9.6 PUBLIC VALUES AND UTILITY SECTORS. TOWARDS A LEGAL ASSESSMENT FRAMEWORK

9.6.1 Introduction

In utility sectors, public values such as affordability, quality, universal service and continuity of service require safeguarding. During the last two decades most utilities have been either liberalized, privatized or both. This change has challenged governments to start regulating utility sectors in a different way. This study aims to contribute to this shift from traditional regulation towards a new approach. The assessment framework that I have developed is limited to certain instruments. Nevertheless, its open character makes it possible for other instruments to be added. Furthermore, the systematic approach of this framework could be applied to other sectors of great public interest as well.

In this thesis I have examined aspects associated with liberalization and privatization of utilities in general (chapters 1-4) as well as in four specific utility sectors (chapters 5-8). The assessment framework is designed to enable the legislator and scholars to take a systematic approach with regard to decisions concerning liberalization and privatization of utility sectors. In this brief introduction the research thesis and research plan are described (9.6.2), after which the assessment framework will be presented (9.6.3). This summary will be concluded with a short review of the comparison between the four sectors, applying the assessment framework (9.6.4).

9.6.2 Research thesis and plan

The central question this thesis ultimately seeks to answer is which conditions and restraints are important with regard to the regulation of markets in utility sectors in order to safeguard public values from the perspective of the national legislator, within the limits posed by EU-law? In answering this question, this research aims to create an assessment framework with which the national legislator could develop regulation in a more systematic way.

This question is divided into sub-questions which are discussed in general chapters 1 to 4. Chapter two explains which prerogative remains with the national legislator given the limits imposed by EU law. Chapter 3 then goes into the specific aspects that need to be taken into account when safeguarding public values in regulated utility markets. The question addressed in chapter 4 is what can be expected from a number of specific instruments dealing with regulated markets in utility sectors.

These findings are then applied to four specific utility sectors: drinking water (chapter 5), electricity (chapter 6), local transport (chapter 7) and cable (chapter 8). In these chapters the same question is addressed: “to what extent is the national government (Minister and Parliament) equipped to intervene in these sectors to safeguard public values whilst taking into account the limits set by EU law, the competition model, the available instruments and the accountability born by either government or market?”

In the conclusion the findings of the general chapters are recapitulated (9.2) and a comparison of the findings in the four utility sectors is made (9.3). After this the assessment framework, which has been applied to the four utility sectors and which is based on the findings in the general chapters, is presented (9.4). This summary is mainly based on chapter 9 as it addresses the findings of all previous chapters.
9.6.3 The assessment framework

The assessment framework put forward in this thesis enables the national Dutch government to impose a well-balanced set of instruments in order to regulate markets in utility sectors. The framework consists of different components. The first four components tackle the question of how to handle EU law, how to deal with public values, how to choose between different types of competition and which parties to involve when regulating markets in utility sectors. The fifth component addresses which instruments can be used in order to safeguard public values in each different type of competition.

(1) EU law

EU law imposes limits on the prerogative of member states to regulate utility sectors, and sets the legal framework within which member states can operate. It is necessary to define these limits in order to ensure both that the Dutch government does not impinge on any boundaries imposed by Union law as well as that the freedom that does remain is used fully and efficiently. For these reasons the first step in the assessment framework covers EU law.

Union law deals with the tension between competition and public values in one of three different scenarios. In the first, member states are still fully sovereign, which means they are free to make any choice with regard to regulation. In the second, primary EU law is applicable, though exceptions might still be possible. In the third, EU-law imposes specific secondary law in a particular sector. In the assessment framework these three scenarios are dealt with.

The first question is therefore if any specific piece of EU legislation is applicable. If this is the case, obligations of member states following this specific law should be investigated. The question then remains how much room the Dutch legislator has left with regard to identifying public values, the choice for a type of competition and the regulating instruments it still possesses.

