

**Why does European Union Legislation sometimes empower  
national regulatory authorities and sometimes empower  
European Agencies to undertake regulation for the single market?**

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## Statement

I, Andrew Dudley Tarrant, confirm that the work presented in the thesis is my own. Where information has been derived from other sources, I confirm that this has been indicated in the thesis.

## **Abstract**

This thesis investigates why EU single market legislation sometimes privileges national regulatory authorities (“NRAs”) as the authoritative decision-makers while other legislation in the same field privileges EU regulatory Agencies.

Most of the literature on both EU regulatory Agencies and independent NRAs has explained their creation in functional terms. While there may be functional benefits to be gained from creating regulatory bodies in EU legislation, the thesis argues that their design is not necessarily determined by the standard functional imperatives – indeed, sometimes such delegates, at least from the perspective of actually meeting functions such as credible commitment, may be designed by principals to be ineffective.

The theory advanced in the thesis is that Member States will prefer NRAs to be the bodies controlling implementation in those cases where there is distributional conflict and Agencies and/or the Commission where there is not. The Commission and the European Parliament will usually advocate supranational regulatory institutions but will be unable to overcome collective Council preferences where they are in favour of NRAs. The empirical findings in the thesis with respect to the acts of delegation suggest these hypotheses are correct. In addition, the thesis hypothesises that regulatory outcomes will be consistent with the type of design adopted. Consequently, an examination of regulatory implementation is also undertaken in order to verify whether this is the case. The thesis finds that implementation outcomes also vary depending on the type of institution selected.



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# 1. Chapter One: Introduction to the Thesis

## 1.1. The puzzle

In 1993, European Union (EU) legislators endowed the European Medicines Evaluation Agency with sole responsibility for drafting union-wide safety clearances for certain classes of drug; national regulators were not permitted to undertake any further evaluations nor to block entry to national markets (European Parliament and Council:1993). In 2001, EU legislators empowered *independent* national regulatory authorities to undertake access regulation for railways, excluded the possibility of a EU agency controlling implementation and explicitly wrote the national ministries of transport into the definition of the independent national regulatory authorities responsible for implementation (European Parliament and Council:2001).

In 1996, the author of this thesis, as a UK government official was tasked with writing a document against a Euro-regulator for telecommunications for the UK government, which was then distributed at a Council of Ministers meeting (OFTEL:1996). The author and his line managers were fully aware that the advocacy points in the paper concerning the applicability and efficiency of the existing Community infringement process were untrue.<sup>1</sup> Nonetheless, the paper strongly advocated the need for regulatory implementation to be conducted by national regulators policed through the traditional infringement process.<sup>2</sup>

The puzzle is to explain why such markedly different institutional choices are made concerning selection of regulatory institutions for single market regulation in EU legislation?

There could be a variety of explanations. The supply of institutions could be largely haphazard, driven by sector-specific factors, where legislators are largely indifferent as to the form of institution and seek only what is believed to work best in the case at hand.

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<sup>1</sup> The telecoms case study includes a reference to a meeting between the UK authorities (including OFTEL) where the latter complained about the inadequacy of the infringement process in opening up markets, see page 162.

<sup>2</sup> From 1998, as an employee of a UK headquartered pan-European operator, the author was employed to advocate precisely the opposite and, in particular, the need for a supranational implementing authority.

Alternatively, sectoral issues might be entirely subsumed by strong views on what is considered to meet constitutional propriety. Or, legislators might have strong preferences driven by the nature of demand from powerful distributional coalitions: sometimes seeking effective institutions and sometimes deliberately seeking to create ineffective institutions. On the other hand, the interests of private actors might be irrelevant; the supply of institutions at either national or European-level might be driven by the *thickness* of existing institutional empowerment, existing regulatory institutions at either level might use their resources to prevent the creation of competitors at another level.

The research question derived from this puzzle is: **why does EU legislation sometimes empower national regulatory authorities and sometimes empower EU Agencies to undertake regulation for the single market?**

## **1.2. The approach adopted**

The general approach adopted in the thesis is drawn from two literatures, principal and agent theory and rational institutionalist analysis of the EU's legislative framework.

Principal and agent theory is based on the economic theory of contracts and was originally deployed to explain delegation to US congressional committees and independent agencies. As is discussed in the literature review, it has subsequently been applied to the construction of European institutions. These analyses seek to explain the nature of the powers delegated to agents and the controls which the legislators, the principals, retain over the agents. They potentially provide a description of the discretion available to the agent. This thesis examines the pre-delegation preferences, the act of delegation and post delegation outcomes with respect to two different types of institution agreed at EU-level: national regulatory authorities and EU Agencies. It assesses whether these two different types of institution give rise, systematically, to different types of implementation outcomes.

The approach drawn from the principal and agent literature is combined with a rational institutionalist analysis framework in order to examine the translation of the principals' (legislators) preferences into institutions. Rational institutionalist analyses of the EU's legislative framework focus on how the preferences of principals are translated into

authoritative acts via the rules which apply to decision-making. Such rules may have the consequence of privileging the input of one set of legislative principals over another.

The reason for combining approaches derived from these two literatures is to avoid reducing EU legislators to a single principal whose preference can be read off from the final piece of agreed legislation. The risk of adopting the latter approach would be to miss competing preferences with respect to institutional construction and what determines their selection or otherwise. If the latter are not analysed, we may miss the politics of institutional selection and thus the reasons why one type of institution is favoured over another.

### **1.3. The aims of the thesis**

The aims of the thesis are pursued in an investigation into three sectors in which there has been extensive EU legislative activity. This activity has ostensibly been designed to facilitate a single market through regulating barriers to market access in telecommunications, rail and pharmaceuticals. The aims are: to investigate the extent of distributional conflict in each sector that arises between the economic position of economic actors and effective implementation of EU access directives; analyse Council, Commission and Parliament preferences;<sup>3</sup> examine which legislator dominates in the legislative process and which body or bodies' preferences as to regulatory design are adopted; and, to investigate the relative effectiveness of regulatory implementation by national regulators as compared to EU Agencies.

### **1.4. Research objectives**

In order to pursue the aims of the thesis, the following objectives have been pursued:

collation of evidence as to state ownership in the EU;

collation of evidence as to market shares and assessments of regulatory outcomes;

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<sup>3</sup> Throughout the thesis, the European Council, European Commission and European Parliament are referred to as Council, Commission and Parliament.

review and analysis of all draft and final EU legislation in telecommunications, rail and pharmaceuticals;

analysis of relevant EC jurisprudence;

sixty-seven semi-structured interviews with EU officials, parliamentarians, representatives of national ministries, national regulators, state owned companies, competitors and EU trade associations in order to ascertain their views on preferences and outcomes;

structured interviews with a subgroup of stakeholders to ascertain its views on the independence of NRAs (National regulatory authorities) and the constraints or otherwise imposed by membership of networks of regulators;

analysis of regulatory and market outcomes.

## **1.5. Definitions**

This section of the introduction unpacks the terms used in the research question. This initial definitional exercise indicates some of the key differences in regulatory design between NRAs, agencies and Agencies, which are explored in more detail in the thesis.

### **1.5.1. National regulatory authorities (NRAs): current definitions**

Gilardi defines NRAs as “public organisations with regulatory powers that are neither directly elected by the people, nor directly managed by elected officials” and gives the UK telecommunications regulator as a typical example (Gilardi:2004:67; see also Curtin and Egeberg:2008:640; Christiansen and Laegrid:2005:503).

Thatcher provides a similar definition:

“...[the] minimum requirements for inclusion as an IRA [independent regulatory authority] refer to the formal institutional position and comprise the following: the agency has its own powers and responsibilities under public law; it is organisationally separated from ministers; it is neither directly elected nor managed by elected officials.”

Thatcher (2002:127)

However, Thatcher also notes that “all regulatory agencies face continuing controls by elected officials – nominations, annual budget allocations, and requirements to report to legislatures” (Ibid:127). This suggests that NRAs do not in practice meet the definition of an IRA since they may in practice be *managed* by elected officials. Thatcher’s solution is nonetheless to define them as independent : “...Thus *independent* agencies may include bodies which are *semi-independent* from legislatures and governments; for ease of reference, they are referred to henceforth as independent” (Thatcher:2002:127). Thatcher includes national utility regulators in the EU amongst IRAs (Coen and Thatcher:2005:330; Thatcher:2007:267).

### **1.5.2. The ambiguity of existing definitions: why it is feasible for NRAs to be more national**

What the definitions above indicate is that while these regulatory entities have a degree of autonomy from normal government departments that degree of autonomy is ambiguous. EU legislation that empowers independent NRAs usually preserves this ambiguity. Normally, EU legislation does not mandate implementation by any particular national institution at all (Curtin and Egeberg:2005:649). However, in a number of cases dealing with single market regulation, where there is perceived to be a conflict of interest between member state ownership of economic entities and regulation, EU legislation requires member states to empower independent national regulatory authorities. As will be discussed in the rail and telecoms case studies<sup>4</sup>, the definition of independence in EU legislation has been a term contested by the different EU principals, as it potentially impacts on the degree of control over NRAs available to the member states. The consequence has generally been that EU legislation recognises a conflict of interest, requires the creation of an independent NRA but then fails to deal with the degree to which elected officials can manage the NRA. The consequence is that it is potentially open for the regulatory decisions of individual NRAs to reflect the preferences of individual member states.

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<sup>4</sup> See pages 165-166 (telecoms) and 226 (rail access).

### **1.5.3. EC law does not engender a countervailing European perspective**

In addition, and this is not a point which is made in the politics literature, a further characteristic of an NRA created by EC law, as opposed to an Agency, is the limited extent to which its actions can be challenged in EC courts. Typically, responsibility for a NRA's actions lies with a member state and if an NRA fails to implement EC law, the recourse for the European Commission is to commence the inefficient process of an infringement action against the member state government to which the NRA is responsible. Often, as the case studies will discuss, when NRAs are empowered, the legislation also provides for a great deal of discretion, making successful infringement processes technically unlikely. The consequence is that even if European Community courts were predisposed to the pro-integration and pro-cross border trader innovation that Sandholz and Sweet argue is the case, there is little raw material with which they could work (Sandholz and Sweet:1998:18).

### **1.5.4. EU agencies: current definitions**

The Commission defines an agency as “an independent legal entity, created by the legislature, in order to help regulate a particular sector at European level and help implement a particular Community policy” (Commission:2005). A wider definition would include the Commission as an executive body that was created to carry out tasks for the legislature (Thatcher:2001; Pollack:2003:75; Kelemen:2002: 94). More typically, and this is the entity envisaged by the Commission definition, we think of the *satellite* authorities brought into existence since the early 1990s to assist with implementation as the EU Agencies (Agencies) (Kreher:1997:227). These can also be divided into regulatory Agencies and distinguished from executive Agencies (Szapiro:2005:2). The latter are delegated non-discretionary and specific implementation tasks. The former, the regulatory Agencies, can be divided into those that provide information and those that engage in *pre-decision making* (Orator and Griller:2010:3).<sup>5</sup> Implementation in the case of the latter requires the exercise of policy-making discretion. However, it is important to note that where this type of Agency is empowered, EC law always requires that the

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<sup>5</sup> Griller and Orator also define a sub-group of decision-making Agencies (see page 111). However, where Agencies make decisions, the field is required legally to not involve any policy-making discretion and the function could be considered as an executive one (see page 45).

Commission be formally endowed with the power of decision-making as regards implementation. This means that where Agencies take regulatory *decisions* they are in fact draft decisions. The decision-making role may include the ability to undertake administrative reviews of individual NRA actions giving the Commission the ability, advised by the Agency, to veto NRA decisions (as, for example, is mandated by the 2004 Railway Safety Directive for the European Railway Agency).

### **1.5.5. Why a EU Agency is likely to be more European**

The fact that the creation of an Agency always means empowerment of the Commission is sometimes missed in the literature (Busuioac:2009:610) and not appreciating this design feature may lead to an assumption that the Commission is always likely to be antagonistic to Agencies, due to the role potentially played by member states' institutions within the Agency, while the member states are likely to be favourable (Dehousse:1997). In fact, the veto role which formal decision-making provides the Commission is likely to make it favourable, at least in certain circumstances, to the creation of Agencies. The fact that the formal regulatory decision is taken by a Community institution means that the draft decisions of an Agency are potentially directly challengeable by an individual before a Community court. Research for the pharmaceuticals case study found that where an Agency's draft decision is in fact the body of the Commission's formal decision then the European Court of Justice will review the legality of the Agency advice as well as the Commission's formal decision.<sup>6</sup> Regardless of the Court's role, however, the interaction of the Agency and the Commission means that regulatory decisions must always embody a wider set of preferences than those of a single member state.

### **1.5.6. Regulation for the single market**

A primary legislative focus of the EU's institutions since the Treaty of Rome has been to build a single market without impediment to the free movement of the factors of production (Dehousse:1997:250; Hix:2005:235). Menon and Kelemen consider that most of the legislation passed since the mid-1980s has been adopted to complete the single

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<sup>6</sup> See page 49.

market (Kelemen and Menon:2007:176). This has, inter alia, required the elimination of non-tariff barriers to trade between member states (Dinan:1994:335). Such barriers to trade could arise from national rules designed to protect consumers, where the lack of coordination between member states or historical accretion of different rules means that products compliant in one member state are non-compliant in another. (Dehousse:1997:248). Both of these forms of regulation are *positive* regulation: they require new Europe-wide rules to replace the existing national rules, rather the simple removal of the national rules (i.e. negative regulation) (Scharpf:1999). This requires harmonisation of the national rules, i.e. agreeing a common European rule; or, since 1985, the harmonisation of a minimum set of requirements which, if they were adjudged to be met in one member state, required mutual recognition of the authorisation in all other member states (unless a member state could show a defined public policy reason for refusing entry) (Majone:1997:269).

In some sectors, such as medicine, where each new product is an innovation and there is a potentially high risk to public health, new collective governance arrangements were (eventually) agreed as no workable ex ante minimum set of requirements could be applicable to each new product (Gehring and Krapohl:2007:211). This type of regulation is examined in the pharmaceutical case study, and the safety and interoperability aspect of the rail case<sup>7</sup>.

