Background paper

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BACKGROUND PAPER

By the Secretariat[1]

1. Introduction

The "regulated conduct defence" shields conduct from competition law[2] consequences where it is required by a federal or state regulation. When firms invoke the doctrine as a defence against allegations of illegal anti-competitive behaviour, they seek a regulated conduct defence or regulated conduct exemption.[3] The defence has direct links with several legal doctrines that lead to the non-application of competition law in some circumstances: express immunity, implied immunity, or the state action doctrine.

The regulated conduct defence is important to ensure that the state can exercise its sovereign power to apply regulation that it deems justified for economic and/or social reasons even though the regulation may conflict with competition policy.[4] The defence is also important to ensure firms do not face multiple and inconsistent legal demands, in particular from regulations and competition law. The risks of such inconsistent legal demands are particularly important given the wide applicability of competition law and its evolving interpretations. In the specific case where the regulatory structure has the same goals as competition law, the regulated conduct defence may also be justified on the basis of a cost-benefit analysis when there is no added-value to apply competition law in addition to regulation.

The regulated conduct defence carries, however, also important risks and, with them, high potential costs for society. Indeed, the defence may lead to the application of regulation that is unduly anti-competitive and entails a welfare cost not justified to achieve the objective of the regulation.[5] Government restraints on competition may be as harmful to consumer welfare as private restraints. This will be particularly the case if the regulation results from the lobbying by private interests, which may be more common in period of economic downturn. The defence may also lead to an exemption from competition law oversight of a conduct that is only weakly regulated by the state.

This paper will emphasise a number of key points:

- Regulations can at times require actions that would, absent the regulation, constitute potential violations of competition law.

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2 The paper does not deal with the state aid rules that are applicable in some jurisdictions.

3 Related terms include the regulated industries exemption, regulated industries defence and regulated industries doctrine. See Competition Bureau of Canada (2010, p.1).

4 As observed by Carlton and Picker (2007, p.15), regulated conduct defence may move competition from the market to the legislative bodies.

5 See OECD (2011a) and OECD (2011b). The OECD Competition Assessment Toolkit aims at identifying regulation that unnecessarily restricts competition beyond what is necessary to achieve the regulatory goal.

- One way to avoid inconsistent demands on companies is through sector exemptions, but these are typically overbroad and better tailored solutions exist. The regulated conduct defence offers a narrower form of immunity than exempting an entire sector from the application of competition law.

- The application of the regulated conduct defence is more complex in multi-level governance settings as different legal principles may collide.

- The regulated conduct defence should only apply where companies have no autonomy over their behaviour.

- In some jurisdictions competition rules enacted at federal level prevent state regulators from imposing or facilitating conduct that would otherwise violate competition rules.

- The regulated conduct defence may be invoked as a defence in merger cases.

- Institutional settings can play an important role in reducing potential inconsistencies between the design and the enforcement of regulatory structures and competition law.

- The regulated conduct defence may entail substantial welfare costs for society and should therefore be applied by courts with caution.

This background note is organised as follows. Section 2 is a general introduction and deals with the rationale for the regulated conduct defence and the risks for consumer welfare. This Section characterises the main differences between competition rules and regulation, the different relationships between both sets of rules and the scope for a regulated conduct defence. Sections 3 and 4 go into more detail concerning the conditions of application of the regulated conduct defence in the two main branches of competition policy: on the one hand, anti-competitive agreements and abuses of dominant position/monopolization cases, and on the other hand, merger review. Section 5 then moves from substantive to institutional issues. It deals with possible measures to alleviate or reduce harmful conflict in the design and the enforcement of regulation and competition rules. Finally, Section 6 briefly concludes.

2. The regulated conduct defence: rationale and risks[6]

2.1 The objectives and the tools of competition rules and regulation

Competition law has the specific goal of making markets work better for the benefit of consumers. Competition law provides two main prohibition tools: (i) prohibition of anti-competitive agreements and abuses of a dominant position (or monopolization) so as to impede the harm for consumers that would result from artificial increases in market power; and (ii) prohibition of mergers that would substantially lessen effective competition. In most jurisdictions, they apply uniformly to all economic sectors, unless specified otherwise.

Regulation is a much broader concept that may have very different economic or non economic objectives.[7] It relies on a variety of instruments and usually is more prescriptive than competition law[8]:

6 This section draws heavily from the work of the International Competition Network, see ICN (2004a).

7 Baldwin and Cave (1999, Chapter 1), Breyer (1982, Chapter 1).

8 As noted by ICN (2005, p.7): “the emphasis of competition law is on what undertakings should not do, whereas regulation does the reverse and tells market agents what to do”.

- Regulation may correct *market failures* and, as competition law, make markets work better to the benefit of the consumers:

  - It may reduce *transaction costs*, via rules related to property rights or contracts.

  - It may address *information asymmetries* among economic agents that are not easily corrected by experience, such as rules ensuring minimum quality standards or preventing consumer harm.

  - It may address *externalities*, i.e. situations where economic agents neglect the spill-over effects of their decisions on third parties, which may be positive (such as in case of education) or negative (such as in case of pollution, traffic congestion and of financial market instability).

  - It may permanently address *structural market power* when the characteristics of the sector prevent effective competition (e.g. a natural monopoly). In this case, regulation may aim at mimicking the result of effective competition with, for example, retail price controls.

  - It may also temporarily address *market power when the sector is being liberalised* but the application of competition rules is not sufficient to ensure a competitive market. In this case, regulation may steer the sector towards effective competition through structural (vertical separation) or behavioural (compulsory third-party access) obligations.[9] This is for instance the case of the EU electronic communications regulatory framework discussed in Box 1.

- Regulation may address *distributional issues*, such as ensuring the provision of minimum or universal services to all consumers at affordable prices. In those circumstances, regulation may sacrifice efficiency to increase equity, but then the regulation should try minimizing the efficiency costs to society.[10] For instance in the EU, the provision of telecommunications universal service is intended not to distort competition and should minimise market distortions.[11]

- Regulation may address many other issues, such as health, safety standards and risk.

Regulation may at times suffer from failures.[12] It may go beyond what is necessary to achieve the public interest objectives and impose a welfare cost that is not commensurate to the public interest.[13] This is particularly the case when regulation results from the lobbying of private parties to favour their own at the expense of the general interest (regulatory capture). For instance, regulation may serve as a coordinating mechanism for a cartel. Moreover, there is a potential for economic distortions to arise, as different sectors are subject to different regulatory environments. Such distortions can have a negative

9 On structural separation measures, see the OECD Council Recommendation on Structural Separation (OECD, 2001) and the Report on the Implementation of the Recommendation on Structural Separation (OECD, 2011c).

10 On this issue, see OECD (2004).

11 Directive 2002/22 of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services, OJ [2002] L 108/51 as amended by Directive 2009/136, Art. 1(2) and 3(2), and Case C-220/07, *Commission v France* [2008] E.C.R. I-95, paras.29 and 31.

12 Peltzman (1976) and (1989), Stigler (1971).

13 For some examples, see the contributions in Amato and Laudati (2001).

impact on economic welfare by distorting consumer decisions as to which products and services they purchase. In addition, regulation may quickly become out-of-date, especially in fast-moving industries for technological reasons that are not directly connected with the legal regime, or where liberalisation has begun and some companies are moving fast to adapt to the new situation.

From a public interest perspective, it is therefore important that regulation applies only when its economic and social benefits outweigh its costs. Potential regulatory failures may in some cases imply that effective competition and competition policy may be a better solution than regulation.

According to Carlton and Picker (2007, p.51): "The relative advantages and disadvantages of each mechanism became clearer over time. Regulation produced cross-subsidies and favours to special interests, but was able to specify prices and specific rules of how firms should deal with each other. Antitrust, especially when it became economically coherent within the past 30 years or so, showed itself to be reasonably good at promoting competition, avoiding the favouring of special interests, but not good at formulating specific rules for particular industries. The partial and full deregulation movement was a response to the recognition of the relative advantages of regulation and competition law. This does not mean that no sector will be regulated, but rather that competition, constrained only by competition law, will be used over more activities, even in regulated industries". According to Temple Lang (2008, at section II) "competition law gives power only to stop already identifiable illegal actions, whether by companies or State measures, while regulation gives power to alter an existing situation which is entirely legal, to promote regulatory objectives. Regulatory powers, or competition law powers being used or misused for regulatory purposes, therefore create a temptation to "improve" the existing market"[14].

Box 1. The EU electronic communications economic regulation

In 2002, the European Union substantially changed the economic regulation of the electronic communications sector. The goal of the reform was to render economic regulation closer to economic realities, technologically neutral, flexible and more harmonised between the Member States. According to the Framework Directive[15], the national regulatory authorities follow three steps to regulate a market. Such steps should be applied prospectively and repeated every 2-3 years to take into account market developments.

First, the regulatory authority selects, on the basis of Recommendation from the European Commission, the markets justifying possible regulation on the basis of three cumulative criteria: (i) the existence of high and non-transitory barriers to entry of a structural, legal or regulatory nature; (ii) a market structure that, taking account of the barriers to entry, will not tend towards effective competition within the relevant time horizon of the market analysis (2-3 years); and (iii) the insufficiency of competition law alone to adequately address the market failure(s) present on the market. Then, the regulatory authority defines the product and geographical boundaries of the selected markets according to the antitrust methodologies relying on the so-called SSNIP (small but significant non-transitory increase in price) test;

Second, the regulatory authority analyses the market to determine whether one or several operators enjoy significant market power, which is equivalent to the dominant position in competition law;

Third, the regulatory authority imposes on the operators having significant market power the most appropriate and proportionate regulatory obligations provided in EU law Directives, such as transparency, non-discrimination,

14 On a comparison between antitrust rules and regulation in terms of substance and processes, see also Katz (2004, p.245-246), Laffont and Tirole (2000).

15 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, OJ [2002] L 108/33, as amended by Directive 2009/140, Art.14-16 and European Commission (2002). See Garzaniti and O'Regan (2010, Chapter 1), Monti (2003), de Streel (2003).

accounting separation, third-party access, price control, or functional separation.

This competition-based regulation has several advantages. It is more flexible and guarantees that national regulatory authorities' decisions are based on sound economic principles and reflect the reality of the market. It ensures a progressive removal of obligations as competition develops on the relevant markets (market-by-market sunset clauses) and facilitates the transition towards the mere application of competition law. Such an approach requires close co-operation between regulatory and competition authorities.

2.2 The relationship between competition law and regulation

When a business conduct is directly or indirectly affected by regulation, a conflict may exist between the implementation of the regulation and the enforcement of antitrust rules.

