scheme of the Telecommunications Act, OPTA's dispute settlement powers aim to guarantee interoperability. Seen against that background, the Court's approach seems rather narrow. Indeed, OPTA should also have the power to settle disputes as regards indirect interconnection, since this type of dispute might threaten interoperability as well. Nevertheless, due to the lack of clarity in OPTA's legal mandate and the express legislative intent to formulate OPTA's powers as narrowly as possible, one can understand why the Court chose to interpret OPTA's powers as narrowly as possible in order to safeguard the rights of regulated firms.

Access to the cable

By virtue of Section 8.7 of the Telecommunications Act, OPTA has the power to settle disputes between a broadcasting network operator and a programme provider at the request of the parties concerned. Section 8.7 was included within the Telecommunications Act 1998 as a consequence of an amendment in the course of the parliamentary process. Here as well, neither the Act nor its history provides any guidance to OPTA as to which principles it should take into account in deciding the disputes.

Since the operators of broadcasting networks may have a regional dominant position within section 24 of the Competition Act (prohibition of the abuse of a dominant position), the NMa and OPTA have concurrent powers to act against network operators. By virtue of the informal co-operation agreement between the OPTA and the NMa, the authorities have agreed that OPTA will take the lead in remedying any restrictive practices on part of network operators. In order to ensure that OPTA will apply general competition law concepts in harmony with the NMa practice, the NMa and OPTA published common guidelines on the assessment of the conditions for the access to broadcast networks in 1999.[63] These guidelines were adopted after OPTA had held a public consultation on this matter.

In the view of OPTA and the NMa, it follows from competition law that the operators of broadcast networks should respect the principle of cost-orientation. The guidelines state that the operators' prices should be based on the fully-allocated costs of service provision, including write-offs and a reasonable return on investment. Operators should allocate common costs by virtue of an estimate of the effective capacity use. Unlike the MTA tariff case, the assumption here was that the network operators could recover all historic costs, even if inefficient.

As with the publication of the MTA tariff guidelines, it was not clear to what extent OPTA and the NMa could actually force the operators to abide by cost-orientation *ex ante*. Although it is true that the NMa uses cost-orientation as a guideline in *assessing* whether the prices of dominant firms are abusive, it is heavily

[63] OPTA en NMa, Richtsnoeren inzake toegang tot de omroepnetwerken, *Staatscourant* 1999, nr. 159, p. 6.

debated whether the NMa can *impose* cost-oriented pricing as a remedy. The European Commission has followed a very reserved approach when it comes to excessive pricing under EC competition law. So far, prices were found abusive only if they were excessive in comparison to the underlying costs or to tariff levels in comparable markets.[64] The Commission's prudent approach can be explained in that competition authorities are usually empowered to control excessive pricing *ex post* only, in response to an alleged abuse of a dominant position. Competition law itself does not grant the general competition authority the power to set the actual price level or to formulate any *ex ante* rules on cost accounting. Since there are no well-established economic standards for the allocation of common costs in multi-service sectors, it may well be argued that competition authorities should try to respect as much as possible the commercial freedom of the dominant firm to allocate its common costs. Consequently, the competition authority could only take enforcement action against excessively high prices, where the dominant firm cannot prove that the prices are reasonably related to the incremental and common costs.[65] In the light of the preceding remarks, it seems that the NMa itself would have gone beyond the normal scope of competition law by using it to prescribe *ex ante* how cable operators should account for their costs.[66] Moreover, whatever legal standards the NMa applies to assess the prices of a dominant firm, it should be noted that OPTA itself is not empowered to apply general competition law as such. From EC law and the Telecommunications Act 1998 it merely follows that OPTA is prevented from approving tariffs that might lead to an abuse of dominant position within the meaning of general competition law.

Finally, in 2003 the Rotterdam District Court annulled a decision of OPTA that was based on the guidelines.[67] In the opinion of the Court, the guidelines conflicted with the system of the Telecommunications Act 1998, because under that Act only SMP operators could be required to follow cost-orientation in their pricing. Since the regulatory framework did not provide that broadcast networks operators could be designated as SMP operators, these operators could not be forced to apply cost-oriented pricing *ex ante*. Moreover, the Court also considered that the purpose of the Telecommunications Act was to promote competition, and not to interfere with the commercial freedom of private parties to determine their own prices, so that there should be an explicit legal basis to warrant the imposition of cost-orientation, which remains the exception and not the rule. The Court considered that the fact that the network operator had a dominant position within the meaning of Section 24 of the Competition Act did not have any influence on the legal norms that OPTA could apply within the context of Section 8.7 of the Telecommunications Act 1998.

