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# EUROPE'S NEW REGULATORY TOOLBOX

Winston Maxwell\*

## THE GENESIS OF EUROPEAN BROADBAND LEGISLATION

About the time when the FCC issued its "Digital Tornado" paper, Europe was debating its "Convergence Green Paper." What emerged five years later in Europe were six new directives that created a comprehensive regulatory framework designed to deal with convergence.

What's a directive?

As a preliminary matter, it is important for readers to understand that the European directives are not like U.S. federal laws. As their name suggests, directives are binding instructions to Member States to enact national legislation that has certain characteristics and achieves a certain outcome. Directives can be compared to a cooking recipe. Some directives leave freedom to Member States, specifying only the end result that should be achieved (e.g. the end result should be a "chocolate cake"). Other directives are so detailed that they provide the precise ingredients and cooking time, leaving virtually no room for national lawmakers to improvise. Most aspects of the new European communications directives fall into the latter category. They are detailed and leave little room for interpretation. This is hard for national lawmakers to accept, since it is their job to debate policy and enact national legislation in light of national circumstances; hence, the tendency for some national parliaments to take liberties with the directives' plain language.

Currently, the French and German parliaments are debating national legislation designed to "implement" the new package of EU directives. The directives were supposed to be implemented by

July 24, 2003. The UK and a number of Scandinavian countries were right on time. France and Germany are late. Moreover, France and Germany are tinkering with the directives' language under pressure from various interest groups. So, we will end up in Europe with a series of late adopters, and some national legislation will be only partially compliant with the directives' language. This could lead to inconsistent regulatory regimes in Europe, with frustrated companies who don't understand why a seemingly clear term of a directive ends up getting muddled.

What do the new directives say?

The terms of the directives are summarized in the annex to this article. Put simply, the new directives abolish all regulatory distinctions between cable networks, telephone networks, and the Internet. All networks are now called "electronic communications networks." Services are called "electronic communications services." Europe no longer uses the term "telecommunications."

After putting all services and networks into a single, all-encompassing, regulatory category called "electronic communications," the new directives attempt to create a light-handed and flexible set of rules that will regulate these networks and services only to the extent necessary, paving the way toward the day when *ex ante* regulation can disappear altogether, to be replaced only by competition law. The glide path toward competition law is already written into the directives.

In theory, this all sounds good. In practice, crafting "light handed and flexible" rules and remedies in the communications field is not easy.

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ELECTRONIC COMMUNICATIONS: THE NEW EU FRAMEWORK, (Winston Maxwell, ed., 2003). This outline contains excerpts from the book.

## Access remedies under the new framework

The main subject of this article is the various access remedies that can be applied to broadband networks and services under the EU framework. There are a number of similarities between how access remedies for broadband will operate in the U.S. under the Triennial Review Order, and how they will function in Europe under the new framework. When I speak of access remedies, I mean the circumstances under which a new entrant can have access to the infrastructure and services of another operator, often the incumbent.

The first similarity between the US and European approach to access remedies is a broad definition of network elements. Under the new European framework, practically anything can be a “network or associated facility” to which competitors can gain access in certain circumstances. This is similar to the U.S. concept of Unbundled Network Elements (“UNE”): practically anything can be included in the concept of UNE.

The European concept goes even farther than the U.S. notion of UNE, since the European regime covers cable networks, wireless networks, satellite networks, the Internet, and even power lines if they are used to transmit data. The U.S. concept of UNE is limited, I believe, to the incumbent’s traditional telephone network.

The second similarity is that the new European framework uses a balancing approach not unlike the approach used in the FCC’s Triennial Review Order. The balancing in Europe is done by each national regulator when crafting appropriate access remedies. Each regulator must promote the key objectives listed in Article 8 of the Framework Directive (there are 19 objectives, the key ones being: “promote competition”, “develop the internal European market”, “promote the interests of EU citizens”). European regulators must also take into account the need to promote innovation and protect investment in new infrastructure. Regulators also need to look at the replicability of the existing infrastructure, barriers to entry (an analysis resembling a watered-down essential facilities doctrine), and the risk taken by the incumbent when investing in new infrastructure. This resembles the balancing exercise described in the Triennial Review Order.