2.2.1 Complementarity of regulation and competition law

In most cases, competition law and regulation enforcement pursue distinct objectives, use different tools and affect different aspects of business conduct. Therefore, the two instruments complement each other and may be applied cumulatively.

For instance, regulation aimed at limiting pollution does not reduce the need for the competition law prohibition of anti-competitive agreements, abuses of a dominant position or anti-competitive mergers. Similarly, mandatory labelling or the prohibition of misleading advertising aim at promoting transparency and increasing the ability of consumers to choose among different alternatives, complementing competition law in ensuring an effective competitive discipline.

The complementary role of competition law and regulation is also evident in recently liberalised sectors where the role of regulation has changed radically. Historically, regulation was responsible for issuing licences and setting prices. Now in certain liberalised sectors, regulation is increasingly based on competition analysis and respects market forces. As stated by M. Monti (2003), a previous EU Commissioner for competition policy, "competition instruments and regulatory tools are complementary means. They deal with a common problem and try to achieve a common aim. The problem is high levels of market power and the likelihood of it being abused, and the aim is putting the end user at the centre of any economic activity"[16]. Both legal instruments have specific characteristics: Regulation focuses only on the main aspects of business conduct (for instance, access or final pricing), providing the ex-ante framework that regulated firms need to follow. Competition law prohibitions on agreements and abuses are expressed in more general terms and are enforced ex-post. The prohibition of abuse of a dominant position, for example, seeks to impede behaviour that may distort competition and is not specifically covered by regulation. In most jurisdictions, when an industry or a firm is regulated, competition law enforcement represents an additional tool, with the baseline being determined by regulation.

2.2.2 Substitutability of regulation and competition law

In some cases, however, the application of both competition law rules and regulation is incompatible as regulation may restrict competition (for example by establishing entry barriers) or impose behaviours that may be condemned under competition law (for example fixing minimum prices). In such cases, regulation may imply an exemption to the application of competition law.

Such exemption may be beneficial to the society when the regulation aims to correct market failure or ensure distributional objectives, while at the same time the possible anti-competitive effects are reduced to

16 Also see the remarks of the current U.S. Assistant Attorney General Varney (2010, p.14).

the minimum. If, however, regulation goes beyond what is necessary to achieve the underlying public interest objectives, the competition law exemption is detrimental.

It is thus important that exemptions to competition law apply only when the economic and social benefits of the exemption outweigh its costs. That is why the OECD (1997, p. 271) has taken the position that exemptions from the general competition law should be minimized or even eliminated: "As a general reform strategy, governments should expand the scope and effectiveness of competition policy. The scope and effectiveness of competition law and competition authorities should be reviewed, and strengthened where necessary. Exemptions to competition law should be eliminated, absent evidence of compelling public interests that cannot be served in better ways."[17]

Thus where a specific rationale for exemptions has been identified, consideration should be given to the means by which its scope can be minimized. For example, an exemption which is narrow and focussed is better than a broad exemption. In the same vein, a legislated monopoly requiring all producers of a particular commodity to sell to a particular licensed exporter may be an inferior substitute to a system that allows producers to engage in co-operative export selling arrangements, but does not compel them to do so.

This is now clearly understood in most jurisdictions where the solution to "exempt" the whole regulated sector from the application of competition law has been progressively abandoned for several reasons[18] (i) technical progress has allowed competition in many previous natural monopoly environments and justified liberalization in several network industries, (ii) competition law has increasingly been recognised as a more suitable regulator given the limitations of industry regulation and (iii) the increased use of economics in competition law analysis has allowed for an improved balance between pro and anti-competitive effects.[19]

If the broad sector exemption is not applicable, the issue is whether and at what conditions a specific regulated conduct may be exempted from competition law enforcement. Given the possible welfare costs of such exemption,[20] the conditions for a regulated conduct defence should be strictly designed.

2.3 The scope of the regulated conduct defence

In practice, the courts have restricted the use of the regulated conduct defence in order to diminish its risk and potential costs for society. The courts have generally accepted the regulated conduct defence when the firm's contested behaviour is the policy choice of a sovereign government. However, it has not been accepted where private parties have invoked it in order to manipulate the democratic process in such a way as to give themselves effective, unsupervised control over a market.[21] As noted by ICN (2004a, p. 4), "Antitrust enforcement, unless there is a specific exemption, is always possible when there is a restriction of competition which falls under the prohibition of the antitrust law and this restriction may be attributed to an autonomous firm decision, i.e. it is not mandated by regulation. In some jurisdictions antitrust rules may also be applied when the anticompetitive regulation is clearly not in the general interest and it delegates the power to implement its provisions to the regulated firms themselves".

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17 Also see OECD (2005a, p.12).

18 See Baldwin and Cave (1999, Chapter 10), Breyer (1982, at Parts II and III), Cooper and Kovacic (2010, p.1558). On the means and the benefits to bring competition to regulated sectors, see OECD (2005a).

19 On that last point, see in particular Varney (2010).

20 Carlton and Picker (2007, p.16).

21 Hovenkamp (2005, at §18.5).

The regulated conduct defence has different conditions and implications depending on whether it is relied upon in an ex-post or an ex-ante antitrust case. Both types of cases will be considered in the following two sections.

3. The regulated conduct defences in anti-competitive agreements and monopolization or abuses of dominant position cases

In cases involving anti-competitive agreements and abuse of a dominant position or monopolization cases, the regulated conduct defence is based on several doctrines that allow exemption from competition law under some conditions. These doctrines are mainly of a legal nature and do not always meet strict economic efficiency criteria. They have been developed pragmatically on a case-by-case basis without drawing on a fully coherent framework. One of the main criteria for allowing an exemption from competition law is whether the regulation was taken at the same level as the competition law or at an inferior level. This paper deals with both questions in turn in the following two sub-sections.

3.1 Regulated conduct defence when regulation is at the same legal level as competition law

3.1.1 Explicit legislative regulated conduct defence and immunity to antitrust

The regulated conduct defence may be based on an explicit exemption from competition law. Such immunity may be provided by the competition law itself or by a regulation when adopted at the same level as the competition law. Exemption may vary in intensity: it may provide limited competition law immunity for specific conduct or types of agreements between firms, it may apply to narrow areas but provide a broader immunity, it may apply broadly but provide a limited immunity or it may create a broad immunity for entire areas.

In the U.S., the competition law provisions are contained in federal and state acts. The federal competition law, which the Supreme Court has called "the Magna Carta of free enterprise"[22], generally applies to interstate commerce or any activity affecting interstate commerce, whether or not the conduct at issue is subject to state or federal regulation.

Some federal regulatory acts, however, provide for an express immunity to the federal competition law provisions either directly or by giving a federal agency the authority to grant competition law immunity via administrative decision.[23] In general, such explicit exemptions are strictly construed,[24] which has been welcomed by the bi-partisan Antitrust Modernization Commission.[25] There are more than thirty statutory competition law exemptions and they relate mainly to the following sectors: agriculture and fishing, maritime or railroads transport[26], banking, insurance and financial services, sport leagues, professional societies, export cartels, labour, healthcare, education.[27] According to the Antitrust

22 *United States v. Topco Associates, Inc.*, 405 U.S. 596, 610 (1972).

23 See Antitrust Modernization Commission (2007, p.347-356), Carlton and Picker (2007, p.16-19), Hovenkamp (2005, at §19.7).

24 *FMC v. Seatrain Lines*, 411 U.S. 726, 733 (1973) construing the exemption so as to cover operating agreements but not mergers.

25 Antitrust Modernization Commission (2007, p.356: Recommendation 61).

26 Shipping Act of 1984, 46 USCA § 1706. Motor carrier Act of 1980, 49 USCA § 10706(b); Staggers Rail Act of 1980, 49 USCA § 17706(a) permit firms to engage in joint rate making without violating antitrust provisions against collusion.

27 See the list of statutory exemptions from Antitrust Law in Antitrust Modernization Commission (2007, p.378).

Modernization Commission:[28] "Statutory immunities (…) should be granted rarely, and only where, and for so long as, a clear case has been made that the conduct in question would subject the actors to antitrust liability *and* is necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S. economy in general."

In the EU, the competition provisions are contained in the Treaty on the Functioning of the European Union (TFEU), which is the constitutional Charter of the EU[29] and in the laws of the Member States. EU competition rules apply to private and public "undertakings", which have been defined by the Court of Justice as every entity engaged in an economic activity regardless of its legal status or the way it is financed.[30] Economic activity, in turn, depends on the function carried out by the entity, and consists of offering goods or services on the market where that activity could, at least in principle, be carried out by private undertakings in order to make profits. Thus EU competition law applies to all entities, private or public, that offer products or services normally provided against remuneration. Conversely, competition law does not apply to activities where the Member states exercise sovereign power (such as control of air space, anti-pollution surveillance) or that are governed by the principle of solidarity such as compulsory social security insurance schemes (for examples in the healthcare sector, see Box 2).

EU competition law applies to all sectors of the economy with very rare exemptions. The TFEU provides for a possible exemption in the agricultural sector.[31] However, the Council of Ministers decided to make competition law applicable to agriculture with certain exemptions to Article 101 TFEU in order to ensure a proper functioning of the Common Agricultural Policy and its national organizations of agricultural markets[32]. The TFEU also provides for exemptions for nuclear energy and military equipment.[33] The Council also provides for an exemption to Article 101 TFEU for certain agreements in rail, road and inland waterway transport aiming at technical improvements or achieving technical cooperation.[34] Thus, in all other sectors, competition law applies fully. The European Commission, however, adopted several block exemptions for certain economic sectors: motor vehicle, insurance, and transport (air, maritime). In those cases, competition law applies, but the agreements meeting the conditions set by the Commission are automatically exempted on the basis of Article 101(3) TFEU. The Commission has also adopted cross-sectoral block exemptions for some types of horizontal (research and development, and specialisation) agreements, vertical agreements and Technology Transfer agreements.[35]

Moreover, the Treaty provides that competition rules do not apply to economic activities when it is necessary for the provision of services of general economic interest (SGEI)[36] as explained below.

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28 Antitrust Modernization Commission (2007, p.350: Recommendation 57).

29 Case C-294/83, *Les Verts v. European Parliament* ECR [1986] 1339, at para.23.

30 Case C-41/90 *Hofner and Elser v. Macroton* [1991] I-1979.

31 Art. 42 TFEU.

32 Council Regulation 1184/2006 of 24 July 2006 applying certain rules of competition to the production of, and trade in, agricultural products, O.J. [2006] L 214/7. See Whish (2008, p. 957-961).