Barriers to trade could also arise where member states granted national monopolies in a particular economic sector or permitted the owner of a de jure or de facto monopoly to leverage that monopoly into adjacent economic activities (Pelkmans:2001). Since the removal of de jure monopolies, dealing with de facto monopolies has been a major focus of the activities of the EU (Gatsios and Seabright: 1989; Pelkmans:2001). Typically, the rules agreed are a mixture of principles and detail, but a great deal of discretion is necessarily assigned to the regulator in order to deal with unforeseen issues in an area of high technical complexity. In other words, using the terminology of principal and agent theory, regulators are delegated scope to deal with incomplete contracts. This in turn, potentially creates scope for variation in the quality of implementation

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<sup>7</sup> See chapters 5 and 6 of the thesis.

(Nicolaidis:2004:607). Legislation agreed at European level to deal with non-tariff barriers and which provide for regulators to implement is described as regulatory framework legislation. Wherever regulatory rules for dealing with either type of non-tariff barriers (economic access or safety) are agreed, an institution is required to implement the incomplete legislation. The type of body that is selected may well determine how complete the “incompleteness” ever becomes.

## **1.6. Theoretical approach: a combined principal-agent and legislative opportunity structure focused rational institutionalist analysis**

A principal-agent approach is applied to analyse the selection of institutions for undertaking regulation for the single market in three cases studies. The concept of the principal is disaggregated into its component parts at EU-level and each stage of the legislative process traced in order to observe which preferences were selected and why. A discussion of the theory is set out in the literature review. A model is proposed in the theory and methods chapter. The methodology applied is process tracing in each case study. However, there is also quantitative analysis of implementation with respect to each case study. Supporting research into the perceptions of stakeholders is also used. This methodological triangulation may enhance (or disconfirm) the reliability of the findings derived from analysis of the act of delegation (Bulmer:1984:32).

## **1.7. Method**

### **1.7.1. Process Tracing**

Historical case studies are undertaken in three sectors: telecommunications, rail and pharmaceuticals. Each case study focuses on the same questions related to the proposed hypotheses and their rivals. The comparative historical research design permits the application of several methods to tackle the research question.

First, historical process tracing permits identification of the distributive concerns at each legislative point; identification of the preferences of the different EU legislators during each legislative iteration; identification of the decision-making rules and any factors specific to the sector which enhance or diminish the negotiating power of any of the negotiating parties, and, the specific delegation outcomes of each legislative iteration.

The identified values can be used to compare co-variation of the independent and dependent variables within sectors at succeeding legislative points and also co-variation of the variables between sectors. The former is conducted within the sector chapters, the latter in the concluding chapter.

Second, process tracing permits us to test whether there is a strict chain of causation between changes in the independent variables and changes in the dependent variable and, thus, to verify the strength of the probabilistic claim generated by assessments of co-variation.

Third, it also permits testing of the potential rival hypotheses on the same basis. Where process-tracing gives rise to indeterminate findings for some hypotheses, it may nonetheless be able to falsify others (George and Bennet:2005:217).

### **1.7.2. Qualitative and quantitative assessment of implementation outcomes**

If legislators design regulatory institutions because they favour certain outcomes over others, then we should find that those outcomes vary depending on the institution adopted. The thesis examines qualitative assessments of outcomes and, where possible, statistical correlations of state ownership, market share and measures of regulatory effectiveness.

### **1.7.3. The cases**

The three case studies comprise telecommunications, rail and pharmaceuticals between 1990 and 31 December 2010. These are all sectors where there is EU single-market legislation requiring both regulation and delegation of authority to institutions to undertake it. They are also sectors that are considered to be of key economic and political importance by member states (Thatcher:2007:6; Stevens:2005:90; Hauray:2006:11). These cases were selected because there are variable levels of distributional conflict between member states and between member states and the European institutions in each of the sectors (with change over time in some sectors); some variation in the negotiating power of the European Commission and Parliament; a variety of disputes over

institutional design; and, a variety of different institutional and implementation outcomes.

Typically, the existing literature either looks at the selection of networks or the selection of Agencies but does not compare the process of deciding between them in a range of sectors (see, for example, Kelemen (2002) on Agencies; Thatcher and Coen (2008) on networks of independent NRAs). A more extensive justification for the selection of these cases is set out in the Theory and Methods Chapter<sup>8</sup>.

There have been no previous comprehensive studies of the European delegation process in telecommunications or rail. Those studies, which do exist, cover parts of the period only (generally because of the date at which they were written). Perhaps more significantly, they also tend not to examine all of the legislative documents leading up to a final law but only the final document. This, at least under qualified majority voting, is a document agreed by all the institutions, and examining only these common documents may contribute to missing disputes over the scope and scale of discretion and the type of institution to which regulation is delegated. For example, in an influential article Thatcher argued that the Commission and the member states were partners in regulatory design in telecommunications. However, the article does not contain any discussion or reference to the multiple control mechanisms over the NRAs the Commission and Parliament advocated in the initial legislative rounds of the 1997 Interconnection Directive and which were rejected by the Council; the bibliography does not contain any reference to any of the draft iterations of the directive (Thatcher:2001:580-581).

The detailed study of the acts of delegation in pharmaceuticals also comprises of original research. However, in this sector, there is now a comprehensive study, published in French in 2006 (Hauray:2006). His approach is an intensive historical case study of the development of the European regime rather than a cross-sector study. There are no explicit hypotheses. Nonetheless, his findings are consistent with the findings in this thesis. He also finds that the creation of an Agency had a dramatic impact on effective European-wide safety licensing in pharmaceuticals. This contrasts starkly with the prior

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<sup>8</sup> See page 111.

situation where mutual recognition was managed in a network of NRAs and was effectively both optional and ignored in practice by member states.

## **1.8. Chapters of the thesis**

Chapter 2: this chapter contains the literature review. It sites the thesis in the context of the existing literature on NRAs and networks, Agencies, comitology, principal and agent theory, the regulatory state, independence, rational choice institutionalism, supranational institutionalist theory, implementation, and Europeanization. A critical review of this literature suggests the hypotheses explored in the thesis to answer the research question.

Chapter 3: this chapter contains the theory advanced in the thesis. Three hypotheses are advanced which should hold if the theory is correct. Three rival hypotheses are drawn from literature with alternative theoretical explanations and which, if affirmed, would falsify the theory proposed in this thesis. The chapter also explains the selection of the methods applied in the case studies in order to test the hypotheses.

Chapter 4: This chapter contains the telecommunications case study. Telecommunications was the first monopoly utility sector that the Commission sought to open to competition. The chapter explores why competition law was an inadequate tool for regulating economic assess and the key regulatory issues which would need to be tackled in order to ensure that market entry and cross-border competition could be feasible. It investigates the degree of distributional conflict. It examines the institutional proposals and preferences for sector-specific regulation and the outcomes in regulatory design. Telecommunications is a sector in which the NRA has been selected as the authoritative decision-maker. The chapter explores the extent to which NRAs have delivered effective sectoral regulation and whether their performance varies where the regulated entities are state owned. It records the results of interviews with NRA representatives as to the nature of cooperation between regulators and also the perceptions of a wider group of stakeholders as to the extent to which NRAs can be considered independent.

Chapter 5: This is the rail case study. Access issues in rail have been more complex in rail than in telecommunications and pharmaceuticals as EU legislators have had to deal with both economic access and safety issues in this sector. Developments in both areas

are investigated. As with telecommunications, the chapter explains why sector-specific rules were a *sine qua non* for competition and why generic competition law was inadequate. Institutional preferences and outcomes are analysed. Economic access to rail is an issue with respect to which the authoritative decision-maker is also the NRA – although specifically defined in this sector to include the national Ministries<sup>9</sup>. Conversely, for safety, the authoritative decision-maker is in practice an Agency. The effectiveness of regulation and perceptions of networks and independence are analysed in an identical fashion as in telecommunications case study in Chapter 4.

The methodology adopted in the thesis is to trace the legislative process through each legislative iteration. The consequence of adopting this approach has had positive and negative consequences for the chapter on rail. The positive consequence has been the capture of relevant variations in preferences and outcomes that are sometimes different from those established in the better-known telecommunications and pharmaceuticals cases. The negative consequence is the length of the case study. It transpired that there has been much more extensive legislative activity in this sector than in the other two (twelve rounds of completed legislation for rail, compared to four main rounds of legislation each in telecoms and pharmaceuticals). I hope that the reader will forgive the length of chapter to which the maintenance of methodological consistency gave rise.

Chapter 6: Pharmaceuticals authorisations was the first sector to have a *pre-decision making* Agency, which has in practice become the authoritative decision-maker. This chapter traces the institutional development in this sector through legislative iterations. It shows how initial reliance on NRAs was abandoned after the latter mechanism lead to a complete failure to achieve mutual recognition. An identical methodology is pursued in this chapter as in the other two sector chapters.

Chapter 7: The conclusion brings together the data derived from the sectoral chapters. It aggregates these findings in order to determine the extent to which the sectoral observations confirm or falsify the hypotheses advanced in the theory chapter. It points out the value of these findings for principal and agent analysis of EU regulatory institutions. It suggests the extent to which these hypotheses might hold if applied to a

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<sup>9</sup> See page 226-7.

wider population of cases. It also discusses the strengths and weaknesses of the thesis and how the latter might be met by further research.

## **1.9. The contribution the thesis is intended to make**

### **1.9.1. The specific contribution of systematic and detailed examination of delegated powers and institutions**

Principal and agent analyses of sectoral regulation in the EU tend not to engage in comprehensive analysis of the acts of delegation, i.e. the delegating legislation. On occasion, they pick out elements of a law without examining the interaction of different elements of the legislation and thus its actual likely consequences. In other cases, the content of delegated powers are incorrectly categorised and cited as evidence for arguments that they do not support. For example, Sabel and Zeitlin state that the Commission was delegated power in 2002 to veto NRA regulation in telecommunications and that this is evidence of a move towards pro-integration discursive decision-making (Sabel and Zeitlin:2009:281). That a power was granted is certainly true – but it was only a narrow power, applying to procedural issues, and, as the telecommunications chapter will show, it was also very carefully designed not to apply to the actual content of NRA implementation. In addition, the detailed tracing in the telecoms chapter finds that this was an outcome the Commission and the Parliament were against. However, they were overruled by the Council when jointly seeking to obtain a wider control power for the Commission. Accurate categorisation of legislative outcomes should assist in assessing a correct identification of principals' preferences. This, in turn, should facilitate the confirmation or falsification of the theory advanced as to the formation of principals' preferences.

### **1.9.2. The value of examining delegation in the context of the specific markets to be regulated**

Studying context in terms of the market that is being regulated is also important. All the existing literature appears to assume that the dominating functional pressure is for effective regulation to support cross-border trade (Sandholz and Sweet:1998:162; Eberlein and Grande:2005:91; Thatcher:2007:129:). This may be a legacy of Haas's argument for the reasons for which we should expect to see effective regulation

(Haas:1956). However, the existence of regulation is not sufficient evidence that it is designed to be effective. Each case study therefore sets out what would comprise effective regulation in the sector, so that iterative rounds of legislation can be assessed for the extent to which they actually delegate the relevant powers, since limitations on scope are also a form of control (McCubbin:1985:722). Nor does the existence of regulation necessarily mean we should assume that the pressure from cross-border traders has been effective. This assumption probably also reflects Majone's identification of the retreat of the state from production as a cause of the rise of the regulatory state in Europe (Majone:1994:80). The case studies will explore whether such a retreat has actually taken place. Such an investigation of the *demand-side* is important for analysing whether the causes of "a fragmented, cluttered and complex European regulatory space" lie primarily on the "supply side" and to arise as a consequence of existing regulatory institutions survival instincts (Thatcher and Coen:2008:830) or whether they arise from the response of the NRAs' principals to existing *demand*.

### **1.9.3. Post-delegation implementation**

Each of the case studies also examines post-delegation implementation in the sector. As Thatcher and Levi-Faur have pointed out, post-delegation implementation has hardly been examined in the literature that looks at NRAs (Thatcher:2005:347; Levi-Faur:2006:107). The same point has been made in the recent literature on Agencies (Curtin and Egeberg:2008:650; Rittberger and Wonka:2009:9). Assuming a consequential logic, if variation in implementation correlates with type of institution selected then we may be able to infer that selection was intended with that outcome in mind.

### **1.9.4. Analysis of the behaviour of NRA representatives in regulatory networks and stakeholders views on the independence of NRAs**

Arguments have been made which suggest that functional equivalents of Agencies exist: either networks of NRAs cooperating to fulfil EC law (Eberlein and Grande:2005:91; Nicolaidis:2004:616) or NRAs acting individually to do so (Curtin and Egeberg:208:640). If these institutions were genuinely functional equivalents, then it might suggest that any observations of poor quality implementation on the part of some

NRAs were accidental rather than intentional. However, the arguments for functional equivalence rely on certain conditions that can be tested. Those who take the view that cooperation between NRAs is the functional equivalent of an Agency posit a number of conditions, which they argue mean that NRAs in a network must behave in this way. Where possible each case study contains interviews with representatives of NRAs from the same three large member states to verify whether participants consider that these conditions hold.

Even if cooperation was found not to create the functional equivalent of an Agency, it might nonetheless be argued that since independent NRAs are independent, variation in implementation cannot be the result of an intended consequence at the time of delegation. Stakeholders, including representatives of NRAs and ministries, new entrants and regulated incumbents from three large member states were, therefore, asked a range of questions to determine whether they perceived regulators to be independent or not. Coen, Heritier and Boellhoff's comparative study of Anglo-German regulation based on interviews covered the same range of interviewees in order to triangulate (Coen et al.:2002). Similarly, the concern motivating the selection of a range of interviewees for this thesis was that some, particularly representatives of ministries, might be less candid than others.