## Greenfield infrastructure

In its recent guidelines on remedies, the European Regulators Group (“ERG”) distinguished between “greenfield” new infrastructure, for which access remedies should not apply, and legacy infrastructure, for which access remedies would be appropriate in many cases. This is consistent with the Triennial Review Order, where the FCC held that FTTH, or new generation networks built by the incumbent, should not be burdened by access remedies. In both cases, regulators try to find the right balance between easing access-based market entry for competitors and the need to encourage infrastructure investment by the incumbent.

Those are some similarities between the US and European approach; now for the differences.

Separate market analysis (and remedies) in each country

In Europe, the balancing methodology has to be applied by each national regulator separately, albeit in consultation with the European Commission. This leads to a risk of inconsistent results. Each regulator must, on its own, apply a three-step approach:

- First, define the relevant market (product and service; geographic market, using the Commission’s Recommendation on relevant markets; and Guidelines);
- Second, identify SMP (dominant) players on the market using the Commission’s Guidelines;
- Third, develop “appropriate” remedies using the balancing test.

At each step of the way, the national regulator must communicate its findings to the European Commission and to other national regulators, and consult with interested parties. While the European Commission has some influence over decisions of national regulators, there is no guarantee of uniformity in the national decisions. For a given service (a mobile messaging service, for example), there could in theory be as many different access regimes as there are Member States. This is certainly not what is intended under the new framework, since regulators are supposed to

harmonize their approaches to those questions. But it is a possible outcome.

The FCC, on the other hand, has identified certain network elements in the Triennial Review that must be made available to competitors, thereby preempting State decisions on those elements. This may create greater uniformity than in Europe, at least for those elements. For other markets or network elements, the FCC defers to the States to do the balancing based on local market conditions. This latter approach resembles the European framework, with a risk of inconsistent results emerging in different jurisdictions.

The biggest fear of the creators of the new framework is that Member States and national regulators will take the principles of the new directives and reach different results. There is a great deal of benchmarking and transparency built into the new framework, via the creation of a Communications Committee, a European Regulator's Group, and the obligation to consult with the Commission and other national regulators. But there is still a real risk of inconsistent results. If the new directives cause Vodafone to be regulated differently in each Member State where it does business, the new framework will have been a failure, since creating a uniform internal market is one of the key objectives of the whole package.

#### Extending "telecom" remedies to new areas (cable, Internet, mobile)

The biggest difference between the U.S. and Europe is no doubt Europe's "converged" approach to regulation, which contrasts with the US framework, which is still based on legacy distinctions. Europe acted on the convergence concept, tearing up its old "voice-centric" ONP legislation and replacing it with the six new directives that tackle convergence head-on. Cable networks don't exist anymore as a separate regulatory category. The distinction between basic and value-added services no longer exists. Europe has started from a clean slate.

One objection to Europe's converged approach is that it creates an invitation to extend telecom-style regulation to new digital networks and services that weren't regulated in the past, and shouldn't be regulated in the future—the Internet, for example.

Let's look at this objection more closely, since it

is one of the most frequent criticisms of the European framework, and we're facing the issue right now in France in connection with VoIP and TV over ADSL.

First, when we speak of the legacy of regulation invading the Internet space, what kind of regulation are we talking about?

There are basically two kinds of regulation: access and tariff remedies (such as those we described above) and other public interest/consumer protection rules.