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[64] E.H. Pijnacker Hordijk en Y. de Vries, 'Onbillijk hoge prijzen als vorm van misbruik van een economische machtspositie onder het Europese en het Nederlandse mededingingsrecht', *SEW* 2002, p. 433 t/m 434.

[65] See also Larouche, who argues that the tariffs of a dominant operator can only be deemed excessive in case the tariffs exceed the stand alone costs of providing the service; the costs the company would make if it would be in the situation that it offers only one product on the basis of the network with no opportunity to allocate the common costs to more services, P. Larouche, *Competition Law and Regulation in European Telecommunications*, Oxford: Hart Publishing, 2000, p. 255.

[66] See also Pijnacker Hordijk en Y de Vries, 2002, who argue that the NMa in general exceeds the boundaries of its powers by establishing a normative return on investments on the basis of the Weighted Average Cost of Capital that may not be exceeded by the dominant companies.

[67] Rechtbank Rotterdam, 26 February 2003, TELEC 99/2658 RIP, *Kabeltelevisie Amsterdam* v. *OPTA*.

The Court's view is rather narrow, since in the end it amounts to denying OPTA the right to respect the principles of general competition law, even on an *ex post* basis. The Court rightly holds that OPTA should interfere as little as possible with the commercial freedom of private firms and that OPTA cannot impose cost-orientation *ex ante* without a sufficient legal basis. Nevertheless, leaving aside the fact that the NMa might have formulated the wrong legal standard for the assessment of the tariffs of cable operators, the Court should have noted that OPTA, when exercising its dispute settlement powers, is under a duty to respect general competition law principles by virtue of national and EC law.

Postal sector: Cost accounting principles

As an example of regulation not working out as effectively as would have been expected, to the detriment of both the regulator and the regulated firm, we can point to the attempt by OPTA to regulate the cost-allocation methods of the Dutch postal incumbent, TPG.

In accordance with the Post Act 1999, which entered into force on 1 June 2000,[68] and the so-called BARP (Besluit Algemene Richtlijn Post) of 23 May 2000,[69] TPG as the holder of the concession is bound to prepare "unbundled" accounts where costs and revenues are allocated to specific activities (including so-called "reserved" and "non-reserved" activities), in accordance with the requirements of the Directive 97/67/EC (the "Postal Directive").[70] The purpose of such transparent cost allocation is ultimately to prevent illegal or unfair cross-subsidisation to the detriment of competitors. In late December 2000, OPTA approved the cost-allocation methodology proposed by TPG for the year 2001, but at the same time imposed a number of conditions. These included requirements that:

(i) OPTA could conduct 'sample' investigations;

(ii) OPTA could require a peer review from an independent accountant;

(iii) TPG should report annually on the profits from reserved services; and

(iv) TPG should within 2 months amend its cost-allocation method in several far-reaching ways.

TPG subsequently sought an administrative review of OPTA's decision, with the result that a second amended decision was adopted on 6 February 2001. TPG appealed this decision before the competent administrative court, the Rotterdam District Court.

It is notable that the Court did not hesitate to criticise the lack of precision in the terminology used in the Post Act, which did not clearly require a separate allocation of revenue (as opposed to costs). It then focussed on the powers attributed to OPTA under the BARP. Again the exact scope of the powers attributed to OPTA were not clearly specified in this instrument, resulting in a dispute as to whether OPTA had any powers at all to impose conditions on TPG. Although it was clear from the wording of the Postal Services Directive and indeed the Post Act too that the Minister could have empowered OPTA to impose

[68] *Staatsblad* 2000, nr. 484.
[69] *Staatscoura*nt 2000, nr. 101.
[70] Rec 28 and 14, *supra*, note 18.

guidelines and conditions, the Court ruled that the Minister had chosen not to attribute to OPTA the extensive regulatory powers to impose the various conditions on TPG which it had tried to impose. As a result the Court annulled some but not all of the various conditions in question. It appears from the judgment that the Court also had some difficulties in interpreting the legislation in question, and chose for something of a compromise solution by allowing certain conditions to remain intact while declaring others illegal. Aware that this in and of itself would create an unsatisfactory situation, the Court annulled the entire OPTA decision and ordered OPTA to adopt a completely new decision, while at the same time ruling that this would not prevent TPG from already appealing against those parts of the Court's ruling where certain conditions in the OPTA decision were upheld. An appeal against the District Court's ruling was subsequently lodged before the CBB by both OPTA and TPG. In the meantime, OPTA adopted a new decision based on the District Court ruling. TPG complied with this decision provisionally, until the CBB had definitely ruled on the legality of OPTA's original decision. Recently the CBB confirmed almost all parts of the District Court's judgment, save that it declared illegal the remaining parts of OPTA's decision that the District Court had not declared illegal.[71]

This episode is illustrative of the types of issues and problems which can arise when basic principles of good regulatory practice are not followed. OPTA's exact role in the regulation of the postal sector was never completely clear, leading to confusion in the past, especially in the area of cross-subsidization. It shares a certain remit with the NMa in this matter, but the exact demarcation between the powers and tasks of the respective institutions is not immediately apparent. Moreover, the general regulatory framework as set down in the law is often vague and certainly does not meet the basic criteria of precision, clarity and consistency.