#### **1.9.5. The overall academic contribution**

Most of the literature on EU regulatory Agencies and networks explains their creation in functional terms – typically emphasising the role which each type of selected body could play in enhancing the expertise, independence and credibility of regulation; building consensus among national regulators; and promoting a level regulatory playing field. This literature is discussed in Chapter 2. The argument tested in this thesis is very different. While there may be functional benefits to be gained from creating EU level regulatory bodies, their design may not, in fact, be determined by the assumed functional imperatives – indeed, sometimes such bodies may be designed to be ineffective. Rather than technocratic functional necessities, more political considerations may drive the design of EU-level regulatory bodies and the fundamental choice of whether to create a centralized, EU-level body or to instead to empower NRAs and establish looser networks of national regulatory authorities. If the latter is found to be the case, such findings will

support those approaches which suggest that there are clear limits to the extent to which the European institutions can escape member state principals where the latter have a collective preference (Thatcher:2001; Kelemen and Menon:2005; Menon:2008:249; Kassim and Menon:2010). This is not at all to suggest that member states will always oppose Europeanisation. Where it meets their collective needs, they are likely to favour it. Indeed, the regulatory outcomes delivered by Agencies may be capable of being used to test whether Europeanisation, defined by Levi-Faur as the creation of supranational regulatory regimes (Levi-Faur:2004:9), gives rise to superior implementation outcomes. This would potentially provide a partial rebuttal of Levi-Faur's hypothesis that Europeanisation makes no difference.<sup>10</sup>

#### **1.9.6. The practical contribution**

As Majone pointed out, design of regulatory institutions plays into the “credibility crisis” of the EU (Majone:2001:277). Majone's analysis suggested that regulatory design could be decoupled from and overcome structuring conditions at national level (Ibid:274). If the hypotheses advanced by this thesis are not falsified, it may suggest that structural conditions at the national level drive regulatory design. If so, when economic actors see single market directives which identify a conflict of interest but vest implementing authority only in national regulators they might be advised to draw the following conclusions.

First, do not invest if that investment is reliant on the actual implementation of EC rules and the location of the potential investment is a member state with reasons for favouring non-implementation. Second, do not expect any kind of endogenous evolutionary institutional process to rescue investments – absent independent structural changes within member states. In the short-term, this may not matter to national policy-makers. However, in the long run, if they collectively do decide that they need significant investment in cross-border activities where there are state-owned operators, for example in energy, they may have a credibility problem.

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<sup>10</sup> Partial, since a full test would in addition require comparing developments where there is an EU Agency with sectoral developments in other parts of the world.

## **2. Chapter Two: Literature review**

### **2.1. Introduction**

This chapter places the thesis in the context of the literature on principal and agent theory and in particular its application to implementing bodies of the EU. It reviews existing studies of delegation, assumptions of functional logics and the institutional characteristics of the possible set of implementing institutions, namely NRAs, networks of NRAs, Agencies and the Commission. It examines the literature on implementation and approaches drawn from the literature which might be applied when looking at regulatory implementation. The chapter sets out how the hypotheses put forward in Chapter 3 are drawn from a critical review of the literature.

The chapter begins with a review of a separate literature relating to legislative decision-making. The thesis explicitly investigates preferences and the rules by which they are aggregated and transformed into acts of delegation. Investigations of regulatory design in the EU tend not to analyse the interaction between preferences and decision-making rules in any systematic way (see, for example, Majone:1996; Kelemen:2002; Eberlein and Grande:2005; Thatcher:2001, 2005; Coen and Thatcher:2008; Thatcher and Coen:2008; Dehousse:2008). In some cases they do not investigate them at all but rather extrapolate back to preferences from design outcomes (Gilardi:2002; Wonka and Rittberger:2010). The significance of decision-making rules goes beyond defining who is a relevant decision-maker or principal. They also help define the extent to which each principal is relevant: some are more equal than others. In addition, the rules in the Treaty may also define the palate of potential institutional designs from which selection can be made. Consequently, the principal and agent based analysis in this thesis systematically integrates the effect of decision-making rules in order to more fully understand the act of delegation.

### **2.2. Legislative opportunity structure**

#### **2.2.1. Introduction**

To understand the design and subsequent functioning of EU regulatory bodies it is first necessary to consider the wider institutional structure within which they are designed and

embedded (Peterson and Shackleton:2002:10) . The institutional selection in each sector is shaped by the preferences of the relevant political actors, but these preferences are mediated by the rules of decision-making that apply (Tseblis and Garret:2000). The relevant principals in the design of any particular EU regulatory body will vary depending on the decision-making procedures applicable in that policy field at the time the new body is designed. There are three legislative scenarios: Treaty amendment, secondary legislation (i.e. directives and regulations),and Commission-delegated legislation (decisions) formalising bodies from which the Commission will take advice (Hartley:1996:98 and 107). The consequence of the interaction between preferences, the legislative opportunity structure and the European Court of Justice's interpretation of the Treaty is that, in practice, the primary choice usually available to the relevant principals if they wish to empower institutions at EU level are either NRAs or an Agency/the Commission.

### **2.2.2. Treaty amendment**

This is not the common mechanism for setting up European-level regulatory bodies. Other than the original delegation to the Commission, only a very small number have been set up in this fashion (for example the European Central Bank (Griller and Orater:2010:4)). The likely explanation for this is that negotiations over such bodies tend to be detailed and costly in terms of time. As a consequence of member states (and other institutions) not having fixed preferences in terms of the constitution of such bodies,<sup>11</sup> it has not been possible to agree a Treaty template and each new body requires a fresh negotiation. An intergovernmental conference (IGC) would have a vastly extended agenda if multiple Agencies were negotiated in that context. Furthermore, the timing of negotiations over such bodies would have to coincide with an IGC. An Agency in a specific area would not usually be of sufficient significance in its own right to justify opening up the Treaty to amendment - with the complex bargaining over a whole range of issues that would then occur and the now notorious difficulties in securing ratification.

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<sup>11</sup> This is the reason for which it has not been possible to arrive at an interinstitutional agreement on the structure of regulatory Agencies. An attempt in 2003 failed and there is currently a Commission review of Agencies and a paper encouraging renewed inter-institutional dialogue (Commission:2008). There is a common framework for executive Agencies (Commission:2003) but this is of less concern to the Council since these are bodies to whom the Commission alone delegates from its existing competencies.

Nonetheless, as noted above, member states have on some occasions have brought Agency design into an IGC.

Member states are obliged to bring Agency design into Treaty negotiations when they wish to create a European role in implementation but wish to exclude the Commission from any decision-making role in a particular field. This is due to the current EU constitutional law interpretation of *institutional balance* (Majone:2002:303; Geradin and Petit:2004:32; Griller and Orater:2010:8). Independent regulatory Agencies at EU-level are in principle viewed as being unconstitutional. They disturb the *institutional balance* of the Treaty by potentially moving European-level executive authority away from the Commission, which under the Treaty should otherwise be the European executive body. In *Meroni* (1956), the Court held that Community law did not allow delegations of discretionary powers to bodies that were not created by the Treaty.<sup>12</sup> It did permit that executive powers could be delegated as long as they were circumscribed and the Treaty-based delegating body remained the decision-maker. The Commission's formal view on regulators is set out in the European Governance White Paper of 2001 which states that "Agencies cannot be granted decision-making power in areas in which they would have to arbitrate between conflicting interests, exercise political discretion or carry out complex economic assignments" (Commission:2001:24).<sup>13</sup> However, a body actually operating as a regulator at European level, independent of the Commission, would likely have to engage in precisely such tasks (Geradin and Petit:2004:48). Legally, this could then only be admissible by making such a regulator another sui generic European institution created through a Treaty amendment.

If a body is created by Treaty amendment then the principals are exclusively the member states (Moravcsik and Nicolaides:1999:69). The input of the Commission and the Parliament is taken into account only to the extent that the member states collectively wish to do so (Shaw:1996:66; Moravcsik:1996:269). The absence of these parties from the act of delegation may mean that they have little role in institutional design.

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<sup>12</sup> Case 9/56, *Meroni v High Authority*; Court of the ECSC: Reports of Cases before the Court 1957:133-155.

<sup>13</sup> Unless the decision delegated to the Agency were sufficiently narrow not to require the exercise of policy-making discretion. Narrow powers have for example been granted to the Office for the Harmonisation of the Internal Market and the Community Plant Variety Office.

### **2.2.3. Secondary legislation**

#### *2.2.3.1. Introduction*

Given that regulatory bodies are not usually created through Treaty amendment, this means that they are normally constituted through secondary legislation (directive or regulation). The Commission always has a role in the design of secondary legislation because it enjoys a monopoly in legislative initiation (Peterson and Shackelton:2002:88; Pollack:2003:84). The extent to which its formal agenda-setting role translates into an influence on the final design of institutional environment in the particular policy area will depend partly on the specific legislative rules set out in the Treaty with respect to the particular policy area. In the field of internal market legislation, where many of the EU's regulatory activities are concentrated, most legislation is now subject to qualified majority voting rather than unanimity (Blomberg and Stubb:2008:53). As a consequence, this may potentially give the Commission scope to advocate institutional designs that do not meet the requirements of every member state, as long as they meet the requirements of a qualified majority (Hix:2005:99-106; Franchino:2007:46-53; Tseblis and Garrett 2000). The Commission is likely to have even greater influence where there is co-decision (rather than mere consultation by the Council of the Parliament) and if it can persuade the Parliament of the merits of its views on institutions as compared to the views of the Council (Franchino:2007:58).

#### *2.2.3.2. The rational-institutionalist legislative model applied in the thesis*

The model applied in the thesis is generally a basic two-dimensional spatial model of EU legislative decision-making (Tseblis and Garrett:2000; Mattila and Lane:2001; Hix:2005:73). One axis is the supply of different types of regulatory institution with NRAs at one end and supranational institutions at the other. The other axis consists of the supply of the appropriate regulatory rules for achieving open markets in a particular sector, from inadequate to comprehensive (in some amending directives issues only one of these axes may be under negotiation; the spatial model would then be one dimensional). Different member states may have different utility functions with respect to the supply of rules on either axes. Similarly, the Commission and the Parliament may each have their own preferences. Legislation is predicted to occur where there is at least a

minimum winning coalition in favour of a particular set of proposals, comprising of a qualified majority in Council, agreement from the Parliament and no withdrawal of legislation by the Commission with respect to a particular set of proposals (Tseblis and Garrett:2000).

The Commission is considered a formal agenda-setter because of its monopoly of initiative: its proposals can be adopted by the Council by qualified majority vote, although only amended by unanimity, and it has an ability to veto Parliament amendments up until the conciliation phase. However, it is also usually considered that the Commission loses its veto rights and hence formal agenda-setting role once a proposal goes into conciliation as there the Council and Parliament are the sole negotiating parties (Pollack:1997:123). However, this analysis may not be entirely correct from a formal perspective. The Commission's right of initiative also includes a right of withdrawal (Rasmussen:2007:246). The institutional agreement concerning legislation under co-decision does not rule out its use at any particular point prior to adoption (Council, Parliament, Commission:2007). The Commission has previously said that it would only do so if the co-legislators introduced amendments that were either manifestly illegal or which comprised a "serious weakening of the Commission proposal" (Commission:2000:6). The latter is, of course, interpreted by the Commission. Consequently, the Commission is here also considered part of a necessary minimum winning coalition. However, this may not make a great material difference to outcomes since the Commission and the Parliament, as will be argued below, are likely to share similar preferences for more supranational empowerment in the regulatory space.

#### 2.2.3.3. *Criticism of the model*

The criticism made of the rational-institutionalist legislative model is two-part; first, that it does not reflect the deliberative element of negotiation. Critics point to the fact that the Council rarely votes against Commission initiatives and that it nearly always adopts legislation consensually (Heisenberg:2005; Lewis:2005). Such criticism itself, does not, of course, reflect the impact of the "shadow of the vote" on structuring the behaviour of both the Commission and the Parliament and on the participants in the Council of Ministers (Naurin and Wallace:2010:5). The second criticism is that it cannot trace the process by which the Council arrived at its position, because the Council rarely votes.

There have been attempts to get around this problem by ex-post interviewing to establish the preferences of individual member states. However, as its practitioners admit, when applied to the model, these do not generate fully accurate predictions of outcomes (Koenig and Junge:2010:93; Schneider:2010:284). The suggestion made is that the theory does not yet include all the relevant incentives (Koenig and Junge:2010:97). This seems likely; there could be rational reasons for member states to vote insincerely (or rather to not vote insincerely as this is how the procedure usually operates in practice). For example, being seen to be in a losing coalition at EU-level could on occasion be more costly in domestic politics than formally registering dissatisfaction at EU-level; there may be “log rolling” at EU-level (Mattli and Lane:2001); there may be a logic of appropriateness that applies to the behaviour of losing coalitions (Heissenberg:2005). For the purposes of this thesis, however, it does not matter if the Council decides by over-size coalitions or unanimity because it is what the Council does collectively that is required to test the hypotheses advanced here.

## **2.3. The regulatory designs available via secondary legislation**

### **2.3.1. An Agency**

The formal definition of an Agency can be found in section 1.6.1 of the first chapter<sup>14</sup>. At a higher level of abstraction, an Agency could be considered simply as a mechanism for obtaining collective agreement on detailed implementation (or incomplete contracts). It is always a supranational entity because where an Agency is created through secondary legislation, it is, legally, due to the Meroni doctrine described above, necessarily the case that the Commission becomes the actual implementing body (Busiouc:2009:610). In this situation, an Agency only has power formally to the extent to which its advice on implementation is accepted by the Commission.