33 Art. 346(1b) TFEU. See Whish (2008, p. 957).

34 Council Regulation 169/2009 of 26 February 2009 applying rules of competition to transport by rail, road and inland waterway, *OJ* [2009] L 61/1.

35 http://ec.europa.eu/competition/antitrust/legislation/legislation.html.

36 Article 106(2) TFEU.

Box 2. The provision of healthcare services

There have been a number of interesting cases concerning the provision of healthcare services which have raised questions about how the involvement of the state effects the application of competition law.

In 2006 the European Court of Justice (ECJ) in FENIN[37] held that public bodies acting as purchasers of medical supplies did not constitute 'undertakings', and therefore Articles 101 and 102 TFEU did not apply to them. FENIN is an association of undertakings involved in the marketing of medical goods used in Spanish hospitals. FENIN had complained to the European Commission (EC) that the public bodies managing the Spanish health service had abused their dominant position as purchasers of the medical goods produced by FENIN's members. The ECJ agreed with the earlier judgment of the General Court (GC) and confirmed that "it is the activity of offering goods and services on a given market which determines whether an activity is economic, not purchasing as such."[38]

The earlier FENIN case before the GC came out a short time after the UK BetterCare II case that also involved abuse of dominance claims in the provision of healthcare. Some interesting parallels can be drawn. Indeed, the OFT was motivated to publish a note to emphasise the different reasoning of the two tribunals.[39] The BetterCare cases concerned a provider of residential and nursing home care who had complained to the OFT that the purchaser, a Health and Social Services Trust (N&W), was abusing its dominant position. The OFT rejected the complaint on the grounds that N&W was not an undertaking for the purposes of the Competition Act 1998. However, on appeal, the Competition Appeals Tribunal (CAT) decided that N&W *was* acting as an undertaking, both through the purchasing of services from BetterCare and the direct provision of elderly care by its own statutory homes. In its policy note the OFT sets out the principle differences between the two cases which allowed the CAT to come to its seemingly divergent decision.[40] In particular it was emphasised that while the GC held that the characteristic of an economic activity does not include the business of purchasing, the CAT's key consideration was whether an entity is in a position to generate the effects which competition rules seek to prevent. The OFT concludes that where a public body is only a purchaser of goods or services in a particular market, and is therefore not involved in the direct provision of any goods or services in that, or any related market, it will not be an undertaking for the purposes of the Competition Act 1998. However, the legal position regarding bodies that both purchase and directly provide goods for non-economic purposes (as is often the case in the provision of healthcare services) was stated as unclear and in a state of development pending the final judgment in FENIN.

The provision of healthcare services in the UK is now able to benefit from the newly formed Co-operation and Competition Panel (CPP). The CPP is an independent, non-statutory advisory body that was established by the Secretary of State to provide advice to the Department of Health, Strategic Health Authorities (SHAs) and other NHS bodies. The CPP has no concurrent powers to enforce competition law as this responsibility remains with the OFT. [41] However, it does have the power to advise and undertake cases concerning the Principles and Rules of Cooperation and Competition (PRCC)[42].

In the 2007 *Baxter* case in Australia *ACCC v Baxter* [2007] HCA 38, it was asserted before the court that competition law did not apply to health care procurements by the States operating hospitals, despite the fact the suppliers were private sector organisations. The ACCC had accepted that the tender and procurement of sterile fluid products by the purchasing authorities did not amount to carrying on a business. This meant that the purchasing authorities themselves were not bound by the Trade Practices Act (TPA), now the Competition and Consumer Act 2010. However, Baxter as a private sector organisation had linked competitive products to monopoly products and was therefore able to supply both on a non-competitive basis. Baxter argued that derivative crown immunity applied, and therefore the TPA could not apply to Baxter as this would affect the freedom of the Crown to enter into contracts of its choosing. The High Court did not agree, and the majority held that Crown immunity does not automatically extend to third parties unless that immunity is clearly necessary to protect the Crown's proprietary contractual legal rights.

37 Case C-205/03, *FENIN v Commission of the European Communities* [2006] ECR I-6295.

38 See above, para 24 of ECJ judgment.

39 See Policy note 1/2004, The Competition Act and public bodies available at: http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_mini_guides/oft443.pdf.

40 See above, para 13.

41 See "Working arrangements between the OFT and the CPP".

42 http://www.ccpanel.org.uk/content/Final-draft-Rules-of-Procedure.pdf.

Baxter's activity of supplying State health purchasing authorities was therefore not immune from the TPA. The decision of the High Court clarifies that companies are subject to the TPA, irrespective of whether the TPA also applies to the other party to the arrangement and companies will not automatically receive the protection of any Crown immunity when dealing with Commonwealth, State or Territory authorities.

In Australia, the competition provisions are included in a federal law (the Competition and Consumer Act 2010) and several regulations adopted at the federal level provide for an exception to the competition law. The main sectors concerned are: postal, banking, financial and insurance services (see Box 8), and customs.[43]

In Singapore, the Competition Act of 2004's prohibitions against anti-competitive conduct does not apply to the government, any statutory body, or person acting on behalf of the government. Moreover, the Act creates a number of sector exclusions, such as for postal, rail, and cargo services while in some other areas, competition oversight of sector-specific businesses has been exempted (e.g., telecoms, media, and energy).

In China, the Anti-Monopoly Law creates immunities from competition law for state owned enterprises in strategic sectors such as aviation, banking, electricity, oil, railroads, and telecommunications.[44] In these sectors it is therefore the industry regulatory authorities that have power to take action against any anticompetitive behaviour.

Two concerns have, however, been raised by SAIC (the State Administration for Industry and Commerce) concerning its inability to act in these areas.[45] First, the industry regulatory authorities usually have a close relationship with the enterprises under their ambit. This may give rise to conflict of interest issues impairing the protection of consumer interests and rights. Second, there have been some inconsistencies in the level of sanctions that regulatory authorities can administer. An example of this can be seen under the Telecommunications Regulations, stipulating that fines for anticompetitive behaviour will be between Rmb 10,000 and Rmb 100,000. These are, however, considerably lower than the fines administered under the Anti-unfair Competition Law which range from Rmb 50,000 to Rmb 200,000.

3.1.2 Implicit judicial regulated conduct defence and immunity to competition law

A regulated conduct defence may also be based on antitrust immunity not explicitly provided by the competition or regulatory law, but which is implicitly in the law and deduced by the courts.

In the U.S., the regulated conduct defence based on implicit immunity requires plain repugnancy between the competition law and regulatory provisions and is strictly construed.[46] The courts will look at

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43 The federal exceptions are listed on the website of ACCC : http://www.accc.gov.au/content/index.phtml/itemId/688173: Australian Postal Corporation Act 1989 , Banking Act 1959 , Customs Act 1901, Financial Sector (Business Transfer and Group Restructure) Act 1999 , Insurance Act 1973, Liquid Fuel Emergency Act 1984, Northern Territory National Emergency Response Act 2007, Payment Systems (Regulation) Act 1998, Payment Systems (Regulation) Regulations 2006, Trade Practices Act 1974, s. 173.

44 See Fox (2008).

45 See China's contribution to 2005 GFC on the Relationship between Competition Authorities and Sectoral Regulators. DAF/COMP/GF/WD(2005)9.

46 *United States v. Philadelphia national Bank*, 374 U.S. 321 at 350-351 (1963). ICN (2004b, p.21).

four elements:[47] (i) The existence of regulatory authorities to supervise the challenged conduct; (ii) The evidence that the regulatory authorities exercise the supervision with the suitable degree of attentiveness,[48] this condition requires that the challenged conduct should have been investigated by a public regulatory agency or possibly approved after a fairly full review of the merits; (iii) The risk of conflicting requirements between competition law and regulation, for instance because both legal instruments have different and conflicting objectives; and (iv) a conduct squarely within the heartland of regulation.

In practice, the courts have accepted a regulated conduct defence based on implied competition law exclusion only in limited instances, in particular in securities regulation supervised by the SEC.[49] The courts tend to exempt, according to the proportionality principle, only to the minimum extent necessary to make the regulatory statute work.

Moreover, when there is rate regulation at the federal (or the state level, see below), the Supreme Court allows implied immunity limited to some sanctions under the "filed rate doctrine."[50] The doctrine forbids purchasers from lodging competition law complaints concerning prices fixed by suppliers, where those suppliers have duly filed their rates with the regulatory authority and the rates have not been disapproved by the authority.

In Canada, the Competition Bureau (2010, p. 7) indicates that "it will not pursue a matter under any provision of the (Competition) Act where Parliament has articulated an intention to displace competition law enforcement by establishing a comprehensive regulatory regime and providing a regulator the authority to itself take, or to authorize another to take, action inconsistent with the (Competition) Act, provided the regulator has exercised its regulatory authority in respect of the conduct in question", and that it "will generally conclude that the enactment by Parliament of specific provisions to address the conduct in question is intended to take precedence over a law of general application such as the Competition Act i.e. application of the *generalia specialibus non derogant* maxim".

3.1.3 A hybrid analysis when regulation complements competition law

In *Trinko,*[51] the U.S. Supreme Court decided that federal competition law could not be the basis for a duty to deal of a telecommunications incumbent operator subject to an access obligation under the federal telecommunications laws. This was not a case of express or implied immunity due to the antitrust saving clause of the 1996 Telecommunications Act. The Supreme Court did, however, a cost-benefit analysis and considered that there was no added-value to apply competition law in addition to regulation which follows the same logic and follows more ambitious goals than competition law. The Supreme Court states that, where such regulatory structure exists, the benefit of an additional application of competition law is small as both legal instruments have objectives going in the same direction while the cost of applying competition law may be high as the authority deciding under competition law (in this case, a judicial court which is not well equipped to deal with the complex issues underlying access obligations) may make errors and condemn practices that are competitive.

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47 *National Gerimedical Hospital v. Blue Cross of Kansas City* 452 U.S. 378, 388 (1981); *Silver v. NYSE* 373 U.S. 341; *Gordon v. New York Stock Exchange*, 373 U.S. 659 (1975); *Credit Suisse Securities (USA) v. Billing* 551 U.S. 264 (2007).

48 According to Hovenkamp (2005, at §19.3c), the same standard of regulatory supervision should apply for a antitrust exemption in case of federal regulation and in case of state regulation.

49 *Gordon v. New York Stock Exchange*, 373 U.S. 659 (1975).

50 *Keogh v. Chicago & Northwestern Railway*, 260 U.S. 156 (1922).

51 *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko*, 540 U.S. 682 (2004).