Assessment in the light of the principles of good market governance

The case studies show that the Dutch regulation of network industries in general does not live up to the principles of clear legal mandate and flexible powers. Consequently, it comes up short as regards other principles as well, such as predictability and respect for competition law. It should be noted, however, that the regulators have followed a good regulatory practice of transparency and communication through extensive public consultation. These processes have improved the accountability of the regulators as regards both interested parties and regulated parties. Nevertheless, there is still insufficient practice as to thorough discussion of regulatory alternatives, meaning that it is not readily ascertainable whether regulatory measures comply with the principle of proportionality. Due to the inadequacies of the legal framework, courts have annulled many decisions of the regulators on formal grounds. Up until now the courts have not been able to give any substantial guidance on the legal principles that should be respected by the regulators.

[71] CBB, 18 July 2003, AWB 02/712 and 02/713 S2, uitspraken op de hogere beroepen van de OPTA en TPG tegen de uitspraak van de Rechtbank Rotterdam van 20 maart 2002, 01/2525 SIMO.

The case studies lead to the following scheme:

Principles	**Price-cap regulation in electricity sector**	**MTA tariffs**	**Access to the cable**	**Cost accounting in the postal sector**
Transparency	+	+	+	+
Independent supervision of the market	-	+	+	+
Clear legislative mandate	-	-	-	-
Flexible powers	-	-	-	-
Proportionality	-	-	-	-
Consistency	N/A	N/A	N/A	N/A
Predictability	-	-	-	-
Accountability	+/-	+/-	+/-	+/-
Respect for general competition policy	N/A	-	-	N/A
Respect for European law and co-operation	N/A	N/A	N/A	-

PART III: LESSONS FOR THE FUTURE

A new Telecommunications Act

The Parliament is now debating a bill from the Minister of Economic Affairs for amendments to the Telecommunications Act, in order to implement the recent European directives on electronic communications.[72] From the contents of the bill, it seems that the legislature has taken into consideration the negative experiences with the current Telecommunications Act. The legal mandate of OPTA will be extended, and the goals of the new Act, clarified. It is very significant that the new Article 1.3. implements Article 8 of the Framework Directive at the outset of the Act, when it states which goals OPTA should take into consideration in exercising its powers. These goals will provide guidance to both the courts and OPTA for the interpretation of the Act. The proposal for a new Telecommunications Act will extend OPTA's powers in various ways. At first, the concept of SMP will be changed in that it will henceforth be aligned with general competition law principles. OPTA will be empowered to designate operators as SMP operators if it can be established that they have a dominant position within the meaning of Article 82 EC. OPTA will assess the economic position of the operators on the basis of a relevant market definition and of an economic analysis of the degree of competition within the relevant market. The relevant market and the economic position of the operators should be analysed in line with recommendations and guidelines from the European Commission. Since the designation of SMP operators will be based on economic analysis, OPTA will have more flexibility to regulate dominant firms *ex ante*. Furthermore, OPTA's powers will be extended in that it will have more discretion in determining which obligations are imposed on SMP operators. In contrast with the current framework, specific regulatory obligations for SMP operators will not automatically follow from the law, but it will be up to OPTA to design and choose the appropriate obligations.

[72] *Kamerstukken II*, 2002/2003, 28851.

From this analysis it follows that it is unlikely that OPTA will face the same kind of problems as in the MTA and cable cases in the future. Although OPTA's powers will have been considerably extended, OPTA will still be empowered to take regulatory action only after having followed the SMP procedure, or where market parties have sought the settlement of a dispute concerning rights and obligations that follow from the new legal framework.[73] The new framework still does not include a stipulation that would put an end to endless discussions as to the exact demarcation of OPTA's powers or that would enable OPTA to take efficient and effective action against certain market problems instead of being forced to settle the same type of disputes on a case by case basis. According to Article 8 of the Framework Directive the Member States shall ensure "that the national regulatory authorities take all reasonable measures which are aimed at achieving the objectives set out in paragraphs 2, 3 and 4" of Article 8 (which set out the broad regulatory objectives). A comparable provision could provide a remedy in case of gaps or omissions in the legal framework, thereby preventing useless legal disputes on the boundaries of OPTA's powers.