In practice, it may be difficult for the Commission to ignore such advice for two reasons. First, Commission implementation powers are usually only exercisable after approval in a ministerial comitology process (Franchino:2007: 120). In some Agencies, the executive

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<sup>14</sup> See page 31.

advice-generating bodies are collectives of the relevant NRAs (Thatcher and Coen:2008:811). The existence of an Agency draft opinion would then mean that the ministerial committee reviewing the Commission's decision is in possession of what national experts active in the sector collectively think is the correct decision. This potentially renders the costs for ministries of ensuring that the Commission does not drift away from the current collective preferences of member states lower. Second, exercise of the discretion set out in the secondary legislation may be structured by limiting and weighting the factors to be taken into account when discretion is exercised (Gehring and Krapohl:2007:218). If the Agency produces a well-reasoned draft opinion, the Court is likely to take it into account if it is called to review the Commission's decision against the requirements in the legislation and for proportionality in general.<sup>15</sup>

It should equally be noted that the legal constraints that apply to the Commission also apply in turn with respect to any attempt by the Council to use comitology to overturn a Commission decision that endorses an Agency opinion (Krapohl:2004:537). The Commission's role also constrains the NRAs collectively, if the latter construct a poor draft opinion, say for example a mere aggregation of incompatible national positions, the Commission, as long as it motivates the decision, can replace the draft decision with its own. The consequence is that all three levels of decision-making: NRAs collectively in the Agency, Commission, and ministries in comitology, can be tied by giving reasons requirements to the objectives set out in the directive (Shapiro:1997:287 and 289). An Agency will also likely be subject to controls from the Parliament, in particular the power to set its budget (Vibert:2004:398).

### **2.3.2. Commission empowered by secondary legislation**

The Commission can be empowered to implement secondary legislation without input from an Agency (Franchino:2007:282). Where this is the case, typically, it will be

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<sup>15</sup> This has been the case in medicines authorizations. See for example case T-326/99 *Nancy Fern Olivieri v Commission and EMEA*, para 55. Equally, if the Agency were to provide a draft decision which breached EC law requirements that would impact on the Court's analysis of the Commission decision, see for example para 197 of case T-74/00 *Artegoden GmbH v Commission* 26.11.2002: "Although the CPMP's opinion does not bind the Commission, it is none the less extremely important so that any unlawfulness of that opinion must be regarded as a breach of essential procedural requirements rendering the Commission's decision unlawful." For a discussion of the role of the CPMP (a committee of the Agency) see pages 288-311 below.

subjected to various forms of comitology as discussed in paragraph 2.11 below<sup>16</sup>. The Commission and the Committee can also be tied to the giving reasons requirements in a particular sector if the principals so desire. The Parliament could potentially use its standard powers for influencing the Commission (legislative, budgetary, hearings, and role in Presidential appointments) in order to influence the Commission's role in implementation in a specific sector (Pollack:2003).

### **2.3.3. Independent NRAs empowered by secondary legislation**

Independent NRAs can be selected in secondary legislation. Unlike an Agency, decisions of an NRA are not usually subject to any administrative review by the Commission, although this form of design is both constitutionally feasible and has occurred (see the telecommunications case study in Chapter 4<sup>17</sup>). However, the Parliament has never sought or been accorded any role vis-à-vis an institution which is considered national. The precise content of *independence* would need to be negotiated in the empowering legislation.

### **2.3.4. NRAs organised into networks**

Networks of national regulators established without an accompanying EU Agency can, but need not, be created through EU-legislative processes (Geradin and Petit:2004:7). Where they are created by directives or regulations, there may be a legal requirement on the Commission to privilege their input to Commission decision-making processes which, in addition, requires the Commission to provide reasoning for not adopting their view<sup>18</sup>. A network with this characteristic would then have the power equivalent to the formal agenda-setting power also potentially held by a regulatory Agency. Where member states have sought this, it means that they are prepared to pool sovereignty on the issue delegated to the Commission and to the network. This is likely to arise where the delegation of powers to the Commission and the network has not occurred simultaneously. The empowerment of the network may be a subsequent attempt by member states to develop a collective agenda setting power vis-à-vis the use of

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<sup>16</sup> See page 81.

<sup>17</sup> See pages 164-165.

<sup>18</sup> See for the example the role of the European Competition Network, p. 330-333.

Commission implementation powers. In this situation, it is likely that the Commission will use its monopoly power over legislative initiative to not propose an Agency.

The difference between an Agency and a network in this situation may be the lesser extent to which a network can set the agenda informally vis-à-vis the Commission because it has not been endowed with the structure and resources which favour it constructing substantive collective positions (Coen and Thatcher:2008:64). Where they are not called into being by legislation, networks can also be created by the NRAs themselves and possibly formalised later by Commission decisions appointing them collectively as advisor to the Commission when exercising its own delegated powers (a situation described as “double delegation” by Thatcher and Coen:2008:50).

However, in the latter situation, the formal influence of networks is limited to the extent to which the Commission itself is empowered by legislation. The Commission may favour the creation of such networks precisely where it is not empowered (Hancher:1996:65; Hocepiéd and de Streel:2005:26)). It may hope that the network will have informal influence on the NRAs. Whether the network will have this effect will depend on the extent to which NRAs are in fact free to take into account any collective opinions expressed by the network and in that event the extent to which they voluntarily opt to do so. Under national constitutional rules, NRAs would not normally be empowered to make international agreements and so could not bind themselves to observe the views of the networks. The rules of the networks, where there are any formal rules, usually make it clear that the collective opinions of the networks have no binding effect on their members (Coen and Thatcher:2008:64).

#### **2.4. Preferences, legislative rules and the hypotheses**

The interaction of pre-delegation preferences and decision-making rules are modelled in Chapter 3<sup>19</sup> and contribute to the first and second hypotheses.<sup>20</sup> Preferences and outcomes and the effect of legislative mechanics are traced in the case studies in order to test the hypotheses advanced regarding institutional preferences.

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<sup>19</sup> See page 105.

<sup>20</sup> See the table on page 91 of this chapter

## **2.5. Principal and agent theory**

### **2.5.1. Delegation to implementing bodies in the EU**

There are many existing academic studies that investigate delegation to bodies tasked by EU legislation with the administrative implementation of EU rules. There are those that examine delegation to NRAs (Boelhoff:2005; Coen:2005; Doehler:2002; Gilardi:2002; Thatcher 2002; Wilks and Bartle:2005; Verra: 2001). There are others that examine networks of NRAs (Eberlein and Grande:2005; Coen and Thatcher:2008; Kassim and Wright:2007; Thatcher and Coen:2008; Nicolaidis: 2004). There are studies that examine the creation of Agencies (Everson:1993;Majone 1997; Kreher:1997; Shapiro:1997; Majone:2000; Feick:2002; Kelemen:2002; Curtin:2005; Gehring and Krapohl:2007; Dehousse:2008; Everson et al.: 1999; Permanand and Vos: 2008 ; Vibert:2007). There are analyses of delegation to the Commission and comitology controls (Dogan:1997; Joerges and Neyer:1997; Franchino:2000; Pollack:2003, Steueneberg:1994; Thatcher:2001; Tallberg:2002; Vos: 1999 ).

What most of these studies have in common is that the investigation of delegation typically takes the form of analysing one type of institution. Where an author looks at multiple institutions, for example Pollack, the author tends to do look at a series of non-homogeneous institutions, tackling very different functional issues such as Commission, Court and Parliament (Pollack:2003). Thatcher and Coen have also set out a typology of possible institutions dealing specifically with market regulation (Thatcher and Coen:2008:58)

This thesis seeks to take a further incremental step and explain the choice of delegation between two different types of regulatory implementing institution: the NRA, often organised into networks of NRAs, and the Agency. Theorising the choice between different types of delegates in the EU was pioneered by Franchino, who investigated the choice of delegating implementation between the Commission and national ministries (Franchino:2006:16).

## **2.5.2. The principals, the agents, and the rules under which agents are defined**

### *2.5.2.1. Introduction*

Principal and agent theory is based on the economic theory of contracts and was deployed in political science by American political scientists examining delegation of tasks to congressional committees and to independent agencies (Pollack:1997:100). More recently it has been applied to the European institutions as described above. Principal and agent theory is an application of rational choice institutionalism. It assumes a consequential logic on the part of principals. Principals delegate power to agents whom they construct with a view to the latter carrying out tasks on their behalf.

### *2.5.2.2. The principals*

The principals, as far as the defining of institutions in EU secondary legislation is concerned, are (under co-decision) the Commission, the Parliament and the Council of Ministers. Although the Commission is not strictly a legislator, its unique power of initiative and its ability to withdraw legislation give it a quasi-legislative role (Hix:2005:104; Tseblis and Garrett:1996:277).

### *2.5.2.3. The agents*

The agents under examination in this thesis are primarily the NRAs and the EU Agencies, although delegation to either may also take place in the context of empowerment of the Commission as an agent also. (As Coen and Thatcher point out, an EU institution can potentially be both principal and agent if it has scope to exercise its own discretion with respect to further delegation (Coen and Thatcher:2008:52; see also Moe:1984:766)).

## **2.5.3. The definition of delegation**

Stone-Sweet and Thatcher define delegation as “an authoritative decision, formalized as a matter of public law, that (a) transfers policy making authority away from established, representative organs (those that are directly elected, or are managed directly by elected politicians) to (b) a non-majoritarian institution either public or private”( Stone-Sweet and Thatcher:2003:3). I use part of this definition – the authoritative decision, formalised

as a matter of public law transferring policy making authority – as my definition of delegation. The rest of the definition is potentially problematic for three reasons. First, it could exclude transfers of authority by elected officials from one non-majoritarian delegate to another. Second, it excludes the possibility of principals being unelected and that may not be appropriate in the case of the EU (Thatcher and Coen:2008:53). The conditions under which the Commission could be considered a principal are discussed in Chapter 3. Third, it begs the question of whether the institution in receipt of the grant of authority is actually non-majoritarian and this may depend on the controls, either formal or informal, put in place during the act of delegation.

#### **2.5.4. Controls over agents**

The point of an agent is that delegation to the agent unburdens the principal of tasks that the principal would otherwise have to conduct. However, the possible risk to a principal or principals is that the agent may not apply the rules in the fashion intended by one or all of the principals. It may develop its own preferences (bureaucratic drift or shirking) or it may fall under the control of a rival principal now or in the future (political drift or slippage) (McCubbins:1985:724; Thatcher:2002:129; Kelemen:2002:96).

Consequently, principals include controls in their acts of delegation. These controls can be ex-ante, taking place prior to the exercise of delegated authority or ex-post, permitting sanctioning the agent if it disobeys the relevant principal (McCubbins:1985:728; Thatcher and Stone-Sweet:2002:5). Under EC rules not all controls may be available to all principals with respect to every type of agent. For example, the Parliament has no power to apply any controls to NRAs (Dehousse:2008:797). This is likely to be an explanation for the finding in the case studies that it is the principal at EU level which is most strongly in favour of the transfer of implementing authority to supranational institutions; a situation in which it would typically gain a supervisory role (Vibert:207:398).

### **2.6. The relevance of principal and agent theory to the thesis**

Analysis of the construction of the EU regulatory frameworks, the acts of delegation examined in the thesis, can potentially clarify the logic for preferring particular agents on the part of each of the principals. The data provided by this analysis will be used to test

all the proposed and alternative hypotheses except issues of implementation (since the latter comprises post-delegation activity). A principal's true preferences may be expressed during debate between the institutions or, conversely, where obscured, may be inferred from a preference for certain delegates or certain controls rather than others. As Pollack puts it:

“The basic approach of rational choice theory to the question of institutional design is functionalist. That is to say, rational choice theory explains institutional choice in terms of the functions a given institution is expected to perform and the effect on policy outcome it is expected to produce.” (Pollack:1997:102)

An analysis based on a functional approach is likely to be more convincing if it can be shown that the particular institutional outcome holds across multiple policy sectors. This thesis examines all the acts of delegation to all institutions in three policy sectors. This provides 20 acts of delegation<sup>21</sup> and can potentially permit us to analyse under what conditions principals favour certain types of agent and certain types of controls as compared to others.

## **2.7. Functional logics**

### **2.7.1. Functional logics for delegation**

There are a number of functional logics that have been identified in the literature to explain the selection of a policy of delegation by principals to national and supranational regulatory bodies. Such delegation can, in theory, be of advantage to the principals in, inter alia, resolving commitment problems; overcoming information asymmetries; enhancing the efficiency of rule-making; and blame shifting (Egan:2004; Levi and Spiller:1996; Majone:2001; Stone-Sweet and Thatcher: 2003; Tallberg:2003). However, just because they could potentially deliver these particular benefits does not mean that it should be assumed that if an institution is created that it is necessarily because either or several of these are the only functional benefits which are sought. And, if these are properties are sought at all, they may only be sought by some of the relevant principals.

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<sup>21</sup> There were in addition two legislative acts concerning rail access under negotiation as of 31 December 2010. These are also reviewed in the rail chapter.

When the actual process of delegation is traced, including the controls placed on the delegate and the outcomes in practice, it may be found that delegation has been limited in the first place or subjected to such controls that the expected or purported functional properties deliberately cannot be realised (Mitnik:1980:335; Kelemen:2002:97). As Wilks and Bartle put it in a description of the early years of the UK and many other European national competition law regimes, the functional needs of national principals was apparent credible commitment: a symbolic need to commit to protect competitive markets alongside the functional requirement for ministerial flexibility in actually permitting or not the application of competition law in different sectors: “The perfect solution was the ineffective agency”(Wilks and Bartle:2003:157).

## **2.7.2. Apparent functional logic for delegation to independent NRAs and Agencies**

### *2.7.2.1. The apparent functional logic for delegation to NRAs*

The apparent functional logic behind the delegation of regulatory competences to *independent* NRAs in the framework regulatory directives applying to utilities was an attempt to achieve credible commitments to market opening. These directives regulate economic sectors where it had been identified that member states had a conflict of interest because of state ownership of the regulated entity. There was a need to set up independent regulators in order to deliver provisions in the directives enabling effective market access that in turn would attract investment. (Levy and Spiller:1996a; Levy and Spiller:1996b; Gilardi 2002:877).

Gilardi analysed the controls placed on telecommunications NRAs in the EU and found that they had been structured to deliver credible commitments (Gilardi:2002). Consistent with this, Thatcher found that there was little evidence of politicisation or political interference with utility NRAs (Thatcher:2002). These analyses of the regulatory regimes in telecommunications are consistent with the theoretical approach which would suggest that, where the credible commitment of the principals is lowest, agents with the greatest degree of independence should be found (Moe 1985:768; Moe 1995:124; Elgie and McMenamin:2005:541 Majone:2001:104). It has also been claimed that for some member states setting up new regulators permitted blame shifting, solved information

asymmetries vis-à-vis the incumbent and made for more efficient decision-making (Thatcher:2001).