For access and tariff remedies, the perceived danger is that the new framework will invite regulators to impose forced access measures on cable operators, interconnect rules on Internet backbone providers, and/or tariff constraints on new innovative services such as TV over ADSL. The US is fighting hard at the ITU to avoid undue regulation of the Internet. France Télécom is lobbying the French Parliament right now so that "innovative" broadband services escape tariff regulation entirely. France Télécom's argument goes as follows: when Microsoft comes out with a new software product, nobody regulates its retail price. Abuses of market power are dealt with through competitive law. Why should France Télécom be different? Intuitively, France Télécom's argument sounds right, except that in many cases the "innovative service" marketed by France Télécom (TV over ADSL is a good example) will rely on legacy infrastructure (the local loop) financed by the French rate-payer when France Télécom was still a monopoly. That's the big difference between Microsoft and France Télécom, and the reason some regulation may be necessary, even for "new" services. By contrast, emerging services provided over entirely new facilities would not warrant regulation. This was recently confirmed by the ERG in their remedies paper, and is consistent with the approach in the Triennial Review Order.

Mobile operators in Europe also are worried that the new regulatory tools in the hands of the national regulators will lead to more intrusive and costly regulation of mobile services. The hot issue right now is whether the charges for call termination on mobile networks should be regulated, since in the absence of regulation they tend to be extremely high.

I'm convinced that the regulators' powers, though broadened under the new framework, won't lead to over-regulation, simply because the

market definition and balancing process puts such a high burden on regulators to justify whatever measure they propose to implement. The new framework gives national regulators a full toolbox of remedies they can apply to situations of “market power.” These tools include the ability to regulate interconnection tariffs, including tariffs charged by mobile operators to terminate calls on their network, and the ability to regulate retail tariffs, even for new “innovative” services. But unlike the old interconnection directive, which had “automatic” remedies that applied whenever an operator’s market share exceeded 25%, the new directives do not *require* that any of these remedies be used in a given situation. National regulators have full discretion to use (or not to use) the tools. The directive only says that the tools chosen shall be “*based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the [Framework Directive].*” Intervention in interconnection pricing must “*promote efficiency and sustainable competition and maximize consumer benefit.*” That’s a pretty flexible mandate, and regulators will in each case have to justify their intervention based on these criteria, sharing their conclusions with the Commission and other national regulators. Under the new framework, access and tariff measures have to be narrowly focused on an actual—or reasonably likely—market failure.

#### Consumer protection regulation

The second kind of regulation is public interest and consumer protection regulation. A good illustration of this problem is occurring with VoIP. Individual licenses have been abolished (except in connection with the use of frequencies, rights of way and numbers). But there will still be general license obligations that will apply to certain classes of operators and service providers. Typically, voice service providers are bound by quality of service obligations, privacy obligations, public safety obligations, law enforcement wiretap regulations, etc.

Under the principle of technological neutrality, there shouldn’t be any distinction in theory between a traditional circuit-switched voice provider

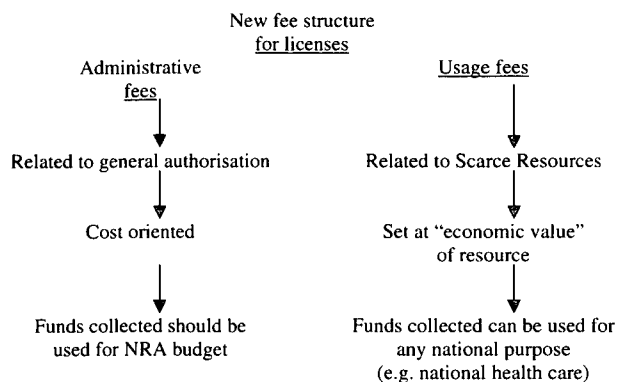
and a VoIP provider. Yet it would be disproportionate to apply all the traditional voice regulations to VoIP, an emerging technology that most users do not consider as their principal phone line. The directives do not provide a clear answer. Member States have some freedom to decide what class of service providers will be subject to traditional “voice” license obligations. Many hope that VoIP won’t be burdened with this kind of regulation until a substantial part of the population actually uses VoIP as their principal telephone line.