According to the Antitrust Modernization Commission (2007, p. 362), "The Court simply held that the specific, regulatory duties to deal established under the 1996 Telecommunications Act did not also create a new cause of action under the refusal-to-deal doctrine of Section 2 of the Sherman Act. *Trinko* is best understood only as a limit on refusal-to-deal claims under Section 2 of the Sherman Act. It should not be read to displace the role of the antitrust laws in regulated industries as an implied immunity, nor should it be taken as a judicial rejection of a savings clause".[52]

3.2 Regulated conduct defence when regulation is at an inferior level than competition law: an application of the State action doctrine

The application of the regulated conduct defence is more complex in multi-level governance settings as different legal principles collide. In such settings, there is usually a legal principle of hierarchy of norms whereby the norm adopted at the superior (e.g., federal) level prevails over the norm adopted at the inferior (e.g., state) level. According to this principle, federal competition law prevails over state regulation and, in such circumstances, the regulated conduct defence should not be accepted.

However, according to, for example, the principles of state autonomy and of subsidiarity, courts in some jurisdictions allow regulation adopted at an inferior level to include an exemption from competition law adopted at a superior level. Moreover under the principles of legal certainty and legitimate expectations, courts have decided that undertakings abiding by regulation that is contrary to a superior competition law norm should not be sanctioned. In all those cases, the courts have allowed, in effect, a regulated conduct defence. Depending on the institutional context and the judicial history, the conditions of the defence may differ among jurisdictions.

3.2.1 State Action doctrine in the U.S.

In the U.S., the federal law prevails over state laws pursuant to the supremacy clause of the U.S. Constitution.[53] Thus in principle, federal competition laws prevails over state regulations. However, the Supreme Court created an exception to the principle and accepted a state regulated conduct defence when the challenged conduct met two conditions:[54] (i) the conduct should be clearly authorised and (ii) the conduct should be actively supervised by the state. The first condition serves to ensure that the state has affirmatively authorized departures from free-market competition. The second condition serves to ensure that state action immunity shelters only the particular anticompetitive acts of private parties that, in the judgment of the State, actually further state regulatory policies.

Clear authorisation

First, the challenged conduct must be authorised by a clearly articulated and affirmatively expressed state regulatory policy. The state should have contemplated the challenged conduct and decided to permit it, while the details of the regulatory scheme may be left to a state agency or government subdivision. The Supreme Court held that the condition was satisfied when the anti-competitive conduct was the

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52 For a different interpretation of Trinko, see among others Shelanski (2011) who sees and regrets and new form of antitrust immunity in Trinko..

53 U.S. Const. Art. VI, §2. ICN (2005, p.66). On the ambiguous relationship between pre-emption and the state action doctrine, see Hovenkamp (2005, at §20.1).

54 *Parker v. Brown*, 317 U.S. 341 (1943); *Goldfarb v. Virginia State Bar* 421 U.S. 773 (1975); *California Retail Liquor Dealers Assn. v. Midcal Aluminium*, 445 U.S. 97 (1986). For an analysis of those conditions, see Antitrust Modernization Commission (2007, 366-377), Bush (2006), Delacourt J.T. and Zywicki TJ. (2005), Elhauge (1991).

"foreseeable result" of a state statute.[55] Such standard led courts to allow regulated conduct to be shielded through "clear articulation" by either a general state authority or through a broad regulatory regime. Moreover, the Supreme Court merely requires that the conduct is authorised, and not imposed, by the state.[56]

Authorisation must come from the state itself in its executive, legislative and judicial branches (state's Supreme Court), but not from a governmental subdivision such as a municipality or from a subordinated agency of the state. As put by Hovenkamp (2005 at §20.4), the courts have focused on three questions to determine what constitutes a state body:

i) "Whether the agency or board at issue has quasi-legislative powers and is not merely instructed to carry certain functions;

ii) Whether the decision makers in the agency, office or board are composed entirely of government officials with no financial interests in the regulated market and not from representatives of the regulated market;

iii) Whether the agency is governed or answerable in some explicit fashion to the legislature, governor or state supreme court".

The FTC State Action Report (2003) notes that some lower courts have implemented the clear articulation standard too loosely in a manner not consistent with its underlying goal. To address this concern, that Report recommended[57] that courts ask two questions in applying the clear articulation requirement: (1) whether the conduct at issue has been authorized by the state, and (2) whether the state has deliberately adopted a policy to displace competition in the manner at issue. Such requirements would focus the inquiry on the existence of deliberate and intended state policies to displace competition.

Active supervision

Second, the challenged conduct must be actively supervised by the state itself. Thus, the state's policy may permit private parties to act anti-competitively, but the state must ensure that private decision makers are acting in accordance with state policy and not carrying out additional anticompetitive acts that fall outside the state authorisation. According to Hovenkamp (2005 at §20.5), three issues should be distinguished: when is supervision required, what kind of supervision is required and who must supervise.

i) The supervision is required when the challenged conduct is that of a private party with discretionary power, but not when the actor is governmental[58] or a private party acting without discretion.[59]

ii) The supervising agency or the court should be empowered to supervise and it should carry out such supervision in practice. As stated by the U.S. Supreme Court, "The active supervision

55 *Town of Hallie v. City of Eau Claire*, 471 U.S. 34 (1985) and *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985).

56 *Southern Motor Carriers Rate Conference Inc. v. United States*, 471 U.S. 48 (1985).

57 Such recommendation has also been made by the Antitrust Modernization Commission (2007, p.371 recommendation 71). On the review of the US State action doctrine, see also Cooper and Kovacic (2010, p. 1585)

58 See *Town of Hallie.*

59 See *Municipal Utilities Board of Albertville v. Alabama Power Co*, cert. denied, 513 U.S. 1148 (1995).

requires that state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy"[60]*, and the "mere potential for state supervision is not an adequate substitute for a decision by the State".*[61] *Similarly, mere reporting or supervision which is limited to process is not sufficient.*

iii) The supervision should be done by the same level of government that has imposed the regulation. If the regulation is from the state, then supervision should be carried out by the state agency in charge of enforcing the regulatory regime. If the regulation is municipal, then supervision should be carried out by the city council directly or by a commission or an agency.[62]

The Antitrust Modernization Commission (2007, p.373) recommends that courts use a flexible, "tiered" approach that requires a different level of active supervision depending on factors such as the type of conduct at issue (e.g. per se violation of competition law or not), the entity engaging in that conduct (whether the entity is more or less governmental), the industry, and the regulatory scheme.

Thus when the conduct is not clearly authorised and actively supervised by the state, a regulated conduct defence is not allowed. However, when there is rate regulation at the federal or the state level, the Supreme Court allows competition law immunity limited to some sanctions under the "filed rate doctrine" explained above.

3.2.2 State action doctrine in the EU

In the EU, the TFEU prevails over all Member States rules.[63] Therefore, EU competition law should normally prevail over national regulations. Although the competition provisions of the TFEU are addressed to private and public undertakings, the Court of Justice decided that, according to the loyalty clause of the Treaty on the European Union (TEU),[64] Member States may not adopt regulation that would deprive EU competition rules of their effectiveness,[65] save the exceptions provided in the TFEU especially regarding the provision of services of general economic interest. On that basis, the Court of Justice has not allowed any industry to claim a complete exemption from EU competition law on the basis of a national regulation.[66]

The prohibited national measures fall into four categories:

- encouraging or reinforcing unlawful agreements or practices;
- giving companies power to regulate themselves;

60 *Patrick v. Burget*, 486 U.S. 94, 101 (1988).

61 *FTC v. Ticor Title Ins. Co*, 504 US 621, 638 (1992).

62 Hovenkamp (2005 at §20.5c).

63 Case 6/64 *Flaminio Costa contre E.N.E.L.*, [1964] ECR 1141.

64 Art. 4(3) TEU.

65 Combination of Articles 4(3) TEU with 101 and 102 TFEU for private undertakings and Article 106 TFEU for public undertakings. Case 267/86 *Van Eycke v ASPA* [1988] ECR 4769 at 16, Case 66/86 *Ahmed Saeed* [1989] ECR 838 at 48.

66 See Case 172/80, *Züchner* v. *Bayerische Vereinsbank* [1981] ECR 2021 (banking industry); Case 41/83, *Italy* v. *Commission* [1984] ECR 873 (telecommunications industry); Case 45/85, *Verband der Sachversicherer* v. *Commission* [1987] ECR 405 (insurance industry).

- requiring conduct incompatible with Articles 101-102 TFEU;
- making violations of those Articles inevitable.[67]

Thus, Member States (legislative, executive, regulatory authorities) may not adopt regulation that would encourage or force undertakings to violate EU competition law. For instance, a regulatory authority may not approve or authorise any price fixing arrangements between companies which is contrary to Article 101 TFEU or any price which is so excessive that it is contrary to Article 102 TFEU. If a Member State would adopt such regulation, contrary to EU law, this regulation should be dis-applied by all Member State's authorities, including a competition authority, a regulatory authority or a court.

However, the Treaty provides that competition rules do not apply, hence national law may apply, when it is necessary for the provision of a service of general economic interest (SGEI).[68] This provision is construed narrowly by the Court of Justice and requires three conditions to be met:[69]

i) Undertaking is 'entrusted' by the state, with legislation or a contract, to carry out a service as SGEI. Although Member States have large discretion to determine what a SGEI is, some EU criteria are emerging: the service should be universal, compulsory and provided for general, and not private, interest.[70] Examples include controlling navigation on an important waterway, a universal and continuous mooring service at ports, operating the public telephone network, broadcasting television, operating the national public electricity supply, the basic postal service, supplementary pension schemes, operating an unprofitable air route for reasons of the general interest, and management of environmentally undesirable waste.[71]

ii) The restriction of competition is necessary to ensure that the service can be provided under economically acceptable conditions;

iii) The restriction of competition is not contrary to the interest of the Union. This provision has not yet received a detailed scrutiny by the Court of Justice, but it requires more than the proof that the state measures do not affect the trade between Member States.

If a Member State does not fulfil its obligations under EU law and adopts a regulation compelling undertakings to adopt anti-competitive behaviours that cannot be justified for the provision of a SGEI, the Court of Justice may allow a regulated conduct defence. This will, however, only be the case in the situation where the regulated firm has no autonomy and if the national law has not yet been declared contrary to EU law by a national authority or by the European Commission.

No autonomy for the firms

67 Moreover, national regulation may not violate the EU internal market rules.

68 Article 106(2) TFEU.

69 Chalmers et al. (2010, p.1030). See Case C-320/91 *Corbeau* [1993] ECR I-2523, Case C-203/*96 Dusseldorp* [1998] ECR I-4075, Case C-475/99 *Ambulanz Glöckner v Landkreis Südwestpfalz*, [2001] ECR I-8089.