#### 2.7.2.2. *The apparent functional logic for the creation of Agencies*

Much of the literature on EU regulatory Agencies has also explained their creation in purely functional terms (Everson:1995; Kreher:1997; Majone:2000).<sup>22</sup> According to this view, EU Agencies are created to address the need for technical expertise and to enhance the independence and credibility of EU regulation. Majone in particular, emphasises that the growing politicisation of the Commission has increased the functional need to delegate regulatory functions to *independent* Agencies at the EU level (Majone:2000:284).

#### **2.7.3. Identical functional logics: two different types of institution?**

The existing literature, therefore, seems to indicate that institutions of two design types have been developed in order to meet the same functional logic of credible commitment. I would suggest that this is not the case and that only one of these regulatory forms is actually designed to deliver credible commitments as opposed to the appearance of credible commitments. I explain in the succeeding sections why I think that there has been an assumption that credible commitments to market opening is what is sought by all member states.

##### 2.7.3.1. *The influence of Majone's "regulatory state" thesis on the analysis of functional logics.*

###### 2.7.3.1.1. Majone's thesis

The assumption of unilateral functional pressures is probably an inheritance from Majone's seminal 1994 article analysing the rise of the *regulatory state*. Levi-Faur recently noted in a historiographical analysis that Majone's work has dominated the field of regulatory governance in the EU (Levi-Faur:2007:104). Majone argued that the regulatory state distinguished itself from the *positive state* in that "the role of the state

changes from a producer of goods and services to that of an umpire whose function is to ensure that economic actors play by the agreed rules of the game”(Majone:1994: 80). The new objectives of the game are solely focused on achieving sectoral economic efficiency rather than the wider and often conflicting goals pursued via state ownership (Majone:1994:79). Privatisation is identified as a causal mechanism that creates the space for the rise of the regulatory state which is delivered via independent agencies (Majone:1994:80; Levi-Faur:2007:105). As a consequence, the implicit assumption has been that where there are observations of independent regulatory bodies, and following Majone’s causal logic, privatisation must have taken place. Majone’s also argues that a second independent variable is the promotion of the nascent regulatory state by the Commission. It is motivated to pursue this form of power due to its lack of command and control or spending powers (Majone:1994:89). Member states agree to transfer regulatory powers to EU level because of the low implementation credibility of traditional inter-state agreements but seek to limit the discretion of the Commission by making it dependent on the information and knowledge provided by national bureaucrats (Majone:1994: 90) However, the Commission escapes these constraints by co-opting the relevant national officials and a wider group of socio-economic actors in issue networks (Majone:1994: 90).

#### 2.7.3.1.2. Recent analysis which subscribes to the Majone thesis

An example of the influence of Majone’s view can arguably be traced in Thatcher’s more recent examination of sectors ruled by EU sector frameworks in a range of sectors: airlines, electricity, postal services, securities markets and telecommunications, where the variables examined seem to derive from Majone’s 1994 approach (Thatcher:2007). Thatcher finds that EU activities have acted as an autonomous force to effect policy change at national level with the consequence that:

“[Member states] ...had adopted comprehensive and similar institutional reforms in most sectors ...long standing monopolies that dated back to the nineteenth century or earlier had been abolished. Instead they had been replaced with rules designed to aid “fair

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<sup>22</sup> For important exceptions, see Shapiro (1997), Kelemen (2002) Dehousse (2008). These studies explore the politics of Agency creation but not by comparison with delegation to NRAs.

and effective competition... [and] Governments had created independent sectoral regulatory agencies and delegated powers to them.” Thatcher (2007:5)

Majone’s view appears to have framed, consciously or unconsciously, Thatcher’s interpretation of the evidence he collected. For example, he describes the European electricity and telecommunications sectors as privatised even though, with the exception of the UK, the evidence he presents from France, Germany and Italy actually shows that in two-thirds of the cases, the state has control levels of ownership in the main operator (Ibid:199 and 214). (In fact, his tables should probably be amended to show state control of German electricity (Ibid:214) and Italian telecommunications (Ibid:196); in which case, state control would apply in 100 per cent of the cases he examined outside the UK).<sup>23</sup>

#### **2.7.4. Functional pressures and distributional issues**

The liberal intergovernmentalist approach to institutional formation in the EC is criticised for focusing exclusively on the treaties and thus potentially over-emphasising the role of member states in the development of the EU (Tseblis and Garrett:1996:269). However, one merit of the liberal intergovernmentalist approach was its focus on the construction of national preferences – the *liberal* part of the approach (Moravcsik:1993:481) and its prediction that national preferences were likely to over-represent existing producer interests rather than either consumers or potential producer interests that might develop as a consequence of changes in rules (Moravcsik:1993:488 and 489). Moravcsik thought that functionalists tended to engage in *supply-side* reductionism: if there was a proposal for developments at European level, it must be because cross-border transactors dominated and the proposed rules must reflect this (Moravcsik:1993:482). He argued that if existing producers have reasons to believe that EU rules may impose costs on them then national preferences regarding delegation are likely to be impacted. Influence would

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<sup>23</sup> Thatcher found in 2007 that the Italian state was considering disposal of a golden share which gave it the same rights as a majority holding. However, the Italian state still possessed the share in 2009 when the ECJ found that the particular rights were illegal. Despite the Court ruling, according to European Competitive Telecommunications Association, the Italian state still holds the golden share (ECTA:2009: Annex III:A4:15). He also found that there were no state holdings in RWE and E.On. It is correct that there is no central-state holding. However, according to the European Industrial Relations Observatory, Laender governments in 2005 were the majority holders of capital: [www.eurofound.europa.eu/eiro/2005/02/study/tn0502101s.htm](http://www.eurofound.europa.eu/eiro/2005/02/study/tn0502101s.htm) as at 8.8.2010.

seem all the more likely where the existing producers are in fact owned by the state. If the dominant producer interests are likely to be prejudiced by the independent implementation of European market opening rules then it might not be surprising to find that the rules are either not binding or that there is no independence in their implementation.

### **2.7.5. Producer interests**

In the sectors regulated by the utility regulatory frameworks, the producers had statutory monopolies until states removed them in the 1980s and 1990s or were forced to relinquish them by the combined actions of the Commission and the Court (see the telecommunications case study in Chapter 4<sup>24</sup>). However, it is important to note that the abolition of a statutory monopoly does not remove a de facto monopoly. The incumbent operators commenced the period of liberalisation with 100 per cent market share within national boundaries and 0 per cent elsewhere in the EU. Directives designed to facilitate competition were, therefore, directly targeted against their existing interests. In addition, the conflict of interest between the state as producer and as regulator had not been relinquished in the way Majone expected. Most existing research has tended to focus on the sale of any interest because this is the measure that is available from sources such as Privatisation Barometer,<sup>25</sup> but this has confused sales with the termination of state control. The confusion arises because in many cases while the state substantially reduced its proportion of capital in nationalised industries, it nonetheless often remained the largest single shareholder or constructed equivalent controls such as *golden shares*,<sup>26</sup> and thus retained its influence on the company.

The body representing public enterprises at EU-level, the European Centre of Employers and Enterprises providing Public Services (CEEP), characterised the opening of capital in public enterprises as being conducted in many states not to remove the involvement of the state but “with the sole aim of drastically reducing national debt” (CEEP:2000:2).

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<sup>24</sup> See page 142.

<sup>25</sup> <http://www.privatizationbarometer.net> as at 12.7.2007.

<sup>26</sup> Golden shares can be defined as: “All legal structures applying to individual corporations for the purpose of preserving the influence of a public authority on the shareholder structure or the management of the corporation beyond the extent to which such influence would be afforded under general corporate and securities law” (Adolff:2002:4).

Cliften et al. note that: “There is little evidence [...] of a monolithic common decision across the EU to emulate a radical privatisation programme UK-style” (Cliften et al: 2006:743-44). Public enterprises continued to employ approximately six million workers and were responsible for 8.5 per cent of added value at the end of the 1990s in the EU-15(CEEP 2000: 6). Beltratti et al surveyed entities that had been privatised by 2000 and found evidence for what they called the phenomenon of “reluctant privatization”, defined as the transfer of ownership rights in state-owned enterprises without a corresponding transfer of control rights. They found that in 2000, governments were the largest shareholder or used special control powers to retain voting control of 62.4 per cent of a sample of privatised firms (Beltratti et al:2007:1).

As the case studies will reveal, state ownership remains very extensive in the utility sectors outside the UK. The countervailing producer interests are very small. Across the utility sectors examined, the value of cross-border transactions (so including the value of transactions conducted by the national incumbents) probably represents between three and ten per cent of the value of the overall European market in each sector in 2010 – after almost a decade or more of market opening. Incumbent market shares have fallen more significantly to domestic rivals – but the incumbents still retain dominant shares of domestic retail markets. This is not the kind of situation where one would expect member states to be likely to be keen to hand powers for tackling domestic market power to a supranational authority.

#### **2.7.6. The specific consequences of variation in distributional conflict**

The case studies, therefore, examine the nature of distributional conflict in each sector. The first hypothesis seeks to test the proposition that the existence or absence of distributional conflict shapes the preferences of the Council of Ministers for different institutional designs.

## **2.8. The independence of independent NRAs**

### **2.8.1. Introduction**

This section of the thesis is devoted to the existing literature on NRAs and in particular the claim of independence for NRAs. This is relevant to any functional claims with respect to the selection of NRAs. If Agencies and NRAs are both potentially capable of delivering the standard functional capabilities for which any kind of agency is selected then what may distinguish them is the extent to which they are dependent on either an individual principal or multiple principals. If an agent is dependent on an individual principal then it can potentially, where there is distributional conflict, be directed through the exercise of controls to deliver policies that deliver the distributional outcomes sought by the individual principal.

### **2.8.2. Independence requirements and EU framework legislation**

The literature sometimes suggests that it is a common feature of EU regulatory frameworks that they require the creation of NRAs that are independent of ministries (Levi-Faur:2004: 8; Majone:2001:111; Thatcher:2007:5).<sup>27</sup> This is not in fact the case. EU directives normally do not specify the nature of the body that is to conduct implementation at national level. It is usually entirely within the member states' discretion as to the domestic administrative arrangements, the selection of the competent body to conduct implementation and the controls placed on any agent by the principal. This is the standard operating procedure for implementation (Weatherill and Beaumont:1995:137). It is only within an extremely restricted set of directives that EU legislation actually interferes with national governance structures and requires *independence*.

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<sup>27</sup> Although, the same authors have also published other analyses that have suggested that Ministries may in fact be able to influence NRAs, see Jordana, Faur, and Puig (2006: 448), Majone (2000: 284) and Thatcher (2005:364)

A review of all EU legislation for this thesis<sup>28</sup> found that the set of frameworks requiring the creation of *independent* national regulators to implement EU regulatory frameworks is, with the exception of central banking, limited only to cases where national administrations suffer an acute conflict of interest between the conduct of regulation and ownership of entities to be regulated. Although it might be expected that there would be requirements for independence wherever there is a requirement for regulation and state ownership is also prevalent, such a need has only been recognised in a subset of cases where the owned entity is vertically integrated and controls monopoly network assets.

It should be noted that the definition of independence for *independent* regulators has itself been contested in legislative negotiations. Although the Treaty contains protections for the independent central banks,<sup>29</sup> member states have until recently deliberately rejected attempts to import identical protective provisions into sector specific directives. The typical requirement for *independence* usually only legally requires that the same unit in a ministry not administrate the state ownership and be responsible for regulation (see the rail and telecoms case studies<sup>30</sup>). Such chinese walls may or may not be robust. As the Belgian rail regulator put it in evidence regarding chinese walls within the Belgian rail operator to a House of Lords committee examining EU rail regulation, the problem with chinese walls is that “sometimes walls can collapse very quickly” (House of Lords European Union Committee:2009: Chapter 3, para 21).

### **2.8.3. Why independence is particularly necessary in the utility sectors**

Non-conflicted regulation is absolutely essential in these cases because access to these assets is required on an equal basis by entrants to the market in order for a market to exist at all. The incumbent vertically integrated entity has an economic incentive to refuse that access (Cave and Crandell:2001:49; Cave and Valetti:2000:332; Helm:2001:307;

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<sup>28</sup> EU legislation in force can be found at <http://eur-lex.europa.eu/en/legis/20091201/index.htm>. As at 31.08.2008, it stood at 16,903 pieces of legislation and these were all reviewed for the thesis to ascertain which contained requirements to set up independent regulatory authorities. A double check was instigated by writing to the information services of each director general to ask them to identify for each sector in which legislation for which they were responsible there was a requirement to set up independent regulatory authorities. All of the EU framework requirements for independent regulators are listed in Annex One.

<sup>29</sup> Articles 108, 237 (d) EC and Article 35.6 of the Statute of the ECB. See Ziloli and Selmayr (2000:627).

<sup>30</sup> See pages 155 (telecoms) and 226 (rail).

Pelkmans:2001:445). The sectors in the EU in which there are vertically integrated companies competing in retail markets and which own bottleneck monopoly access infrastructures to which competitors need access in order to compete are airports, electricity, gas, posts, rail, telecommunications and water. These are also sectors in which research for this thesis has found there to be a substantial concentration of state ownership in the EU.<sup>31</sup> Other than central banking, a requirement for regulatory independence within the national administration has to date only been incorporated in the following sectors: airports, electricity, gas, posts, rail and telecommunications.<sup>32</sup>

#### **2.8.4. Why appearing to grant independence while maintaining control is in the interests of governments**

A question that arises in response to this point is that if member states wished to control outcomes, why did they often create NRAs as opposed to retaining the powers of regulation within a ministry and designating it the NRA for these purposes? It has been suggested that this is ubiquitous and can be explained by isomorphism and a logic of appropriateness (Thatcher:2007:258).

This is the case in telecommunications, all member states have set up apparently arm's length institutions. However, in energy the situation is mixed, with important regulatory powers reserved to ministries in some countries.<sup>33</sup> In rail and pharmaceuticals, however, the majority of NRAs are parts of ministries. This would suggest that member states have a range of options available and that where they choose a particular design, it is because it serves a particular purpose. Where NRAs are selected, the most likely reason is that member states aspire to give the impression of a credible commitment to market access.<sup>34</sup>

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<sup>31</sup> See Annex 2. Records were requested for all member states between June and 31 December 31 2008. Twenty-three member states responded.