Both VoIP and mobile may, in the coming decade, replace traditional voice service provided by the incumbent. The phenomenon is clear in central European countries where a significant number of consumers are abandoning their traditional telephone subscription, relying solely on mobile. As they lose market share, incumbents will be pushing hard for a level playing field: either regulate mobile and VoIP the same way as traditional voice, or else remove regulatory constraints on traditional voice service.

#### PRICING OF SPECTRUM

Several speakers at this symposium discussed the FCC’s new spectrum policy. On spectrum management, the United States is definitely ahead of Europe. The United States is pushing ahead with “flexibility” in spectrum use, phasing out the old “command and control” model. Europe is still generally wedded to the command and control model. Nevertheless, the new directives introduce some new concepts.

The new authorization directive makes a distinction between “administrative charges” and “fees.” Member States can impose administrative charges on all entities operating under a general authorization. But administrative charges are solely destined to cover the costs incurred in management, control and enforcement of general authorizations and usage rights. The charges are cost-based. Usage “fees,” on the other hand, do not have to be cost-based. Member States can impose fees on operators seeking access to frequencies, for example. The fees correspond to the *price* of the scarce resource, i.e., its economic value. This price is unrelated to costs.



But that does not mean that national governments are completely free to set the appropriate price for spectrum. In setting the price for spectrum, national governments must comply with the following principles:

- the fees must reflect the need to ensure optimal use of the frequency resources;
- the fees must be “objectively justified, transparent, non-discriminatory and proportionate in relation to their intended purpose;”<sup>1</sup>
- in setting the level of fees, Member States must take into account the “mission statement” principles of Article 8 of the Framework Directive

Would fees set through a pure auction process comply with these requirements? Fees resulting from an auction could be justified as encouraging the optimal use of frequency resources, because the highest bidder would presumably attach the highest value to the frequency and make the most productive use of it. An auction conducted according to objective and published rules would also be transparent and non-discriminatory. More difficult is the question of whether fees set via an auction are “proportionate in relation to their intended purpose” when the fees attain multi-billion dollar levels. The “intended purpose” of fees is to encourage efficient use of spectrum while promoting the objectives of the new framework’s “mission statement.” Maximizing revenues for the general government budget, though a nice by-product of spectrum fees, is not their “intended purpose.” Consequently, a multibillion-dollar fee could well be considered disproportionate to the intended purpose of the fees. The directive requires that usage fees for frequency be used as an

instrument to ensure the optimal use of such resources, and that the level of fees “not hinder the development of innovative services and competition in the market.”<sup>2</sup> Moreover, if a competitive or comparative selection process leads to a lump-sum payment, Member States must ensure that the payment arrangement ensures that the fees “do not in practice lead to selection on the basis of criteria unrelated to the objective of ensuring optimal use of radio frequencies.”<sup>3</sup> The Commission may publish “best practice” benchmarks for the assignment of radio frequencies. Finally, a pure auction would not further the objectives of the new framework’s mission statement, which requires national governments to strive for effective competition, development of the internal market and interests of users. All this suggests that pure auctions may not be an acceptable means of setting usage fees under the new Authorization Directive.

These principles apply of course to new 3G licenses, but also to the renewal of existing GSM licenses. Many GSM licenses in Western Europe will be coming up for renewal in the next few years, and national governments are already considering whether to raise GSM spectrum fees so that they come closer to UMTS/3G levels. GSM operators are fighting this, and the new directives provide some good arguments for mobile operators, notably the fact that spectrum fees must be “proportionate to their intended purpose.” That requires national governments to define what the “intended purpose” of spectrum fees is. “Raising money for the treasury” is not a permissible “intended purpose.” Consequently, governments must justify high fees in some other way that is permitted under the new framework, which may not be easy. Some mobile operators are even wondering whether the Framework Directive might be used to relax some of the burdensome license fees already imposed in the context of UMTS/3G licenses.

## SPECTRUM TRADING, LEASING

The new framework does not impose spectrum trading. The Framework Directive requires that

<sup>1</sup> Authorization Directive 2002/20/EC, art. 13, 2002 O.J. (L 108) 29.