70 See Case T-289/03 *BUPA v Commission* [2008] ECR II-81, paras 172 and European Commission (2001).

71 See Temple Lang (2008, at section VIII).

The regulated conduct defence, which is construed restrictively,[72] is only accepted when the regulation imposes the challenged conduct and removes any autonomy of the undertakings.[73] This implies that the regulation should have been adopted by public authorities and not by the regulated parties. According to Gerard (2011), the courts consider three main criteria:

i) Whether the regulation is subject to the final approval of a government authority, e.g. a Minister, possibly after consulting with other independent public bodies;

ii) Whether the regulation has been elaborated by a committee composed of a majority of members independent from the industry actors or associations. As noted by Temple Lang (2004), "the case law distinguishes between companies being represented on consultative bodies, which is legal as long as official powers are exercised by an official authority, and situations in which a dominant enterprise or a group of companies are themselves allowed to take the operative decisions or to exercise official regulatory powers, which is illegal.[74] It is lawful for prices to be proposed by committees including representatives of enterprises, provided that the legislation granting the power to propose prices requires the public interest to be taken into account (so that judicial review would be possible on this ground) and provided that the public authority has power to alter or override the committee's proposal";

iii) Whether industry representatives must take into account statutory criteria aimed at ensuring the public interest.

The courts will therefore carry out a test to verify that it is the Member State, acting through a government body that retains the final word in the decision making process administering the regulated conduct. The test is mainly formal and avoids any substantive assessment of the public policy considerations that the state may take into account.[75]

The regulated conduct defence is not permitted when the regulation merely encourages or authorises the undertakings to engage in autonomous anti-competitive conduct. The presence of a regulation may, however, constitute a mitigating factor when setting the sanction. The Commission Guidelines on setting

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72 Case C-198/01 *Consorzio Industrie Fiammiferi (CIF) v Autorità Garante della Concorrenza e del Mercato* [2003] ECR I-8055, at 67 and cases cited therein. At 68-69, the Court of Justice added that: "price competition does not constitute the only effective form of competition or that to which absolute priority must in all circumstances be given. Consequently, pre-determination of the sales price of matches by the Italian State does not, on its own, rule out all scope for competitive conduct. Even if limited, competition may operate through other factors".

73 Wainwright and Bouquet (2004). This is established case-law: Case C-359/95P *Commission and France v. Ladbroke*, ECR [1995] I-6265, para.33, very recently Case C-52/09 *Konkurrensverket v. TeliaSonera* ECR [2011] I-0000, para.49-50.

74 See *e.g.*, Case C-96/94 *Centro Servizi Spediporto* [1995] ECR I 2883; Case C-140/94 *DIP v. Comune di Bassano* [1995] ECR I 3257; Case C-70/95 *Sodemare v. Regione Lombardia* [1997] ECR I 3395 (social welfare health care services: a Member State may decide to allow only non-profit-making operators to provide social welfare, under contracts refunding their expenses to them); Case C-38/97, *Librandi* [1998] ECR I 5955; Case C-266/96, *Corsica Ferries* [1998] ECR I 3949; Case C-35/96, *Commission v. Italy* [1998] ECR I 3851 (legislation allowing a price set by a national committee of customs agents, to be charged by all customs agents, is illegal: the national legislation "wholly relinquished to private economic operators the powers of the public authorities as regards the setting of tariffs"; Case T-513/93, *CNSD v. Commission*, [2000] ECR II 1807.

75 Chalmers at al. (2010, p.1019). Gerard (2011) observes that such formal analysis may be due to the lack of room in the EU competition law system of analysis for the consideration of public interest justifications.

fines[76] state that there is a mitigating factor "where the anti-competitive conduct of the undertaking has been authorized or encouraged by public authorities or by legislation". This view has been endorsed by the Court of Justice in several cases.[77] This is also the case in some Member States, for example Portugal (See Box 7)

The validity of the national regulation

When the national regulation cannot be justified for the provision of a SGEI under EU law, the regulated conduct defence may only be relied upon until a definitive decision has declared the Member State's regulation contrary to EU law,[78] but not after the decision has been rendered.[79]

3.2.3 State action doctrine in Canada

In Canada, the federal Competition Act in principle prevails over provincial regulation pursuant to the federal paramountcy rule and the application of general law in accordance with its plain reading. However, the Supreme Court created an exception to this principle and has accepted the regulated conduct defence when there is a clear operational conflict between the provincial regulation and the Competition Act, such that obedience to the regulation regime means contravention of the Competition Act. It is the specific conduct rather than the industry as a whole that is examined. The Competition Bureau indicates that it will strive to determine Parliament's intention with respect to the application of the relevant Competition Act provision(s) to the impugned conduct, but that it will not refrain from pursuing regulated conduct under the reviewable matters provision(s) simply because the provincial law may be interpreted as authorizing the conduct or is more specific than the Act. The Bureau also observes that greater scrutiny of the activities of regulatees, whether acting in their private capacity or as self-regulators, may be warranted.[80]

3.2.4 State action doctrine in Australia

In Australia, the mechanism to provide exemptions from the competition law was significantly tightened with the National Competition Policy Reform of the mid-1990s. Instead of being shielded by a general state action doctrine, exemptions have now to be explicit. A law could not operate to exempt conduct from competition law unless the exempting law specifically stated that the conduct was exempted and the federal government retained a right to veto state or territory exemptions. Such exemptions are published on the website of the antitrust authority.[81]

3.3 Core principles

To conclude, in most jurisdictions, the regulated conduct defence is based on the following main related legal principles and judicial policies[82]:

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76 European Commission (2006, at 29). This is also the case in some Member States. For instance Bundeskartellamt (2006), para.17.

77 *Fiammiferi*, at 57, *Deutsche Telekom*, at 279.

78 *Fiammiferi*, at 53-54.

79 *Fiammiferi*, at 55.

80 Competition Bureau of Canada (2010, p.5-6).

81 See : http://www.accc.gov.au/content/index.phtml/itemId/688173.

82 ICN (2004b, p.20).

- The defence aims to respect the intent of the legislator and the *bona fide* exercise by the State of its sovereign regulatory powers. In the particular context of multi-level governance, the defence may be justified by the principle of federalism and the principle of subsidiarity.

- Conversely, the defence is also based on the principle that it should not be up to politically unaccountable private actors to determine when marketplace outcomes are unacceptable or not. More generally as Odudu (2006, p.46) observes, "differential treatment of public authorities and private (corporate) citizens can be justified to reflect the differing roles played by citizens and the state in a constitutional democracy," as "public power is exercised in the public interest, and the public interest is determined through democratic representation".

- The defence also applies the principles of legal certainty and legitimate expectations by ensuring that firms do not face inconsistent legal demands from regulations and competition law.

- When regulation pursues the same goals than competition policy, the defence may also be justified by a cost-benefit analysis indicating that there is little added-value of applying competition law in addition to regulation.

In general, courts accepted the regulated conduct defence only restrictively and only to the extent that the exemption to antitrust is necessary to achieve the goals of regulation as all legal doctrines on which the defence is based (express immunity, implied immunity and state action doctrine) are strictly construed.[83] As observed by the ICN (2004b, p. 6), "as a general interpretative rule, exceptions to competition laws are not easily inferred by the courts, who need to be conveniently satisfied that the regulator validly intended to grant competition law immunity to some conducts. Thus, in the majority of cases, permission of a given behaviour under a specific regulatory regime cannot entail per se that the requirements of competition laws need not be complied with by the regulated subjects".

Beyond those core principles, the jurisprudence is complex as it has developed pragmatically on a case-by-case basis and lacks clarity in marginal cases.[84] The degree of supervision that the state should provide where there is an exemption from competition law is one such example. Moreover, sometimes the regulated conduct defence has been accepted too easily by lower Courts as its conditions of application have not been sufficiently strictly respected.[85]

The conditions for a regulated conduct defence may vary across jurisdictions. For instance, the EU has more power to limit the Member States' anti-competitive regulation than the U.S. federal institutions

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83 In some jurisdictions in the past, courts have applied the exemptions too broadly and the legislator intervened to narrow the interpretation. An example is provided by South Africa where the 1998 Competition Act excluded 'acts subject to or authorised by other legislation.' Courts began to interpret this phrase so that firms in regulated sectors escaped Competition Act oversight whether or not the other regulatory process also controlled anticompetitive conduct so that bank mergers were exempted, agricultural co-operatives were exempted. The legislation was amended to avoid the problem in the future: OECD (2003, p. 51).

84 ICN (2004b, p.19) ; Temple Lang (2004).

85 As observed by the Antitrust Modernization Commission (2007, p.344), "Critics warn, however, that the lower courts increasingly have applied the *Midcal* test in ways that allow defendants to obtain antitrust immunity in situations where a state did not intend to displace competition. Others question whether courts have properly taken into account the potential for one state's endorsement of anticompetitive conduct to have spillover effects that raise prices or otherwise harm consumers in other states. And there is also a serious question whether the state action doctrine should immunize conduct by state government entities and municipalities when they act as market participants".

despite the much higher degree of U.S. federal integration. In the EU, Member States have a duty to act in accordance with EU competition policy and organs of state should 'disapply' national legislation contravening EU law. In the U.S., the Supreme Court observes that the State action doctrine does not aim "to determine whether the State has met some normative standard", but rather to consider "whether the State has exercised sufficient independent judgement and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties."[86] Moreover, the case-law differs in some cases due the difference in institutional framework as explained in Box 3.

Box 3. Telecommunications cases in the EU and in the U.S.: Deutsche Telekom and Trinko

In the EU, the European Commission[87] imposed a fine of €12.6 million, on the basis of Article 102 TFEU, on the German telecommunications operator Deutsche Telekom for an anti-competitive price squeeze between its wholesale fixed network access charges and its retail end-users tariffs for access lines. At the same time, the German regulatory authority was regulating the wholesale charges on a cost-basis and imposing a price cap on a basket of retail services which included access lines and calls. The Commission condemned Deutsche Telekom because although it has no autonomy as regards wholesale charges, it has some room for autonomous actions with respect to retail tariffs. Deutsche Telekom could have eliminated or reduced the squeeze by decreasing the tariffs of its access lines (and by increasing the tariffs of its calls). The Commission decision and reasoning were upheld in appeal first by the General Court[88] and then by the Court of Justice.[89]

Adopting a different position, the U.S. Supreme Court[90] refused to condemn, on the basis of Section 2 of the Sherman Act, the telecommunications operator Verizon for not having given competitors access to its network. This was a private enforcement case launched by a customer of Verizon's competitors, Mr. Trinko. At the same time, the FCC and the New York state regulators had condemned Verizon for having violated its access obligation under the 1996 Telecommunications Act. The New York state regulator issued orders requiring Verizon to pay $10 million to its injured competitors, and pursuant to FCC consent decree, Verizon agreed to pay $3 million to the U.S. Treasury. The Court held that the regulatory duties to deal established under the 1996 Telecommunications Act did not create a new cause of action under the refusal-to-deal doctrine of Section 2 of the Sherman Act.