<sup>32</sup> See Annex 1 for a list of all the *independence* requirements in EU legislation.

<sup>33</sup> For example, during the E.On/Endesa bid in 2006, the Spanish government transferred the first discretion-making power to the independent energy NRA, until then its role had been purely advisory. The power was a power to block bids by foreign companies outside of the normal competition law merger control. The NRA promptly prohibited the German company from purchasing its Spanish target (Tarrant and Kelemen:2007:13).

<sup>34</sup> For example, see a speech by the German ambassador to the US in 2001 to US policy-makers in which he sought to counter "misperception No1: the German telecom market is the protected playground of Deutsche Telekom" with arguments that in Germany "market access is unrestricted and fully open to foreign investment" and that this was protected by an independent NRA. (German Foreign Office: 2005)

However, they may have potentially contradictory ambitions, they may want maximum inwards investment combined with no politically damaging market consequences for their incumbents. They may potentially also want their incumbents to be able to gain scale by entering other national markets in the EU and to obtain access via the local regulator. Furthermore, member states whose incumbent operators wish to enter US markets or merge with US operators may be required as a matter of the application of US regulatory rules to set up effective domestic regulatory regimes.<sup>35</sup> Failing to set up an arm's length regulator would also signal to the Commission that the member state did not aspire to the *spirit* of the legislation and that might lead it to focus its scarce competition resources on that member state. These incentives for dissimulation make reliance on vague formal design requirements for NRAs an unreliable guide as to independence.

## **2.8.5. Regardless of EU rules, are national regulatory authorities independent?**

### *2.8.5.1. Claims of independence at national level*

The interpretation advanced in the thesis is that where member states' resisted the creation of Agencies at EU-level, it was derived from distaste for actual independent regulation. This interpretation would be undermined if independence was always granted at national level regardless of EU rules. Member states generally claim that they have created independent regulators. For example, in interviews conducted by Coen et al., a representative of the German Economics Ministry stated that "RegTP [the regulator] was fully independent and claim[ed] that there is no political influence on the decision-making of RegTP" (Coen, Heritier, and Boelhoff 2002:8).<sup>36</sup> However, the same authors wryly note that amongst those complaining in interviews about political interference were the staff of the regulator itself (Ibid:8).

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<sup>35</sup> This was the case in telecommunications in the late 1990s and early 2000s when the US domestic regime was pro-competitive. For example in telecommunications, the US FCC's Effective Competition Order test required a foreign carrier seeking access or buying equity in a US company to show that its country's regulatory regime met a number of criteria including the existence of "an independent regulatory body with fair and transparent procedures [...] to enforce competitive safeguards (Naftel and Spiwak:2000:132).

<sup>36</sup> The speech reported in footnote 34 also stated (inaccurately) that "[RegTP] decisions cannot be halted, cancelled, or modified by the German government."

## 2.8.5.2. *Measurements of NRA independence*

### 2.8.5.2.1. Statutory protection models

Attempts have been made to assess the independence of regulatory authorities by assessing the degree of statutory protection from ministerial instruction or influence with which these institutions have been endowed. There is an extensive literature on the design of independent institutions, although it largely relates to the design of central banks. The OECD study in 2000, *Telecommunications Regulations: Institutional Structures and Responsibilities*, for example, follows in this tradition and states:

“Whilst the degree of independence is also influenced by factors such as political traditions and the personality of the head of the regulatory body, the single most significant factor is the institutional structure of the regulator. In fact, the degree of independence varies from country to country according to the institutional arrangements put in place by law and regulation.” (OECD:2000:14).

However, the OECD report provides no evidence to support this conclusion. It engages in no comparative analysis and simply provides a list of the different institutional arrangements in different countries and suggests why these arrangements would enhance independence. Many of these particular institutional arrangements were then adopted by Gilardi and 21 of them grouped in five categories (agency head status, management board members’ status, the formal relationship with government and parliament, financial and organisational autonomy, and extent to which regulatory competences are shared) and scored in order to provide an index against which agency independence could be measured (Gilardi 2002).<sup>37</sup>

However, the risk of this approach, as Forder has pointed out with respect to such lists relating to the statutory independence of central banks, is that concentration only on the rules contained in statutes, which are ostensibly there to safeguard regulatory independence, produces a measure of the number of controls designed to structure independence/dependence but not of actual independence itself (Forder:1996 and 2001).

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<sup>37</sup> Gilardi scores regulators from seven European countries and in five sectors.

Forder argues that in the context of central banks that statutory independence may not tell us about informal rules and who actually sets policy (Forder:2001). He points out that detecting these informal rules will be problematic if governments have incentives for third parties to believe that there is independence. Furthermore, even if the institution is the decision-taker, it may be under the implicit or explicit threat of legislation or other sanctions if it does not comply with the government's wishes (Ibid).

An attempt to assess the independence of telecommunications regulators using the statutory independence approach was conducted by Edwards and Waverman (Edwards and Waverman:2005). They score NRAs against 12 institutional elements including whether the NRA is appointed by the legislative or the executive and whether the regulator has a fixed term or not. As a consequence of finding the UK amongst the least independent on this basis, they admit there is a methodological problem<sup>38</sup> but otherwise ignore this difficulty. They also find that the German regulator is the most independent, a finding would have equally surprised most industry observers.<sup>39</sup> The latter finding is perhaps a consequence of comparing only institutional characteristics that all NRAs have in common with a consequence that idiosyncratic controls are not measured.<sup>40</sup>

Tenbuecken and Schneider suggest that NRA independence could be measured along three variables: formal, material and de facto independence (Tenbuecken and Schneider 2004:254). Formal independence is defined as the nominal claims made about the relationship between the regulator and other institutions. Material independence relates to the status of an NRA according to the legal acts establishing the authority. De facto independence describes the status of an NRA as it manifests itself in daily regulatory practice. They state that they did not attempt to measure the latter because of the enormous resources it would require (Ibid:255). They analyse telecommunications

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<sup>38</sup> "Independence is, however, much more than a set of formal institutional rules [...]. It therefore must be stressed that the EUR-I index, while capturing independence de jure, does not necessarily capture independence de facto. For example, the UK scores only moderately on the EURI-I index, yet most industry experts regard the UK as the benchmark in independent telecommunications regulation in the EU" (Edwards and Waverman:2005;23-24).

<sup>39</sup> The ECTA studies on regulatory effectiveness have tended to find the German regulator among the least effective in the EU (ECTA 2004-2009).

<sup>40</sup> For example, they did not measure rules that exist in a small minority of countries which expressly allow a ministry to give instructions to the regulator – for example, in Germany (Doehler:2003:110).

regulators in 23 OECD countries and find that there is no variance in formal independence but significant variation in material independence. (Ibid:263)

They conclude that the US, Germany and Ireland are the most independent on the basis of the variables they examine (Ibid:263). However, even with respect to material independence alone, it would be questionable whether this is an appropriate finding. It may well be the case that on many institutional aspects that the structures in these countries score well. However, the model does not seem designed to cope with situations where a country scores vary badly on one institutional element but well on all the others. It would not seem appropriate in these circumstances to score highly for independence. For the latter to be correct, there would need to be an explicit assumption that principals require multiple levers rather than just one. It is hard to see why this should necessarily be so. Illustrative of the problems with this approach can be demonstrated by pointing out issues relating to the three regulators that they consider the most independent. Independence of the US Federal Communications Commission is arguably contingent on lack of single party dominance of the legislative and the executive (Eisner, Worsham and Ringquist:2000:146).<sup>41</sup> The Irish government is empowered to give binding instructions to the Irish telecommunications regulator.<sup>42</sup> The German regulator, inter alia, is subject to legislative override.<sup>43</sup> It would appear that existing indexes of statutory protection are unreliable indicators of independence.

2.8.5.2.2.      Regardless of specification are indexes of regulatory independence likely to be unreliable in European circumstances?

Before considering the informal controls pointed out by Forder, and even if indexes of statutory independence managed to cover all of the formal controls that could potentially

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<sup>41</sup>Republican majorities in the Congress and the Senate as well as the Presidential appointment powers meant that the FCC under George W Bush was able to reinterpret telecommunications rules, leading to the elimination of most fixed telecommunications competition – the leading long distance competitors, AT&T and MCI, abandoned attempts to enter state markets and compete with the state monopolies and merged with them instead.

<sup>42</sup> Section 13 Communications Regulatory Act 2002. The Minister is empowered to “give such policy direction to [Comreg] as he or she considers appropriate.”

<sup>43</sup> Para 9a of the Telecommunications Act as amended in 2007 required that the NRA not regulate “new” markets. An amendment adopted by the incoming CDU-SPD coalition in response to threats made by Deutsche Telekom to lay off employees if its new fibre network was regulated, announced during the electoral campaign in 2005.

apply in each member state, they might still be unreliable as a measure of NRA independence. The reason for this is that the formal control of appointment as head of the NRA or to the board of the NRA is probably far more significant a control in European member states than it is in the US.

In the US, different members of the board of an agency may be separately appointed by different institutions (President, Senate or Congress) (Eisner, Worsham and Ringquist:2000:146). The latter may be under the control of different parties and even where that is not the case, party discipline is far weaker than is the case in most European countries. One of the findings from the application of principal and agent theory in the US was that multiple principals could provide regulators with a zone of discretion (McCubbins et al.:1989; Shapiro:1997:279). In an index constructed to measure the independence of US federal agencies, there might be less reason to give appointment a large weighting in an index as scoring on this variable might not serve to differentiate between them.

In the EU, equally, it would not serve in most cases to differentiate NRAs – but for the opposite reason: NRAs tend not to have multiple principals in most EU states. Once that is true of an agency, it may not matter all that much how many other controls or protections against control exist. There is no separation of powers in most European countries between the legislature and executive. Even in those countries where nomination requires the assent of more than just the head of the executive, it is usually members of the same party, ultimately reporting to that head of the executive who provide additional consent. Elgie and McMenamin, in their attempt to score the independence of French authorities, give higher scores for those where appointments require consent of more than one elected official without controlling for instances where all of the officials come from the same party (Elgie and McMenamin:2005). Research of US appointments at state-level indicates that appointment is a key variable in effecting regulatory outcomes. This can be tested at state-level in the US as implementation of public utilities in the US is in part conducted by state-level public utility commissions, and in some states these commissioners are appointed by politicians and in others they are directly elected. (Regulators and regulatory commissions are not directly elected anywhere in the EU).

Besley and Coates examined mean electricity prices for a panel of 40 states that did not change their regulatory regime between 1960 and 1997. They found that residential prices were significantly lower in states that elected their regulators. The theoretical explanation they give is that when regulators are appointed, regulatory policy becomes bundled with other policy issues for which the appointing politicians are responsible. Because voters only have one vote to cast and regulatory issues are not salient for most voters, there are electoral reasons to respond to stakeholder interests. If regulators are elected, on the other hand, their stance on regulation is the only salient interest so the electoral incentive is to run a pro-consumer candidate (Besley and Coates:2000).

The consequence of appointment by a unitary executive is that the heads of European NRAs are formally not independent and can have reduced room to manoeuvre.<sup>44</sup> On this basis, it could be assumed, even formally, that European NRAs are less independent than European Agencies who always have multiple principals.

#### 2.8.5.3. *Modelling informal pressure*

##### 2.8.5.3.1. Thatcher's model and result

If NRAs are not formally independent, they may nonetheless be independent on an informal basis because of the political costs of exercising that control (Thatcher:2005:348). Conversely, even where they appear to be formally independent, they may not be independent due to the exercise of informal influence (Forder:1996:49). Another model has been suggested by Thatcher for testing independence by observing the relationship between politicians and regulators (Thatcher:2005). The five indicators that he used for testing the use of control by elected politicians over regulators were party politicisation of appointment; departures (dismissals and resignations) of NRA members before the end of their term; the length of tenure of IRA members: the longer their tenure, the greater their likely independence from elected politicians; the financial and staffing

resources of IRAs; and, the use of powers to overturn the decisions of IRAs by elected politicians. This would in principle seem a superior approach to the simple *statutory* approach, since it has the merit of examining some important relationships between elected politicians and regulators, which may be dependent on *rules* other than those that are incorporated in statute. Thatcher's conclusion is that on the whole these powers, with the exception of limiting NRA's resources, were not used to control the regulatory authorities (Ibid:1).

#### 2.8.5.3.2. Counter examples from telecommunications

However, while identifiable use of the controls may not be quotidian, their use with respect to key product markets in telecommunications has in fact been pretty extensive. If we take France, Germany and Spain, as examples, there have been notable interventions. For example, in France, until 2004, the ministry shared regulatory duties with the regulator and is known to have ignored the regulator's views on setting retail tariffs.<sup>45</sup> Currently, there is no effective regulation of France Telecom's fibre network.<sup>46</sup> Similarly, in Spain, the NRA imposed a supporting remedy of transparency with respect to fibre without any access obligation (Intercomms:2010).<sup>47</sup> In Germany in 2006, the

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<sup>44</sup> Cruickshank, former director-general of the UK telecommunications regulator, OFTEL, often considered the template for the independent European NRA (Thatcher:2002:137), did not think he was independent of politicians. In an interview, Cruickshank said: "There was no political interference while I was in office but this was probably because I was doing what the government wanted anyway. I had one meeting with ministers in five years, whereas my predecessor had a meeting every two weeks [...]. This probably reflects the changing objectives of the government – the last major tranche of government ownership in BT was disposed of just as I took up the post" (Tarrant:2005:70).

<sup>45</sup> See, for example, complaints by INTUG, representatives of industry users of telecommunications (INTUG:2004). The sixth implementation report (Commission (2000b)) also noted: "New entrants, nevertheless, maintain the view that shareholder considerations influence regulatory decisions in the Ministry, particularly as regards the approval of the incumbent's tariffs. They are particularly mistrustful of what they see as a lack of transparency in the mechanism for tariff approval, which makes it hard for new entrants to establish how proposed tariff structures are assessed and prevents them from giving their views [...]. Furthermore, new entrants point out that there is little transparency in how the Secretary of State arrives at his final decision, especially when it comes to approving tariffs on which the ART has given an opinion which is positive but which is conditional on changes being made by the principal. The French authorities point out that this raises a question of principle, and it is not appropriate to consult FranceTelecom's competitors systematically on what are essentially commercial matters."