<sup>2</sup> Authorization Directive 2002/20/EC, recital 32, 2002

O.J. (L 108) 24.

<sup>3</sup> *Id.*

the assignment of radio frequencies be managed “as efficiently as possible,” and suggests that “the transfer of radio frequencies can be an effective means of increasing efficient use of spectrum.”<sup>4</sup> The Framework Directive does not require Member States to make frequency usage rights transferable, but says that Member States “may” foresee that possibility. In many Member States, the use of frequency is the equivalent of a lease of public property, and such leases are by nature non-transferable without special legislative action. Hogan & Hartson is conducting a study for the European Commission on the legal aspects of spectrum trading throughout Europe. For the moment, everyone is watching closely the work of the FCC, which has recently authorized spectrum “leasing,” which permits mobile operators to loan each other spectrum according to traffic needs.

Another issue important to mobile operators is whether national governments are able to impose particular technological norms on mobile operators in light of the principle of “technological neutrality.” This recently became an issue in France, where the operator of PAMR services (mobile radios for professional users) wanted to abandon the old technology specified in its license (TETRA) and adopt a CDMA nom, which is part of the IMT-2000 “3G” family. In other words, could the PAMR operator become a 3G operator in disguise? The PAMR operator claimed it

should be allowed to do so under the principle of “technological neutrality” mentioned in the Framework Directive. The French authorities disagreed, holding that the operator must stick with the technology imposed in the license. The consequences of this decision were quite dramatic: the operator filed for bankruptcy and went into liquidation, with consequent loss of jobs.

## CONCLUSION

Europe has adopted legislation that fully embraces the concept of convergence. The fear that national regulators in Europe will take their newfound tools to extend legacy regulation to the Internet is misplaced. Regulators have to use their new tools with surgical precision, and justify their actions to the Commission and other regulators each time they apply a remedy. The standard for defining dominance has also been raised, so that only operators holding a dominant position as defined under competition law will be subject to burdensome *ex ante* regulation. The bigger worries surrounding the new framework are: (a) that regulators will get hopelessly bogged down in the market analysis and balancing processes, leading to regulatory gridlock, and (b) that each national regulator will reach a different outcome as a result of these analyses.

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<sup>4</sup> Framework Directive 2002/21/EC, recital 19, 2002 O.J.

(L 108) 35.

ANNEX: SUMMARY OF KEY DIRECTIVES

The Framework Directive.

The Framework Directive defines the terms “electronic communications networks” and “electronic communications services,” and attempts to draw the line between content (which is not covered by the new framework) and communications networks and services (which are covered). The Framework Directive also sets forth the new definition of “significant market power” (“SMP”). Under the old ONP directives, the notion of “significant market power” was tied to a 25% market share. This old market share test falls short of the traditional competition law threshold for “dominant position.” The new framework directive aligns the definition of “SMP” with the competition law definition of “dominant position” (generally market share exceeding 40%-50%), thereby taking a step toward the day when ONP-style (sector specific) regulation will disappear entirely, leaving only competition law in its wake.

Under the new definition, an operator has significant market power if:

“either individually or jointly with others, it enjoys a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.”

This definition is taken almost word-for-word from the applicable case law defining the concept of “dominant position” under article 81 of the EC Treaty.

The other controversial issue in the Framework Directive is the requirement that national regulatory authorities inform the Commission and other national regulators ahead of time of proposed measures. The Commission insisted on maintaining some kind of control over national decisions, since under the new framework national regulators will have ADDED FREEDOM and there is consequently a risk of diverging rules emerging throughout Europe. The new framework is built on the principles of transparency and benchmarking for national regulatory decisions. National decisions will be circulated among regulators in other European countries before being finally adopted, and other regulators, and the Commission, would have an opportunity to comment. The Framework Directive also requires that national regulators consult interested persons before adopting any measure of import.