Some authors[91] note that the position of the U.S. Supreme Court may partly be explained by the specificities of the U.S. legal system as well as the peculiarities of the case at hand: first, the U.S. telecommunications regulation was very pervasive at the time; second the U.S. competition law provides for high private damages in cases of violation of competition law (possibility of class actions and treble damages) which increase the costs of competition law enforcement errors, and is administrated by judicial Courts which are not able to monitor behavioural remedies; third, Mr. Trinko was a customer of a new entrant that claimed to have suffered loss because his operator had faced refusal to deal from the incumbent (thus Mr. Trinko was more interested by the prospect of earning large financial compensation than by the protection of the competitive structure.)

The differences between the EU and U.S. solutions may also be explained by their different institutional settings. EU competition law has a constitutional value (as enshrined in the TFEU) whose application can not be removed by

86 *FTC v. Ticor Tile Ins. Co.*, 504 U.S. 621, 635 (1992). Note however that, as it is the case in the EU, U.S. state laws can not discriminate against interstate commerce according to the U.S. Constitution. See for instance: *City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978); *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662 (1981).

87 Commission Decision of 21 May 2003, Case 37.451 *Deutsche Telekom*, *OJ* [2003] L 263/9. See also a similar case: Commission Decision of 4 July 2007, Case 38.784 *Wanadoo España v Telefónica*, *OJ* [2008] C 83/6.

88 Case T-271/03, *Deutsche Telekom v. European Commission*, [2008] ECR II-477.

89 Case C-280/08P, *Deutsche Telekom v. European Commission*, [2010] ECR I-0000.

90 *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko*, 540 U.S. 682 (2004).

91 Geradin (2004, p.1548), Larouche (2006, p.7-8).

national sector-specific regulation whereas American competition law has the same legal value as federal sector-specific regulation. Moreover, the Commission is an administrative authority that has the same ability to analyse a case as a regulatory authority. Also, the Commission may want to use competition law cases to ensure that national regulator abide by EU competition rules.

4. The regulated conduct defence in merger cases

4.1 Competition law and regulatory merger review standards

On the substantive side, merger review may be based on different substantive standards across jurisdictions and across sectors. The review may be based on a competition law standard related to efficiency (the merger should be prohibited if it significantly lessens competition but otherwise is should be allowed). Or the merger review may also be based on a broader regulatory "public interest" standard (the merger should be prohibited if it goes against the public interest but otherwise should be permitted). The public interest standard, which may vary by industry, may include efficiency considerations but may also include other types of considerations. On the institutional side, the merger review may be done by the competition authority and/or by a regulatory authority.

For instance in the U.S., a public interest standard enforced by regulatory authorities apply in four industries: certain aspects of electricity (regulated by the Federal Energy Regulatory Commission); telecommunications/media (regulated by the Federal Communications Commission which take into account possible effects on the diversity of views available and the obligation to provide universal service, as well as likely effects on competition); banking (regulated by various banking agencies); and railroads (regulated by the Surface Transportation Board which take into account such factors as public benefits, labour conditions, environmental issues, and effects on competition.)[92] In Canada, the responsibility of the approval of bank mergers resides with the Ministry of Finance while the Competition Bureau and the Office of the Superintendent of Financial Institutions play an important role in the analysis. Also for the approval of major airline mergers, responsibility resides with the Governor in Council.

When the sector or a firm is subject to regulation, two issues arise in relation to a competition law merger review.

- The first issue is whether the regulation leads the sector or the firm to be exempted from the application of the competition law merger review. This issue should be dealt with according to the principles analysed above and the courts only allow exemptions restrictively.

- The second issue is what will be the impact of regulation in competition law merger analysis based on an efficiency standard.[93] More particularly, the issue is whether the regulation may be relied upon and used as an ex-ante defence to facilitate the approval of the merger.

4.2 The regulated conduct (ex-ante) defence in a competition law merger review

In the jurisdictions and sectors where a competition law merger review standard is applicable, the authority (whether the competition authority or the regulatory authority) may decide to take regulation into account when regulation pursues the same goals as competition law and controls the possible anti-

92 Antitrust Modernization Commission (2007, p. 363).

93 The paper does not deal with the relationships between antitrust merger review based on an efficiency standard and regulatory merger review based on a public interest standard: for examples on such issues, see ICN (2004c).

competitive behaviours resulting from the merger. This is particularly the cases in recently liberalised sectors where regulation supports competition law in steering the market towards effective competition. In such cases, the merging parties may invoke a sort of ex-ante regulated conduct defence to facilitate the approval of the merger.

For instance in the EU, the European Commission does not impose competition law remedies in order to approve telecommunications concentrations if the sector regulation is deemed to be sufficient to prevent anti-competitive behaviour or anti-competitive effects as a result of a merger (see Box 4). Similarly in Canada, the Competition Bureau has taken sectoral regulation into account to allow mergers in the electricity sector.[94] In the U.S., the Antitrust Modernization Commission (2007, p.364) recommends that competition law enforcement agencies take into account the effects of regulation in their merger assessment.

Box 4. Regulation serving as a competition law merger defence: Telecommunications in the EU

In the EU, the European Commission does not impose additional competition law remedies to approve a concentration if EU or even foreign[95] regulation is sufficient to prevent anti-competitive behaviour.

- In *Deutsche Telekom/OTE,* the European Commission approved a merger strengthening the power of the Romanian incumbent by taking into account the regulation imposed by the Romanian regulator on RomTelecom, a subsidiary of OTE.[96]

- Similarly in *Vodafone/Tele2 Italy/Tele2 Spain,* the European Commission approved a 4 to 3 merger by taking into account the regulation of fixed and mobile termination rates by the Italian telecommunications regulator.[97]

- In *T-Mobile/Orange Netherlands*, one of the reasons why the European Commission approved the merger was the fact the mobile termination rates of the merging parties were regulated by the Dutch telecommunications regulator, thereby limiting the merged entity's ability to foreclose rivals.[98]

With the strengthening of EU sector-specific regulation, its alignment to competition law principles and the adoption of the Roaming Regulation,[99] the tendency to take into account regulation in the assessment of concentrations has increased significantly. It led to many mergers being cleared without any competition law remedies being imposed, particularly in respect of vertical foreclosure concerns, where effective regulation is one factor preventing the implementation of foreclosure strategies by the merging parties.

Conversely, the European Commission imposed merger remedies where sector-specific regulation was deemed

94 ICN (2004c, p.6).

95 Commission Decision of 7 October 2005, Case M.3752, *Verizon/MCI*,.

96 Commission Decision of 2 October 2008, Case M.5148, *Deutsche Telekom/OTE*, paras.26, 89 and 115.

97 Commission Decision of 27 November 2007, Case M.4947, *Vodafone/Tele2 Italy/Tele2 Spain*, paras.22–27.

98 Commission Decision of 20 August 2007, Case M. 4748 *T-Mobile/Orange Netherlands*, para.49, where the Commission took into account in its competition assessment the fact that the Dutch regulator found that no undertaking possessed SMP on the wholesale mobile market for access and call origination.

99 Regulation 717/2007 of the European Parliament and of the Council of June 27, 2007 on roaming on public mobile telephone networks within the Community and amending Directive 2002/21, O.J. 2007 L171/32, as amended by Regulation 544/2009, O.J. 2009 L167/12.

to be inadequate.

- In 1999, in *Telia/Telenor*, the Commission found that the sector-specific regulatory regimes in place in Sweden and Norway at the time were inadequate to prevent anti-competitive conduct by the merged entity, which justified the imposition of remedies of a regulatory nature (*i.e.* local loop unbundling).[100]

- Later, in *Telia/Sonera*, the Commission appeared to take the view that both the *ex post* nature of regulation in Finland and Sweden and the EU's sector-specific regulatory regime (which required accounting separation, but not structural separation of undertakings with SMP and local loop unbundling) were (despite strengthening in the meantime) still inadequate to prevent anti-competitive conduct that could have arisen due to the vertical effects of the merger. The Commission therefore imposed conditions requiring the legal separation of the different fixed and mobile network and service businesses of the parties in Sweden and Finland, in addition to more "traditional" divestment conditions.[101]

Similarly in *Newscorp/Telepiu*,[102] the Commission imposed substantial access and behavioural remedies (even though the Italian media regulator had jurisdiction to apply sector-specific regulation), and relied on the Italian regulator to monitor their implementation.

Source: Garzaniti and O'Regan (2010 at 8-025 and 8-026)

5. Institutional settings to alleviate or reduce conflict between regulation and competition law and policy[103]

The legal conditions for the regulated conduct defence do not always correspond to the economic criteria for effective and efficient regulation. This may lead to the application of regulation that unduly restricts competition. It is therefore important that institutional mechanisms are in place to alleviate or reduce unjustified conflict between competition and regulation. Such mechanisms may play a role in the design and in the enforcement of regulation.

5.1 Institutional settings to alleviate or reduce conflict in the design of regulation and competition law

One of the main means to alleviate regulations which unduly restrict competition is to perform a competition assessment on the proposed and the existing regulations.[104] Such competition assessment is particularly important if the regulation provides for an explicit competition law exemption. However, for efficiency reasons, a detailed and comprehensive competition assessment should only be undertaken when the initial estimate suggests that the potential costs of the anti-competitive effects of the regulation are significant enough to justify the necessary expenditure of resources that an in-depth competition assessment requires.

100 Commission Decision of 13 October 1999, Case M.1439, *Telia/Telenor* .

101 Commission Decision of 10 July 2002, Case M.2803, *Telia/Sonera* .

102 Commission Decision of 2 April 2003, Case M.2876, *Newscorp/Telepiu*, , para.259.

103 Also Sokol (2009).

104 As recommended by the Council of the OECD: see Recommendation of the Council of the OECD of 22 October 2009 on Competition Assessment.

The OECD Competition Assessment Toolkit[105] provides a general methodology for identifying unnecessary competitive restraints and developing alternative, less restrictive policies that still achieve government objectives. It includes the following four steps:[106]

- Identify policy objectives,
- State alternative regulations which would achieve the same policy objectives,
- Evaluate the competitive effects of each alternative policy option, with the help of a competition checklist,
- Compare the alternatives.