<sup>46</sup> The NRA has imposed duct sharing only rather than access to the fibre itself, a policy that is known to be largely ineffective (OXERA:2009).

<sup>47</sup> The transparency requirement is included in the directives to permit the NRA to verify that the retail arm of the incumbent receives the same wholesale price from the network arm of the incumbent as new entrants. A transparency requirement is pointless if no wholesale product is required to be supplied to competitors in the first place.

coalition government passed legislation providing for a regulatory *holiday* for Deutsche Telekom's fibre network, a development against which the Commission opened infringement proceedings.<sup>48</sup> In Spain in 2004, the Government was unhappy about access rules that the regulator was developing to allow rivals to Telefonica to access its networks to provide tv over the internet. It consequently transferred responsibility for this issue back to a ministry. The regulator challenged the government's ability to do this legally, but a national court found that the regulator had no constitutional protection and that the EU directives did not protect it from reorganisation.<sup>49</sup> These examples fit with the findings of those studies that have focussed on relationships between individual NRAs and other national institutions and found that ministries play a role (Coen et al.:2002; Coen and Heritier:2005; Doehler:2003; Gehring:2004; Frova et al.:2004).

#### 2.8.5.3.3. Observational equivalence of limited use of controls

While the above findings are serious, market-altering, levels of interference, they are only a limited series of examples. In his article, Thatcher concludes that the absence of data that he could find, did not necessarily mean that IRAs are independent from elected politicians. Instead, he suggested that if the latter do control regulators, they do so through more informal means which are much more difficult to observe (Thatcher:2005:364). This seems particularly likely since as he also finds the transaction costs of principals applying controls was potentially very low in EU countries (Ibid:355). Awareness of how low they are is generally likely to be clear to principal and agent.

Consequently, this appears to be a situation akin to that described by Weingast and Moran, where lack of use of the controls may be evidence that the requirements of the principal have been internalised by the agent (Weingast and Moran:1983:792). Thatcher suggests exploring the informal arrangements. This has been pursued here in the case studies through oral interviews. The results are used to support investigations of the third hypothesis regarding the relative effectiveness of NRAs and Agencies. The results are

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<sup>48</sup> The European Court of Justice found against the policy in December 2009. However, the German government had effectively achieved its ambition of a full regulatory *holiday* since the NRA's consideration of regulation only commenced in 2010, five years after the network was rolled out.

<sup>49</sup> Case 598/2004 of 4 October 2006 Sentencia Audiencia Nacional (sala de lo Contencioso-Administrativo. Seccion 3). There was no reference to the ECJ.

also relevant to the fifth hypothesis regarding the proposition of Council indifference between networks of NRAs and Agencies.

#### 2.8.5.3.4. Assessing independence through systematic outcomes

In addition, assuming outcomes are the logical consequence of the intention of principals, the extent to which different types of regulatory regime actually implement effective regulation would seem to be a possible additional test and this is also examined in each of the case studies of the thesis. This is discussed further with respect to the literature on implementation in paragraph 2.12 below. If one of the available designs for a regulator is less independent of national politicians than others then this may explain its selection. Outcomes are assessed in relation to the third hypothesis comparing the relative effectiveness of NRAs and Agencies.

## **2.9. The independence of networks of independent NRAs**

### **2.9.1. Three approaches to networks of independent NRAs**

Some authors have suggested that the activities of networks of regulators may operate to “close” the regulatory “gap” caused by the “decentralization problem” of devolving implementation to multiple NRAs (Eberlein and Grande:2005: 99-100), or at least that there has “been a gradual strengthening of networks of national regulators ...and their powers enhanced” (Thatcher and Coen:2008:829). Eberlein and Grande approach networks of regulators from a constructivist perspective, finding evidence of deliberative supranationalism (Ibid:101). Thatcher and Coen approach networks of regulators from two angles: a historical-institutionalist approach (Thatcher and Coen:2008) and a principal and agent approach (Coen and Thatcher:2008). Their principal-agent analysis appears to be more pessimistic about the capability of the networks than the historical-institutionalist account.

#### *2.9.1.1. Deliberative supranationalism and networks of independent NRAs*

##### 2.9.1.1.1. Eberlein and Grande’s general argument

Eberlein and Grande argue that regulatory networks of national NRAs will give rise to informal cooperation between national regulators to meet the functional need for

effective European-level regulation which would otherwise be frustrated by the resistance of member states to devolve regulatory powers to a supranational institution. Effectiveness is defined by Eberlein and Grande as “the capacity to produce (including to make other actors produce) collectively binding decisions on the supranational level, decisions that fill the regulatory gap” (Eberlein and Grande 2005:156).

This theory is consistent with and derives from other theories that seek to explain the “New Governance” of the EU. The latter is defined as methods of policy-making that depart from the *Community* method of legislating through the use of regulations, directives and decisions and instead rely on participation at European level of national actors in a collective learning process (Eberlein and Kerwer:2004:123). In particular, Eberlein and Grande’s work draws on application of the theory of *deliberative supranationalism*.

This approach has been developed in studies of committees in the EU. In committees, it is argued that a culture develops of “interadministrative partnership which relies on persuasion, argument and discursive processes rather than on command, control and strategic interaction.” (Joerges and Neyer:1996: 620). The outcomes of the decisions made in the committees, it is argued, are neither intergovernmental, because the participants are socialised into pursuing collective decision-making within the parameters of the formal objectives devolved to the committee under the legislation, pursuit of which gives a primacy to objective scientific evidence; nor are they purely supranational, because the Commission is obliged to recognise that it cannot pursue objectives which will not meet with at least a qualified majority of supporters (Ibid: 618).

The solution to this apparent dichotomy is that the participants to the committees pursue the scientific-rational logic of the committee, overcoming the interests of the institutions that they represent. The suggested mechanisms of this divorce are: (i) participation means that delegates have an informational advantage over their domestic administrations which allows them to shape national preferences (Ibid:620); and (ii) participation means the

development of common converging definitions of problems and philosophies for their solution (Ibid:620).<sup>50</sup>

#### 2.9.1.1.2. Specific working of the theory in the context of networks

The unwillingness of member states to grant regulatory powers to supranational authorities where there are distributional issues at stake means that regulatory powers are granted to national regulators instead. However, this gives rise to a decentralisation problem as national regulators could defect from the spirit of EU legislation. There is therefore, according to Eberlein and Grande, a functional need for cooperation in order to ensure a level playing field (Eberlein and Grande:2005:99). In response, regulators should come together to achieve harmonising decisions. Defection is prevented by *professionalisation*: “Professionalisation creates a strong, shared frame of reference that facilitates convergence and harmonisation. National officials are driven by a “reputation game” with their international counterparts. They will seek to comply with “best-practice” regulatory standards to maintain their good standing in the professional community.” (Eberlein and Kerwer:2004:162). If this is not sufficient constraint, then the transparency of regulatory regimes reinforces it. A further pressure for conformity is that a regulator that is unable to make credible commitments to its partners and will not be able to become effectively involved in transnational networks (Eberlein and Grande:2005:103).

#### 2.9.1.1.3. Weaknesses of the explanation

There are, however, some clear potential weaknesses to this theory in relation to the regulated utility sectors, which are characterised by the existence of monopoly access operators with state ownership. Eberlein and Grande do recognise that if there are redistributive conflicts between member states that this may adversely impact on the effectiveness of informal harmonisation (Ibid:140). However, since this is arguably the reason for the empowerment of NRAs and the creation of informal networks only rather

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<sup>50</sup> Or as Joerges and Neyer put it in another article, delegates “slowly move from representatives of the national interest to representatives of a Europeanised interadministrative discourse in which mutual learning and understanding of each others difficulties surrounding the implementation of standards becomes of central importance” (Joerges and Neyer 1997:291).

than upwards delegation in the first place, adverse effects are likely to be intrinsic to the system of cooperation from the beginning rather than an exogenous force. In other words, the description of a *functional need* in the theory is rather one-sided. The functional need from a single European market or a new entrant perspective may well be a level playing field; it could be quite another from a national government's perspective, where the first best option could be compliance by everyone else but not by one's own regulator,<sup>51</sup> or indifference to any cross border trading and a political priority to preserve the numbers of people employed by the domestic incumbent. While professionalisation, a need to provide credible commitments to partners and information advantages might be capable of having the effects described, there has been little investigation of whether these incentives actually exist in networks of utility regulators. Such an investigation is conducted in the case studies.

#### 2.9.1.2. *Historical institutionalist perspective on regulatory networks*

It has been argued that regulatory design in regulation has been shaped by the preferences of the NRAs themselves and that this endogenous force is likely to have better explanatory value for succeeding institutional development than arguments based on rational design (Thatcher and Coen:2008:809). If this were true, it would be the case that in each round after the initial delegation round that national ministries were not the true originators of the preference to retain NRAs. Thatcher and Coen argue that “actors created in one phase become significant in pressing for movement towards further changes” (Thatcher and Coen: 2008:808) and that the consequence is “evolutionary change [which] has resulted in centralisation and institutionalisation of the EU's regulatory space, but through strengthening of networks of existing actors rather than comprehensive reforms.” (Ibid:830).

However, it is unclear to what the extent the actions of the NRAs could or did act as an independent causal variable since, arguably, that depends on the controls placed on the

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<sup>51</sup> In a separate article, Eberlein provides the following example of beneficial defection: “Take the example of an incumbent operator in the electricity business. A lenient domestic regime helps to protect the home market from new competitors. Almost unassailable at home, the operator can more easily expand into foreign markets that are open to new entrants. The current expansion of French electricity giant EDF from a rather secure home base into other European markets illustrates this point quite clearly” (Eberlein 2003:153).

actors in the original delegation phase. It is also not clear to what extent national ministries, who have a formal monopoly over the states vote in Council, would take into account the views of NRAs on institutional design. What one might expect if NRAs are not independent of national ministries is that they themselves stay within the negotiating positions of their national ministries. In the telecommunications case, my finding is that in so far as the collective groupings of regulators in telecommunications press for what might appear to be *thicker* institutionalisation at European-level, it is only for those powers already conceded to the Commission by the member states in previous legislative rounds. The European Regulatory Networks (“ERNs”) have not advocated any transfer of implementation powers from the national level to the Agencies. If the NRAs are exerting any pressure, it is not *evolutionary* in the sense of pushing for institutions that can close the *regulatory gap*.

#### 2.9.1.3. *Principle-Agent perspective on regulatory networks*

Separately, Coen and Thatcher describe how the ERNs are formed as a result of a *double delegation* from the Commission and from the NRAs. They investigate finance and telecommunications as case studies (Coen and Thatcher: 2008). They do find that the transfer of powers has been limited (Ibid:2008:51). However, the picture is arguably starker. If delegation is a more significant act than creation alone, but rather constitutes the transfer of the formal power to act on someone’s behalf then the description of *double delegation* would not seem appropriate. If we take Thatcher and Stone-Sweet’s definition of delegation: “An authoritative decision, formalised as a matter of public law, that *transfers policy making authority*” [My emphasis] (Thatcher and Stone-Sweet:2003:3), then there is no delegation to ERNs. They are advisory bodies to which neither the Commission nor the NRAs have transferred any formal authority to take decisions. Furthermore, in so far as they are producers of opinions, the decision-making process is in practice consensual and despite the Commission being the formal creator of the bodies, control by the NRAs over their activities is complete. The NRAs have an exclusive vote on the content of opinions and recommendations. As a consequence the output consists of non-binding opinions that are capable of very wide interpretation. The concept of *double delegation* also includes the possibility that these bodies might, despite their formal characteristics, nonetheless, acquire informal authority and become

significant agents for Europeanisation through their ability to facilitate coordination and to exercise informal *soft* power. This part of Coen and Thatcher's argument is similar to the Eberlein and Grande argument and is explored in the case studies through questioning network participants about their views on the extent to which the theorised requirements for deliberative supranationalism exist.

#### *2.9.1.4. Networks of regulators and the hypotheses*

The powers and effects of networks of regulators are assessed in the case studies comparing their effectiveness with Agencies in order to test the third hypothesis. As supporting evidence, there is an investigation in each case study of the extent to which participants believe that participation in networks constrains NRA decision-making. These findings are also relevant to the fifth hypothesis assessing whether the Council is indifferent between selection of either networks of NRAs or Agencies.

## **2.10. The independence of Agencies**

### **2.10.1. Introduction**

European Agencies are clearly not formally independent of either the Commission, member states or the Parliament. However, they are always more independent of any one individual member state than a European NRA can be.

#### *2.10.1.1. Agencies are never formally independent*

Like other institutions, the extent to which Agencies are independent of their principals arguably varies depending on the controls that are put in place. Rittberger and Wonka use Gilardi's index to assess each Agency and find that there is no systematic pattern that correlates with the assumed functional requirement for credible commitment (Rittberger and Wonka:2010). Overall, they find that no Agency is either fully independent or under direct full control (Ibid:740). However, applying a test developed for testing the statutory independence of NRAs is not likely to capture the dynamics that generate credibility at EU level. Agencies are not at all like most NRAs in the sense that they are not and cannot be bodies to which formal decision-making authority could be delegated. It is, therefore, formally impossible for them to exercise independent decision-making. EU law holds that the *institutional balance* of the Treaty requires that the Commission is the formal

executive decision-making body of the EU (although this does not prevent the Council from placing controls on the discretion it grants to the Commission).