Finally, the Framework Directive contains a

“mission statement” of key regulatory principles that national regulators should keep constantly in mind when making decisions. These key principles include:

Article 8 Mission Statement

Key Principles

Art. 8(1)	Proportionality Technological neutrality Cultural and linguistic diversity Media pluralism
<u>Promote competition</u>	
Art. 8(2)	End-user choice, price, quality No distortion of competition Encourage infrastructure investment and innovation Efficient use and effective management of frequencies and numbers
<u>Develop internal market</u>	
Art. 8(3)	Remove obstacles to provision of services and networks at a European level Trans-European networks, interoperability of pan-European services No discrimination Cooperate in a transparent manner with Commission and other regulatory authorities
<u>Promote interests of citizens</u>	
Art. 8(4)	Access to universal service Protecting consumers vis à vis suppliers, simple and inexpensive dispute resolution Personal data and privacy Transparency of tariffs and conditions of use Needs of specific social groups Network integrity and security

Authorisation Directive.

This directive provides that electronic communication networks and services no longer require individual licenses. An operator or service provider will only have to send in a notification stating that it intends to begin service, and it can start providing the service immediately.

This light-handed approach to licensing is opposite the current practice in a number of countries, which require relatively heavy license procedures.

Under the new directive, operators would still have to apply for individual permission to use spectrum or numbering resources. For granting spectrum, Member States would have to craft procedures that give due weight to the “mission statement” in the Framework Directive. This means that pure auction procedures may be prohibited. Rights of way will continue to be complex under the new framework. The directives do little to harmonize national practices, and local authorities may decide to “fill the void” with burdensome local requirements.

Access Directive.

The new access and interconnection directive

maintains the current interconnection obligations that exist today, but would empower national regulatory authorities to modify the interconnection and access obligations over time as a function of the market and the new definition of "SMP." National regulators will have the power to order access to any kind of facility or service listed in the directive, provided that the regulator finds that *"the denial of access . . . would hinder the emergence of a sustainable competitive market at the retail level, or would not be in the end-user's interest."*<sup>1</sup>

The national regulator would have power to order access to cable networks or third generation mobile networks, for example, if doing so was necessary to ensure competition.

#### Universal Service Directive

This new directive consolidates the various ONP directives that exist already on universal service, leased lines and voice telephony. The directive contains a sunset clause that would allow national governments to phase out certain provisions once "effective competition" is achieved, and contains new rights for end-users, including a right to out-of-court dispute resolution procedures. Importantly, the Universal Service and Users' Rights directive also describes how regulators are supposed to control retail tariffs, both to protect consumers, but also to protect competition (against instances of price squeeze for example).

#### Communications Data Protection Directive

This directive updates the 1997 telecommunications data protection directive to ensure that Internet-related data are also covered by privacy provisions. The directive introduces an "opt-in"

regime for unsolicited e-mail ("spam"), as well as an opt-in regime for the use of location data on mobile networks (data that indicates exactly where you are at a given time). The directive requires that operators erase or render anonymous personal data (including logs of Internet use) as soon as they are no longer required for billing purposes. Applied literally, this means that ISPs that bill customers on a flat-rate basis would have to erase logs immediately after the connection. But the directive's rules are "without prejudice" to national provisions on law enforcement and national security. As a practical matter, therefore, national data retention rules designed to assist law enforcement will continue to apply, and may vary considerably from one European country to the next.

#### "Competition" Directive

The competition directive consolidates the existing "Services Directive," and restates some of the principles that exist under the Framework Directive (access to rights of way, independent national regulatory authorities, universal service). Why restate principles that have been explained in other directives? The reason is that the principles flow also from competition law. The two pillars of European telecom legislation are competition law (from which the 1990 Services Directive was born) and the ONP rules (that arise out of "sector-specific" rules). The Commission's "competition" directive is there to remind us that if a Member State does not implement one of the basic principles of the Framework Directive, that Member State (and the national operator) may be violating the competition rules set forth in the EC Treaty.

<sup>1</sup> Access Directive 2002/19/EC, art. 12, 2002 O.J. (L1

08)15.