If the assessment identifies significant potential for a weakening of competition within the affected industry or related industries, policymakers should seek, according to the proportionality principle, the least anti-competitive alternative that would achieve the same policy goal. Moreover, the benefits and costs of such a regulatory approach should be weighed against each other. Anti-competitive regulation is only justified if its benefits exceed its costs.

Such competition assessment should be integrated at an early stage in the policy making process[107] and competition authorities should be associated as much as possible. In particular before putting in place explicit competition law immunity through a legislative measure, the U.S. Antitrust Modernization Commission recommends to consult the federal antitrust agencies.[108]

In the EU, the European Commission Impact Assessment Guidelines require an ex-ante analysis of the impact on effective competition of all major EU initiatives.[109] In the United States, Regulatory Impact Analysis (RIA) guidance documents require consideration of market impacts.[110] In Australia, a very comprehensive competitive assessment of federal and state regulations was undertaken in the mid-nineties (see Box 5). Today, the ACCC requires that all RIA documents state whether the proposed regulation complies with the terms of the National Competition Policy agreements, and include analysis to support this conclusion.

Box 5. Australian National Competition Policy Reforms

After the completion of the Hilmer Committee's report in 1993 which urged greater microeconomic openness with a focus on pro-competitive reforms, all nine governments agreed in 1995 to undertake a systematic review of legislation that had anti-competitive effects, even if it was not directly inconsistent with the competition law. This included laws that set up entry barriers, such as licensing regimes, or that controlled conduct by setting or controlling qualifications, opening hours, prices, technical specifications, and marketing arrangement. Some 1700 separate enactments, mostly at the state level, were identified as requiring a review. Most reviews were completed in 2001. The standard of review was that the restriction on competition should be necessary to achieve the objectives of the regulation, and the benefits of the restriction should outweigh the costs. New legislation requires a regulation impact

105 See OECD (2011a and 2011b). Also Baldwin and Cave (1999, Chapter 7), Cooper and Kovacic (2010, p. 1607).

106 OECD (2011a, p.35).

107 Also ICN (2002, p.60).

108 Antitrust Modernization Commission (2007, p.353: recommendation 59).

109 European Commission (2009, p. 33 and 40-41). In the EU Member States, see OFT (2007).

110 See Office of Management and Budget, Circular A-4, 17 September 2003.

analysis that incorporates the same standard. The federal government offered funding to aid state and territorial governments with any adjustment costs that might arise from revisions of legislation.

Other means ensuring the reduction of unjustified conflicts between regulation and competition rules are: to provide the regulation with a sunset clause forcing the legislator to revisit after a certain period the need for a regulation which may have anti-competitive effects[111]; or to base regulation on competition principles as it as been done for instance with the EU regulatory framework for telecommunications (see Box 1).

5.2 Institutional settings to alleviate or reduce conflict in the enforcement of regulation and competition law

Even if regulation and competition law pursues similar objectives, a conflict may still arise in the enforcement of both types of rules. This is especially the case when different authorities are involved. To alleviate those risks, several mechanisms are possible. These mechanisms should be adapted to the national circumstances and flexible enough respond to, develop, and change in accordance with, new economic circumstances.[112]

5.2.1 Delimitation of jurisdiction between authorities in charge of enforcement of competition law and regulation

Single authority in charge of competition law and regulation

The most radical means to alleviate conflict between the implementation of competition law and regulation is to ensure that the same authority is in charge of both legal instruments. In Australia, New Zealand or the Netherlands, the competition authority applies the regulation affecting certain network industries.

Conflicts may, however, still arise even if the same authority is responsible for both competition and regulatory enforcement. There is a risk of conflict that may arise between the objective to protect competition and other objectives pursued by the regulator (for example financial market stability). Regulatory objectives may in some cases take precedence over those pursued by competition rules.[113] Internal co-operation and hierarchical oversight are thus required to ensure close integration of competition and regulatory objectives.

Different authorities in charge of competition law and regulation

A common institutional set-up in many jurisdictions is based on a functional separation of the regulatory and competition law enforcement activities. Enforcement of competition law is therefore overseen by the competition authority while the regulation of prices and access is assigned to an often sector specific regulator.[114]

111 Antitrust Modernization Commission (2007, p.353 recommendation 60).

112 ICN (2004c, p.4), ICN (2005, p.10). For examples of institutional settings to reduce conflict in the telecommunications sector, see OECD (2006).

113 ICN (2004a, p.4), Temple Lang (2008, at section VI).

114 ICN (2004a, p. 4).

The main advantage of this functional approach is transparency and specialised expertise of each body.[115] There are, however, also a number of risks including: inter-agency conflict, inefficient use of resources and increased costs, additional requirements and complexities due to multiple and divergent standards of review, potential delay in closing the transaction in merger cases, potential lack of transparency, risk of inconsistent results when complying with the requirements of both authorities, risk of regulatory gaming by market participants.[116] Thus a sound allocation of tasks between authorities and cooperation is necessary.

When there is a specific regulatory authority, it may have concurrent power to apply competition rules. In those circumstances, one means to alleviate conflict is through the conclusion of cooperation agreements between authorities which set out the respective roles of each. (See the example of the UK in Box 6).

When there is no concurrency power, an allocation of roles may be decided by the laws, courts or by agreements or practices between agencies. For instance, in Mexico, the law provides that the competition authority is responsible for some aspects of regulation: the determination of market power that is needed prior to regulation of a firm's product or services. In the U.S., courts have decided, under the primary jurisdiction doctrine, that the competition authority should remain the appropriate body until the regulatory authority decides when the regulatory decision has a bearing on the competition law dispute.[117] In the EU, the Commission has transferred several telecommunications competition law cases to the national regulatory authorities when they could be dealt with by such national authorities equally efficiently.[118]

Box 6. The division of work in case of concurrency power: The UK case

Under the 1998 UK Competition Act[119], the OFT and sector regulators have concurrent power to pursue cases of alleged anti-competitive behaviour. The Competition Act (Concurrency) Regulations 2004 sets out which regulator is to undertake the relevant functions. In 2004 the OFT also released guidelines entitled "Concurrent application to regulated industries" which state that the purpose of the concurrency regulations is to ensure "the coordination of the performance of concurrent functions under the Act by the OFT and the Regulators".[120]

The power of sector regulators to apply competition law has recently been considered in the Cityhook case[121]. Cityhook claimed that the OFT had acted unlawfully in failing to consider whether the case should be transferred to the telecoms regulator Ofcom (at the time Oftel) under the concurrency provisions. At the start of the case the OFT and Ofcom had formally agreed that the OFT would take on the case. The OFT then decided, due to administrative priorities, to close the case. One of the reasons given by the OFT was Ofcom's concurrent jurisdiction in the matter. However, at no point did the OFT engage in a dialogue with Ofcom which would have allowed the regulator the opportunity to take over the case. The court held that as a result the OFT had not respected the concurrency regulations. Proper consideration should have been given to the possible transfer of the case to Ofcom, who should be

115 On those advantages, see also Laffont and Tirole (2000)

116 ICN (2005, p.9). Note that Barros and Hoernig (2004) show that it may be more efficient that both authorities decide a case independently than jointly for three reasons. First, with independent decisions, the probability that cases are solved is highest, even though each authority may give less attention to the case than it was alone. Second, independent decisions are less vulnerable to lobbying. Third, it is also less likely that no authority feels responsible for a given case.

117 *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973). See Hovenkamp (2005 at §19.4).

118 Geradin and Sidak (2005, p.539), Garzaniti and O'Regan (Chapter V).

119 See section 54.

120 See OFT (2004, p.30).

121 *Cityhook Ltd, Cityhook (Cornwall) Ltd v Office of Fair Trading* [2009] EWHC 57 (Admin).

able to decide for itself (based on its own available resources and administrative priorities) whether to take on the case.

The National Audit Office (NOA) 2010 Review of the UK's Competition Landscape[122] also discusses in some detail the role of regulators in applying competition law. One of the findings of the review was that "to date Regulators have used their competition enforcement powers sparingly, with the risk that the case law is not as rich as it needs to be." Regulators tend to prefer using their regulatory powers and the review provided three main disincentives against the use of competition powers; (i) the duration of Competition Act cases, (ii) the difficulty of proving an infringement and the resource commitment and (iii) the impact on a regulators own limited resources when compared to using regulatory powers.

5.2.2 Cooperation between competition and regulatory authorities

When different authorities are in charge of the enforcement of competition law and regulation, they may conclude formal cooperation agreements to alleviate or reduce conflict between their activities. Such cooperation is particularly necessary in some jurisdictions such as the EU where regulatory authorities can not violate EU competition rules and where the principle of proportionality requires the avoidance of multiple procedures on similar facts. Cooperation agreements may provide for the following:[123]

- A right for the competition authority to make submissions or provide industry regulators with comments or experts reports, participate in regulatory hearings, and ask for optional referrals. For instance, under the EU telecommunication regulation, a national regulator performing a regulatory market analysis should associate the national competition authority and then submit its draft decision to the Commission (including the Directorate-General for Competition) for possible veto for violation of EU law (including competition rules).[124] In the U.S., the Antitrust Division of the Department of Justice participates in proceedings, submits comments to, appears before, or consults on competition-related issues with many federal agencies. Also Section 271 of the U.S. Telecommunications Act of 1996 requires the FCC to consult with the DOJ regarding entry in the long distance telephony market and to accord "substantial weight" to the DOJ's evaluation. In Canada, the Competition Bureau has authority under sections 125 and 126 of the Competition Act, to make representations in federal and provincial regulatory proceedings in respect to competition and those representations are given serious consideration by the regulatory authorities.

- Allowing for joint proceedings in certain instances in order to make use of complementary expertise;

- Mandatory agreements, consultations and referrals by the competition authority to the regulator, or notification of investigations that are within the jurisdiction of the other agency as in Portugal (see Box 7), and mandatory consultation or referrals as is the case for example in Germany;

Both authorities may also rely on more informal and soft techniques of co-operation in the following manner, which is important to develop a shared culture:[125]

122 Available at http://www.nao.org.uk/publications/0910/competition_landscape.aspx

123 ICN (2004c, p.8) and ICN (2005) which contains specific examples in some jurisdictions, OECD (2005b).

124 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, OJ [2002] L 108/33, as amended by Directive 2009/140, Art. 7, 7a and 16(1).

125 ICN (2004d, p.6) and ICN (2005, p.11) which contains specific examples of some jurisdictions.

- Formal and informal contacts, and exchange of views, appointment of contact persons within each agency, appointment of industry experts, regular or ad-hoc meetings to consider pending matters, and the creation of joint working groups or inter-agency task forces. Such contacts usually require the exchange of information that may need to be prescribed by law if the information is confidential.