If the sector has not yet been harmonised or if the harmonisation is not exhaustive, it should be ascertained whether and to what extent the services rendered or goods delivered qualify as services of general non-economic interest (SGNEI) or services of general economic interest (SGEI). Primary EU law does not apply to a SGNEI. It follows that member states have a prerogative regarding the regulation of SGNEI’s. It should be noted that the applicability of EU law is partly dependent on the way a specific sector is organized. If the organization is based on the principle of solidarity, fulfils only a social function and there is no aim for profit, the Court can conclude that the goods and services qualify as non-economic and therefore as SGNEI’s. This conclusion has not been reached so far in utility sectors but cannot be categorically ruled out.

If the goods and services do qualify as a SGEI – which is often the case in utility sectors – EU law is applicable, though certain exceptions could be justified. A legitimate exception to EU competition law needs to meet four criteria. Firstly, there must be an act of entrustment, whereby the State confers responsibility to an undertaking for the execution of a certain task. Secondly, the entrustment must relate to a service of general economic interest. Thirdly, the exception has to be necessary for the performance of the tasks assigned and proportional to that end (hereinafter; “the necessity requirement”). Finally, the development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

A legitimate exemption from the application of internal market legislation, i.e. the rules regarding the four freedoms, also needs to meet certain criteria. There should be a mandatory requirement relating to the public interest. Moreover, the measure has to be proportion-
ate. The Court has adapted a strict proportionality-test with regard to this exception, which means there should be no other, less intrusive, way to attain the same goal.

If the goods and services qualify as ‘normal’ goods and services (no general interest) EU law is fully applicable.

(2) Public values
The next step is to identify the public values that the regulation should address. In this thesis, public values are defined as all the goals government wants to reach in a sector regardless of whether it will be attained by government or by market players. The most prominent public values that have been identified by the EU and national governments are: continuity of service, user- and consumer-protection, universal service (including affordability), quality of service, protection of the environment and public health.

First it should be determined which public values stem from EU law. It is of great importance that the national legislator subsequently identifies – as far as possible – these public values in a specific sector. It is not always possible to define public values completely. As chapter 3 demonstrates, public values turn out to be ambiguous and change over time. Apart from that, they can be conflicting and therefore might require a trade-off. Because of their changing nature, public values cannot and should not always be defined in legislation. Furthermore, public values sometimes cannot be defined, since their safeguarding sometimes is the result of the process of competition. Nevertheless it is important that the legislator identifies and ranks the public values as much as possible. If this is not possible it should be noted who will eventually identify and weigh the public values.

(3) Competition model
The third component of the assessment framework consists of the choice for the right competition model. This choice is dictated by the economic characteristics of a specific sector. There are roughly five models to choose from: competition between markets, competition on the market, competition for the market, yardstick competition (including benchmarking with intervening measures) and no competition (including benchmarking without intervening measures). The central economic characteristic that justifies regulation in utility sectors is a natural monopoly. Utilities are often transported through an infrastructure with sunk costs. It follows that duplication of the infrastructure is not profitable. Moreover, a utility is of general interest and often hard to substitute.

In a natural monopoly, competition between markets is not realistic. However, this is by no means a fixed conclusion. As can be seen in the telecommunications sector, a natural monopoly can become less strong or even fade away due to technological innovations.

The other mentioned models of competition are realistic options in case of a natural monopoly. Competition on the market demands a division of the infrastructure so that suppliers can compete whilst the transporter stays monopolistic. If the characteristics of the sector allow this, competition on the market can therefore be a realistic option. Competition for the market demands the possibility and the profitability to hand over the operation of services periodically. The final option is not to introduce competition. Benchmarking encompasses a periodical comparison of different aspects of performance such as price, quality etc. If useful, intervening measures could follow.

If there is no (longer) a natural monopoly in a utility sector, competition between markets is preferable. From an economic perspective, this model provides a productive situa-
tion for competition, which makes governmental intervention on this point unnecessary. Other characteristics can of course still make other interventions necessary.

(4) Actors
The next step is to decide which actor in a given type of competition in a utility sector identifies and balances public values. The first question is whether the public values should be identified by the government and if so whether it should be done under political responsibility. If the safeguarding of public values is left to private actors, it should be assessed whether they are equipped to this end.