Nevertheless, under the new framework the main challenge for OPTA will be to perform adequate economic analysis and fashion proportionate remedies. It is likely that the debate between OPTA and the market parties before the reviewing courts will focus more and more on the substance of the case, instead of on formal issues of competence. Therefore, it is very important that OPTA exercise its discretion in an adequate way. OPTA's discretion will partly be restricted by the recommendations and guidelines from the European Commission, in exercising its powers. Moreover, by virtue of Article 7 of the Framework Directive, the European Commission and other European regulators will have the power to comment upon OPTA's decisions concerning the definition of the relevant market, SMP and remedies. The European Commission may even prevent OPTA from taking a decision which in the eyes of the Commission would run contrary to the goals and principles of the EC regulatory framework. Nevertheless, in implementing the European principles OPTA will still need discretion to apply economic and technical concepts. The incorporation of the principles of good market governance within the legal framework might structure the way OPTA performs the process of economic analysis and the balancing of different interests.

Incorporation into the legal framework

The legislature should respect the principles of good market governance in drafting legislation concerned with economic regulation. We recommend that these principles be inserted in general Directives for Legislation (Aanwijzingen voor de Regelgeving). In order to ensure good market governance, the principles should be implemented not only in the organic legislation, but also in the practices and processes of the administrative agencies. It is interesting to note that the DTe is already working on ways to improve the quality of its processes and the quality of regulation. For instance, it has proposed to conclude a "governance contract" with the operator of the transmission network, TenneT. This contract would provide

[73] For instance, OPTA will have the power to settle disputes on site sharing or interconnection obligations that rest upon non-SMP parties.

transparency as to how DTe will exercise its powers as regards TenneT. Moreover, DTe has published a plan in which it also explains in a transparent fashion how it will exercise its enforcement powers. DTe's initiatives show that there is a need for legal instruments to increase the legitimacy of the agencies. Although it is a positive development that the agencies themselves are working on improving their decision-making processes, the Minister in change should also take his responsibility and establish uniform review mechanisms to assess the performance of the agency and the regulatory regime. Unlike the governance code that has been proposed by the DTe, which only applies to a part of the agencies' activities, the code should apply to all of the administrative processes performed by the agency.

In order to stimulate the agencies to respect the principles of good market governance, we recommend to integrate these principles within the regulatory framework. For instance, organic acts could stipulate that the agencies should respect the principles of good market governance. Moreover, organic acts could require the agencies to adopt a plan to integrate these principles within their respective practices and processes (a code of good governance). In order to ensure the accountability of the agency to politics, the Minister could have the power to check whether the codes comply with the principles. For instance, the Minister could check whether the regulator has set up an adequate RIA process to accompany its measures. After the Minister has approved the code, the agency should follow the code in its decision-making procedures. It should make public how it has implemented the code and how it has complied with it.

A legally-binding code of good governance will enhance the accountability of the agencies to all interested and regulated parties and form an effective check upon the exercise of their discretionary powers. Since the Minister supervises the substance of the codes of the different agencies, these codes will enhance transparency and the consistency of regulation through all network industries and other markets. Moreover, they will enable the judiciary to check whether the agency has exercised its powers in a reasonable way and thus improve the quality of judicial review, which as illustrated here has been limited to a marginal, formalistic exercise.

CONCLUSION

Until now, the Dutch legislator has not paid enough attention to the fundamental principles which should form the basis of market legislation in order to realize goals of the regulatory regimes.

The case studies show that a general disrespect for the key requirements of a clear legal mandate and flexible powers have prevented regulatory agencies from carrying out their tasks efficiently and effectively. Moreover, due to unclear legislation, meaningful judicial review of agency actions has been hampered. In most cases the courts have annulled agency decisions on formal grounds. The proposal for the new Telecommunications act shows that the tide might be turning. On the one hand, OPTA will have more flexible powers to respond to new market developments. On the other hand, the Act explicitly sets out which goals OPTA should strive to achieve in exercising its powers. Giving OPTA more flexible powers

might at first seem to run counter to the principle of a clear legal mandate. However, by formulating the legislative mandate not so much as a static allocation of tasks, but rather as a set of clear objectives which the agency should pursue in the exercise of its powers, the tension between a clear legal mandate and flexible powers may be reconciled. Moreover, transparent procedures and cooperation with the European Commission, with regulators from other EC member states and with the NMa will ensure that OPTA exercises its flexible powers in a consistent and predictable manner.

In addition, the agencies should be obliged to adopt a code of good market governance, with which they should comply in all administrative processes. The incorporation of the principles of good market governance in the practices of the regulatory agency forms an extra check on the exercise of discretionary powers by the agencies. Moreover, the adoption of such code will improve the accountability of the agency as regards the politics, the interested market parties and the judiciary.