- Training and exchange of staff and officials on a regular basis, such as providing educational co-operation and vocational training by the other authority, allowing staff at each agency to work at the other, and encouraging staff secondment or exchange of officials between agencies. For instance, the Australian Competition and Consumer Commission (ACCC) has associate commissioners in addition to the five permanent commissioners. Associate commissioners can include appointees from Commonwealth and State regulatory agencies.

Box 7. Consultation between Sector Regulator and Competition Authority in Portugal

In 2008 the Portuguese Competition Authority found that *PT Comunicações* (PTC) abused its dominant position in the wholesale market for circuit leasing. Wholesale clients lease circuits for interconnection between fixed and mobile networks and the sector is subject to regulation by ICP-ANACOM, the National Communications Authority. PTC was applying discriminatory conditions for equivalent services, to the benefit of enterprises in its own group and to the detriment of competitors. PTC had proposed its scale of charges to ICP and the regulator decided not to oppose them coming into effect.

In Portugal, competition law and sector regulation are applied in complementary legal frameworks, with the ICP review taking place ex-ante and competition law coming into play ex-post. Intervention (or lack of it) from a sector regulator does not prevent the possibility of the competition authority taking action. Companies are therefore obliged to ensure that their behaviour confirms to both legal frameworks.

Whenever the competition authority carries out an ex –post analysis in the electronic communications sector, it is obliged to consult with ICP. In this case ICP was consulted both at the instigation of the case, and before the decision was adopted by the competition authority. The final decision took into account the opinion issued by ICP on the case.

In setting the fine for PTC the competition authority took as mitigating circumstances the decision of ICP not to oppose the scale of charges when they initially came into effect, and the fact that PTC ceased to apply them after the sector regulators later decision on the issue.

Box 8. The interaction between payments systems interchange fee regulation and competition law in Australia

The Reserve Bank of Australia (RBA) has powers to regulate payments systems where it considers it to be in the public interest. In this context the public interest is defined to include financial safety of the payments system, efficiency and competitiveness (Payments Systems (Regulation) Act (1998)). The Australian Competition and Consumer Commission concurrently has general powers to enforce the competition law's price fixing provisions and to grant applications for exemptions from the price fixing prohibitions (known as "authorisation") where there is net public benefit. There is a Memorandum of Understanding between the two agencies to facilitate efficient processes and outcomes.

When using its powers, the RBA's policy is to encourage participants to voluntarily reform their payments systems and, failing a voluntary solution, the RBA would generally regulate. The RBA's power to regulate includes, amongst other things, the power to make standards setting or controlling interchange fees paid between institutions for processing payments within a payments system. Indeed, under this regulatory framework there have been voluntary interchange fee reforms and also the RBA has imposed regulations on a number of occasions.

In one case of attempted voluntary reform, the participants in the Electronic Funds Transfer Point of Sale system (EFTPOS), agreed to adopt a zero interchange fee in response to firm moral suasion by the RBA of a reasonably

specific nature. Because the proposal for a zero interchange fee was by agreement between the participants, the conventional wisdom was that the agreement would risk breaching the prohibition against price fixing unless the participants sought and were granted ACCC authorisation. The ACCC did indeed grant authorisation but merchant customers of the system successfully appealed to the Australian Competition Tribunal Re EFTPOS Interchange Fees Agreement [2004] ACompT 7 (25 May 2004) who quashed the grant of authorisation and the voluntary reform therefore failed. This ultimately resulted in further reform work and a mixed voluntary and regulated outcome.

In another case where voluntary reform failed to satisfy the RBA's reform priorities for the Australian part of the Visa and MasterCard systems, the RBA used its powers to regulate the interchange fees The Setting of Wholesale ('Interchange') Fees in the Designated Credit Card Schemes (2005). In this case, the question then arose, as to whether participants in such payments systems who followed the RBA's requirements might be in contravention of Australia's price fixing prohibitions These are now contained in the Competition and Consumer Act (2010) and previously known as the Trade Practices Act (1974). There are a number of possible theories: perhaps there is no breach of the competition prohibitions because the RBA regulations remove the freedom of agreement between the parties and therefore there is no real "agreement" to set prices; perhaps there is an agreement but the agreement did not have the purpose or effect of fixing prices because the regulation not the agreement had that purpose and effect; or perhaps the enactment of the RBA's powers constitute a limited implied repeal by Parliament of the general competition law prohibition. On the other hand, perhaps the competition law prohibition would be contravened.

ACCC litigation was at least a theoretical possibility and private sector litigation was reasonably likely. Rather than leave the answers to these questions uncertain, an exemption from the competition law prohibitions were put in place, initially temporarily by regulation and subsequently by legislation. After the temporary regulation was replaced the permanent legislation is contained within section 18A of the Payments Systems (Regulation) Act (1998) and this operates in conjunction with section 51(1)(a) of the Competition and Consumer Act (2010).

5.2.3 Consistent interpretation of regulation and competition law via judicial appeal

Another important means to alleviate conflict between the implementation of competition law and regulation is to ensure that both sets of rules are interpreted consistently. This may be achieved through the following techniques:

- Ensuring a common appeal framework against the decisions of the competition law and regulatory authorities.[126] This is the case in Belgium, France and the UK where the appeal against the decisions of the competition authorities and of some network industry regulators are heard before the same appeals court.

- Ensuring that the competition authority or the regulatory authority can be heard by judges as *amicus curiae*.

- Ensuring that competition authorities adopt interpretative guidelines clarifying in advance the application of competition law to the regulated sectors. Such guidelines are useful for firms but also for judges. For instance in the EU, the European Commission adopted guidelines on the application of competition policy in the telecommunications or postal sectors.[127] This was also the case in Japan in the electricity, gas and telecommunications sectors.[128]

126 ICN (2004d, p.8).

127 European Commission (1998a) and (1998b). Temple Lang (2008, at section I).

128 ICN (2005, p.61).

5.3 The importance of advocacy by competition authorities

As defined by the ICN Advocacy Report[129], "Competition advocacy refers to those activities conducted by the competition authority related to the promotion of a competitive environment for economic activities by means of non-enforcement mechanisms, mainly through its relationships with other governmental entities and by increasing public awareness of the benefits of competition". Thus advocacy refers to practically all the activities of a competition authority that do not fall under the enforcement activities.

The effectiveness of such competition advocacy is affected by three main factors: the timing of the consultation, the compulsory or non-compulsory status of the consultation and the degree to which the recommendations made are binding.[130]

In the context of a regulated conduct defence, advocacy implies convincing other public authorities to abstain from either designing or enforcing a regulation in an unduly anticompetitive way. As explained above, this implies (i) encouraging and participating in competition impact assessment, (ii) cooperating with regulatory agencies to ensure that they fulfil their mandates by respecting competition policy objectives, and (iii) co-operating with judicial bodies to ensure they interpret regulatory provisions in a way consistent with competition policy.

In the specific context of deregulation, ICN (2002, p. 70) observes that advocacy has been carried out in three main ways:

- Elaboration of sector specific studies that consider market structures, emphasizing the benefits of allowing access and of introducing competition,

- Implementation of cooperation agreements between the sector regulatory agencies and the competition authorities, especially useful to detect restrictive anticompetitive practices on competition by the regulated agents,

- Drafting of guidelines and sector codes of conduct or compliance with the competition law.[131]

The practice shows that such advocacy has been particularly useful in the sectors of telecommunications, electricity, transport, and financial services.

6. Conclusion

The "regulated conduct defence" shields companies who carry out potentially anticompetitive behaviour from enforcement action when the behaviour is required under federal or state regulation.

A number of key points emerge from this paper:

- The regulated conduct defence is grounded in several legal principles (state sovereignty, federalism, subsidiarity, legal certainty and legitimate expectations). The openness of competition law authorities to the legitimacy of regulated conduct defences is essential for ensuring that companies are not placed in situations where they face inconsistent legal demands. The regulated

129 ICN (2002, p. 25).

130 ICN (2002, pp.59-67). Also Cooper and Kovacic (2010, p.1581).

131 See above footnotes 127 and 128.

conduct defence may, however, entail substantial welfare costs for society. Therefore, the courts should adopt a cautious approach when applying the defence.

- Regulations can at times require actions that would, absent the regulation, constitute violations of competition law. (i) When regulation complements and pursues the same objectives as competition law (e.g., total or consumer welfare), regulated conduct is less likely to be at odds with competition law, assuming the regulation and competition law rigorously implement the common goal. (ii) When regulation restricts competition (e.g. by establishing entry barriers or fixing minimum prices), disputes may require weighing of different societal objectives.

- The regulated conduct defence is a narrower form of immunity than exempting an entire sector from the application of competition law and permitting this defence should be preferred to broad, sector-wide exemptions from competition law.

- The regulated conduct defence is based on several legal doctrines such as express immunity, implied immunity and the state action doctrine that have been developed pragmatically in the case-law. Although the core principles are relatively clear in many jurisdictions, uncertainties remain.

- The conditions of application of a regulated conduct defence depend on the hierarchy of norms. When competition law and regulation are at the same hierarchical level, the regulated conduct defence applies if one of the legal rules provides for competition law immunity (express immunity) or if there is a plain repugnancy in the application of both legal rules to the challenged conduct (implied immunity). In some jurisdictions, the defence also applies where there is no added-value in applying competition law in conjunction with regulation. When competition law is at a superior level to the regulation, the regulated conduct defence applies when the challenged conduct is imposed or at least actively supervised by the regulator.

- The regulated conduct defence should only apply in cases where companies have no autonomy over their potentially anti-competitive actions. If a regulation strengthens or facilitates anti-competitive behaviour without directly imposing specific conduct, a company's conduct is open to discretion and competition laws should in principle apply to the regulated conduct.

- In some jurisdictions competition rules enacted at the federal level prevent State regulators from imposing or facilitating a conduct that would otherwise violate the competition law.

- The regulated conduct defence is sometimes used as a defence in merger cases on the basis that merged companies, even if they gained market power, would not be able to harm others due to access or price regulations, that constrain the ability to exercise market power.

- Institutional settings can reduce potential inconsistencies between the design and the enforcement of regulatory structures and competition law, for example by (i) assessing competitive effects of regulations before the adoption of regulations, (ii) providing regulators with competition law enforcement powers or a competition authority with regulatory powers, (iii) ensuring mutual co-operation between regulators and competition authorities through both formal and informal agreements and (iv) ensuring a consistent interpretation of regulatory and competition rules through, for example, advocacy by competition authorities.

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