(5) Instruments
For each type of competition, the assessment framework contains an evaluation of a number of instruments. The framework specifies which conditions and restraints should be taken into account when deciding the instruments to use for each type of competition. I have distinguished three functions an instrument can have; the design function, the control function and the correction function. When a certain type of competition is chosen, the market should be organized using instruments that ensure all these functions are covered. The first step is to assess which instruments can enable competition in a given situation, and in which way public values could best be identified and balanced. This assessment concerns the choice of instruments with a design function. After designing the market, the way in which design instruments can best be supervised should be determined, culminating in a choice for instruments with a control function. Finally, it should be determined which instruments are necessary if it appears that public values are not met by the design and control instruments.

Competition between markets
Where there is competition between markets, identifying and balancing public values should chiefly be done by the market actors through competition. As a consequence, only few instruments should allow intervention through the political arena, as any intervention would probably disturb the process of competition. In this situation, political actors should therefore exercise restraint towards the market process.

The instrument of commanding law has a design function and has an important part to play in this type of competition (compared with other instruments). With far-reaching competition there is little need for specific and concrete public intervention. Therefore only the preconditions and rules of play should be established. These conditions and rules can be laid down in law, allowing national and regional legislators to set the parameters within which competition can take place. In this way, safeguarding public values by private actors can be facilitated and restrained. Only preconditions and rules of play should be laid down, since there is little room in this type of competition for far-reaching public intervention with regard to, for example, price and quality.

Since only preconditions and rules of play are to be laid down, it is not problematic that these are hierarchical and relatively inflexible. It is important that rules, whenever possible, are laid down at a level that enables that they can be changed more easily. This could be at the level of a regulator, whose lack of political accountability could be compensated by equipping the minister concerned with a right to reverse any interventions made.

Apart from this, the availability and publication of information is of great importance, and can also be considered an instrument with a design function in this type of competition. Consumers need to be enabled to make a rational choice in order to ensure that adequate and
effective competition will materialize. For this to happen, sufficient information has to be available to them. It should be well noted that consumers often lack rational behaviour. It follows that in utility sectors a certain degree of supervision on the adequacy and effectiveness of competition will remain necessary.

Regulating the prices in advance is in principle not necessary provided that adequate and effective competition arises. Ex ante price intervention can be very disruptive of market forces and should therefore only be used if no other option to address the situation is available. An intervention later on, on the grounds of general competition law, is another if the prices turned out to have been unreasonably high. Furthermore, commanding legislation could stipulate that reasonable prices should be applied if a market is transitioning towards more effective competition.

Another instrument that could be used to intervene in order to fulfil a design function is a license. This instrument does have the drawback that it is very far-reaching. Moreover, licenses are more suited to situations in which an extensive weighing of interests is needed. If all licensees should meet the same conditions, a duty to report and commanding legislation could be adequate measures instead.

With this type of competition, public ownership (of shares) is not suitable considering the far-reaching competition that is envisaged. Only where it concerns very vital infrastructure for which public control is imperative, this could be considered an option. Where this is the case, it should be well noted that another type of competition might be more suitable, considering the obvious nature and weight of the public values involved.

Furthermore, it should be considered which other instruments are necessary, more in particular instruments of an administrative nature with which existing rules can be enforced. It depends on the situation if a periodic penalty payment (“last onder dwangsom”), a coercive measure (“last onder bestuursdwang”) or a binding instruction (“bindende aanwijzing”) is appropriate.

Competition on the market
When addressing the issues of competition on the market one must distinguish the market of supply and the market of transport. In the market of supply, direct competition exists, while the market of transport is monopolistic in nature; the infrastructure remains in control of a natural monopolist who is obliged to allow access to suppliers.

As the issues concerning the market of supply greatly resemble the issues addressed in the above on competition between markets, whilst in the market of transport there is no competition, only the market of transport will be discussed hereinafter.

Because of the absence of competition, obligations of the monopolist(s) should be laid down in some detail in commanding legislation. The most important of these obligations is the ensurance of access to the infrastructure and the applicable conditions.

As a consequence, prices for access should be laid down in advance under political control. This applies both to prices that suppliers pay for access and to prices that consumers pay for transport.

The availability and publication of information is chiefly for reasons of control. The monopolist should be obligated to provide information to the government in order to check whether the applicable rules are observed.

Whether public ownership should be stipulated depends on the necessity to be able to keep public control of the infrastructure. It follows from this study that complete unbundling of ownership is not compatible with the rules on free movement of capital.
9. Summary

Competition for the market

Competition for the market needs an instrument with which the monopoly can periodically be transferred and with which the monopolist can be restrained. This is necessary to prevent market failure. The franchise (‘concessie’) is a suitable instrument to organize this type of competition. Identifying and balancing public values can be done by the national legislator as well as by the franchiser.

Since the franchisee is a monopolist, it is important to lay down quite detailed rules concerning price, quality etc. Prices should be set in advance as well. It is necessary to estimate how much freedom franchisers should have in laying down these prices.

The availability and publication of information fulfils a control function in competition for the market. The franchiser needs to be able to control the observance of the franchisee and to see whether other problems arise. A drawback from the public intervention perspective is that it is hard to change the content of the franchise since mutual consent is required.

There is no good reason for public ownership when dealing with competition for the market. The instrument of franchise brings far-reaching public influence. In general the monopolies do not enclose the ownership of infrastructure.

Benchmark with and without intervention measures (yard stick competition)

If direct competition is not suitable, benchmarking can offer an alternative. It is used when permanent monopolies are in place and the introduction is not wanted or productive. In this type of competition, identifying and weighing public values is mostly done by the government. The existence of these monopolies necessitate laying down rules and performance indicators in legislation into some detail. When there are intervention measures linked to the benchmark, more details can be omitted from the applicable legislation since underachieving monopolists will be disciplined by these measures.

The core of the benchmark is the availability and publication of information. The benchmark itself is an instrument with a design function. This instrument should impose that the monopolists provide the benchmarker with relevant and adequate information. Additionally, the government should be enabled to check whether the rules that are laid down are complied with.

In the case of benchmarking with no intervention measures, prices should be regulated in advance because of the permanent monopoly. When intervention measures will follow, the prices need not be set in advance but they should be closely scrutinized. Public ownership can be designated because of the existence of permanent monopolies. This can be important especially for keeping vital infrastructures public.

9.6.4 Application to the utility sectors

When applying the assessment framework to the different utility sectors it is clear that some issues in these sectors need to be addressed. In general the choices of the Dutch legislator with regard to the drinking water sector are found to be quite positive. The Drinkwaterwet stipulates that the companies can only be owned by public parties and not be sold to others. This constitutes a restriction of the freedom of capital which cannot be justified under EU law.

In the electricity sector the legislator has not ranked public values. EU law dictates the choice of the type of competition: competition on the market. The Dutch legislator has over-stretched its competence to regulate the sector under EU law by demanding the complete unbundling of ownership. This is incompatible with the freedom of capital under EU law.
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Analysis of the actors in the sector demonstrated that a lot is expected from the competition between suppliers. In practice, few consumers are eager to change supplier. To address this aversion to change supplier, suppliers should be obliged to present information in a similar and more structured manner. This would enable consumers to make a good comparison between suppliers.

In the near future, EU law will dictate the introduction of competition for the market in the local transport sector. The public values in this sector have unfortunately not been made explicit, which makes it hard to assess to what extent they are met. A lot is expected in this sector from the local authorities that will act as franchiser and function under political democratic control. The price of local transport is laid down by these authorities and is no longer subject to parliamentary control. A recommendation that has been made is creating a distribution mechanism of concessions that, unlike with public procurement law, has room for deliberation.

In the cable sector the national legislator has very limited room to make choices regarding the regulation. As EU law is in this research a given and not object of discussion no recommendations for this sector are made.