## **2.10.2. Agencies may have effective agenda-setting power**

### *2.10.2.1. Agenda-setting power*

Agenda-setting power is typically considered as either formal or informal. Formal agenda-setting power arises when the agenda set by an institution cannot be revised and must be the set of proposals on which the vote is taken (Pollack:1997:121). A body without formal powers of this sort may still have informal agenda-setting powers in that it may hold superior information both technically and in terms of the potential voting preferences of principals than the principals themselves (Ibid). However, the structuring of decision-taking may nonetheless give an Agency a power equivalent to formal agenda-setting power. This is despite the fact the Commission can substitute its own draft decision for that of the Agency and the comitology committee which reviews the Commission's decisions can in turn refer the Commission's draft decision to the Council for the latter to substitute its view. This may arise if the criteria for decision-making in the delegating legislation requires an implementing decision based on scientifically assessable criteria and if this is reviewable by a court. In the case of pharmaceuticals, this structuring of decision-making has occurred and means that neither the Commission nor the member states can collectively move away from the draft opinion of the Agency unless they can provide a superior scientific assessment (Gehring and Krapohl:2007). Rittberger and Wonka's application of Gilardi's scoring mechanism does not capture this dynamic at all since the assessment criteria mark down Agencies that are susceptible to judicial review and marks up Agencies which are not (Rittberger and Wonka:2010:750-752).

### *2.10.2.2. The provisional nature of agenda-setting power*

One of the problems of Gilardi's assessment criteria is that each potential control is considered incrementally and separately whereas there are likely to be dynamic relations between different controls and the effect of a particular control may be positive or negative depending on how other controls operate. For example, and critically, Gilardi's

scheme assesses judicial control as a constraint because it is considered in isolation without assessing the implications of judicial control on the Commission and Council's powers of review.

The existence of Agency agenda-setting powers is entirely provisional, not all Agencies necessarily have them. For example, the European Railway Agency does not have these court-assisted powers with respect to interoperability. The Agency is empowered to draft technical standards of interoperability (TSIs): the minimum standards of, for example, safety, environmental protection and noise levels that rail systems and infrastructure must meet (see page 191). However, each draft TSI is developed by the Agency with respect to parameters and thresholds initially set on an ex ante basis by the Commission and the members states through Comitology for that TSI. The basis for the ex post Commission/Comitology decision after the Agency's draft decision is *viability*, which is a subjective criteria relating, inter alia, to views on cost-benefit, which makes Commission/Comitology discretion extremely wide and in practice non-justiciable. So while there are legal challenges to decisions on drug clearances, there have been no legal challenges to the content of TSIs (Interview: ERA official 2011). On this assessment, Rittberger and Wonka would not seem correct in giving ERA a higher score for independence than the Medicines Agency. Agenda setting power cannot be assumed for an Agency, it must be assessed by examining the controls in place and their potential interaction.

### **2.10.3. Is an agenda-setting Agency likely to be more independent than a collection of NRAs?**

This may depend from which particular principal or principals the Agency is expected to be independent. NRAs are, for example, always independent of the Parliament whereas Agencies tend to face controls from the Parliament (Vibert:2007:398). Rittberger and Wonka make the point that Agencies are likely to have margin to manoeuvre where they have multiple principals and refer to the Commission, member states and the Parliament in this context (Rittberger and Wonka:2010:739).

However, the more significant point as far as credible commitment is concerned, is that the structure of Agency constrains individual member states. The board of the Agency

and the comitology committee will generally make decisions subject to a voting rule where the Commission (and occasionally the Parliament) have a voice but the member states collectively decide. An individual or small minority of member states deviating from a near consensus at European level on a regulatory measure can be overruled. The key difference where the NRA is a stand alone institution is that an individual NRA, potentially instructed by its national ministry, and absent any other mechanism, cannot be overruled by other member states or collective bodies acting on their behalf. The primary effect of an Agency is that member states cannot take the regulatory decisions included within the scope of the powers of the Agency independent of the interests of other member states. Typically, the board of an Agency comprises of technical experts from member states (often specifically mandated to be from the NRAs) whereas the comitology committee comprises of representatives of ministries. If the member states want to lock in the majority view of the technical experts then they can make the Commission/comitology decision justiciable on substantive grounds.

## **2.11. Comitology and the independence of the Commission as an implementing agent**

### **2.11.1. Comitology**

*Comitology* is the term used to describe the situation in which the European Commission is given powers to carry out implementation but where that power is subject to review by a committee of national experts before its exercise. Review can be limited to the passing of comment or extend to transferring the specific decision to the Council for it to take the decision instead of the Commission. The review power of the committee is set out in the secondary legislation empowering the Commission to act in the specific area.

Historically, comitology procedures were designed on an ad hoc basis in each piece of empowering legislation. In 1996 they were codified into four main types: *advisory*, *management*, *regulatory* and *safeguard* (Council:1999). Under each of these, the threshold for a Commission decision is higher. In the case studies, the variants selected are advisory, regulatory and safeguard.

Under *advisory* comitology, the committee can provide an opinion of which the Commission must take utmost account.

Under *Management* comitology, the committee can block a Commission decision by qualified majority.

Under *Regulatory* comitology, a Commission decision requires a positive vote in committee by qualified majority. If a decision is not made, it is automatically referred to Council to be taken by qualified majority voting. If the Council fails to make a decision after a certain elapse of time, it is considered passed.

Under a *Safeguard* committee, a single dissenting member state can refer a decision to the Council which should decide on a qualified majority basis. The comitology power will specify whether the decision passes or falls if the Council fails to act.

In 2006, a further variant was adopted, Regulatory comitology with Scrutiny, which allowed the Parliament also to review decisions if the delegating empowerment made in legislation adopted under co-decision was so wide that it was equivalent to delegating legislative powers (Council:2006).

These are relevant to the analysis of the independence of an Agency since, as discussed, a draft Agency decision can only become a binding decision if it is adopted by the Commission. The Council will typically subject a Commission decision based on Agency advice to a comitology control.

### **2.11.2. Deliberative supranationalism or intergovernmentalism in comitology?**

There are two schools of thought with regard to decision-making in comitology committees. One, derived from sociological institutionalism and based on empirical study of the food safety committee, argues that comitology committees make decisions on the basis of “deliberative interaction” where a scientific discussion dominates and participants are socialised as “cosmopolitans” forming a technocratic common interest which overrides narrow national interests (Joerges and Neyer:1997). The other, based on a rational-institutionalist approach, argues that comitology is a control mechanism designed by the member states to control the Commission’s implementation decisions (Steuenberg:1996; Franchino:2000; Pollack:2003; Franchino:2006). Rational choice institutionalists also base their findings on a variety of case studies (Pollack:2003:148).

Hansen and Bradsma have recently conducted a survey designed to establish the images of comitology practice held by Danish and Dutch national representatives on committees to test these two interpretations. Their findings are that both deliberative supranationalism and intergovernmental bargaining exist but in different committees (unfortunately, they did not test for which types of committees deliberative supranationalism holds, one might suspect that it may tend to exist in advisory committees where the member states representatives can only alter a Commission decision through persuasion due to the decision-making rule set out in paragraph 2.11.1. above). They also find that distributive effects and business interest in an issue are strongly predictive of intergovernmental bargaining (Hansen and Bradsma:2009:733). They find that socialisation effects (measured by length of time as participant in a committee) have no predictive effect at all (Ibid:735).

### **2.11.3. Comitology committees in the case studies of the thesis**

The thesis examines comitology committees in the context of the choices made in the acts of delegation. Comitology typically applies in the case of Agencies. However, it could also apply to NRAs if particular acts of NRAs are placed under administrative review and potential veto or amendment by the Commission. Theoretically, the selection of NRAs, if subjected to strong controls by the Commission could be an effective design to protect credible commitments. If the latter occurred where there were strong distributional concerns (and Sabel and Zeitlin (2009:281), and Thatcher (2007:134) believe such a delegation took place in telecoms) then it would be likely to falsify the first hypothesis of the thesis. The first hypothesis predicts that member states are likely to prefer to empower NRAs alone where there are distributional concerns. The telecommunications case study in Chapter 4 investigates these authors' claims.

## **2.12. Implementation at national level compared to supranational level**

### **2.12.1. Why supranational implementation matters**

The traditional *community* method of governance is that the EU legislates but member states implement (Craig:2006:20). This creates scope for member states to defect from collective agreements should they choose to do so whereas supranational implementation binds all the member states. As Thatcher and Coen point out, the structuring of

implementation is particularly important in the EU because there are strong national traditions of protecting domestic firms, while member states have incentives to aid domestic suppliers by cheating on the implementation of EU regulation, from late transposition or misinterpretation of EU rules to outright non-enforcement (Thatcher and Coen:2008:806).

### **2.12.2. How the community method creates scope for defection**

Under the community method, the Commission is empowered as an agent to enforce the terms of agreed legislation. However, infringement acts are a weak tool for two reasons.

First, the infringement process is a highly political process and only becomes a legal process in its final phase. The latter applies to only about eight per cent of the infringement cases that the Commission commences each year (Smith:2008:778), and the Commission will only take on some of the possible infringement actions, some of the time (Hartlapp and Falkner:2009:292). The ECJ has consistently ruled that the Commission must have discretion as to when it will proceed and will not give individuals a locus to challenge failure to act (Smith:2008:784).

Second, by selecting directives and not regulations as the mode of legislation, member states will in principle exclude direct effect (Brealey and Hoskins:2002:60). This means individuals cannot use EC law as a basis for challenging acts by NRAs. National courts will sometimes, nonetheless, find that directives have direct effect, but only if the terms of the directive are “unconditional and sufficiently precise” (Ibid:60). Unconditionality requires that no further implementing measures are required and precision requires that there is no margin of appreciation for the member states authority. The regulatory frameworks require both further implementing measures, the creation of NRAs, and that NRAs exercise judgement when implementing regulation. As a consequence, they are not directly effective.

Third, individuals might be able to take action for non-implementation of directives via national courts (where the court can assess the national implementation in the light of its consistency with the EU secondary legislation). However, member states can also protect NRA discretion against legal sanction at national level by ensuring that the aims, objectives and specific obligations defined in the EU legislation are drafted to ensure a

wide margin of appreciation for NRAs. Courts are unlikely to substitute their opinion for that of an NRA where complex economic issues fall within the consideration of the NRA but will review only for manifest error or misuse of power. Using drafting as a protection also seems to assist NRAs against infringement actions by the Commission. Officials complain that the Commission Legal Services would not let them pursue cases against “inefficient” implementation as opposed to the much more easily identified absence of implementation (Tarrant:2005:80). The limiting of national court’s purview of implementation largely to manifest error applies equally to the European courts (Craig:2006:433-442).

As the case studies reveal, what is noticeable when analysing the utility sectors, after almost 20 years of European frameworks in some cases, and in an areas where there are constant regulatory disputes between economic actors, is that there are hardly any European cases dealing with access issues. This is the consequence of a legal regime designed to give NRAs discretion.

### **2.12.3. How to measure implementation**

Implementation can be defined as “to give practical effect to, and to ensure actual fulfilment by concrete means” (Sverdrup:2008:197). Until recently, scholars have tended to use member state self-declaration of transposition as a measure of implementation (Falkner, Hartlapp:2009:288). Transposition is the incorporation of EU legislation into a national law and is achieved when a member state notifies the Commission that it has been carried out (Ibid:287). However, research has indicated that member state notification of the extent to which correct transposition has taken place is highly inaccurate. Falkner and Hartlapp have found that in 60 per cent of cases member states had not correctly transposed (Ibid:293). Recognition of the potential unreliability of self-declaration led researchers to examine the extent to which the Commission sanctioned member states for failing to implement (Bursens:2002; Giuliani:2003; Boerzel:2003; Haverland and Romeijn: 2007:759).

The drawback of this approach is that it depends on the ability of the Commission to undertake infringement actions, which is limited by resources (Svedrup:2008:204), wider political circumstances (Smith:2008:784), and the structuring of the relevant directive. In

any event, transposition is merely the adoption by the national legislature of domestic legislation that creates the legal space at national level in which the directives requirements could be met (Haveland and Romeijn:2007:760).

Recent scholarship stresses the importance of going beyond the mere adoption of national statute: “Let us not forget that compliance is more than transposition. Even though the law in the books are a useful starting point for research, the really interesting question is to what extent these are given effect” (Mastenbroek:2003:1116).

Verluis recently looked at transposition of the Safety Data Sheets Directive at the national level and the actual application at working-level and found that: “When directives are *only* transposed into national legislation, while they are not applied in practice, the usefulness of legislation becomes questionable” (Verluis:2007:64).

Research into actual compliance with EU law is at an early stage of its development (Falkner et al:2005:343). This is certainly true in the world of sector-specific regulation. As Levi-Faur put it in a recent essay on regulatory governance: “The link between regulatory developments at the EU level and then at member state level remain largely unexplored” (Levi-Faur:2007:107). To assess the extent of implementation in regulation requires a close examination of the regulatory regime actually put in place in each member state.

#### **2.12.4. Measuring compliance**

Sectoral commercial organisations lobbying the European institutions have, in some instances, been engaged with this issue of compliance or implementation in practice for a longer period than the academic literature (ECTA:2003; IBM:2004). The problem they identified is that the regulatory frameworks typically provide member states with a great deal of discretion, which means they may be in compliance but not actually delivering a single market. Thomson et al. find that member states non-compliance is more likely when member states both disagree with the content of a directive and receive little discretion in its provisions (Thomson et al.:2005:688). This implies that high levels of discretion as to substantive action are what delivers *compliance* with EU law. The response of the lobbying organisations has been to measure transposition and the adoption of measures in all member states against the particular measure adopted in a

given member state which the particular commercial organisation considers best practice. This is potentially a better measure of reality in the way described by Mastenbroek and Verluis (Mastenbroek:2003; Verluis:2007).

However, the downside of this approach is that it necessarily involves a subjective interpretation of what constitutes best practice. (Wide discretion in the directives means that subjective assessment of implementation is what all actors, including the NRAs, are engaged in when interpreting the directives). An example of this approach is the study conducted by IBM for Deutsche Bahn on liberalisation of EU rail markets. IBM constructed two indexes: the LEX index and the ACCESS index. Their overall index of liberalisation comprised of a joint index with a weighting of 30:70 of these two elements. Their justification of this approach was that: “The LEX Index reflects how adequately the countries examined in the study have implemented the regulatory structure, without attempting to comment on the actual administrative implementation and the actual effectiveness of the respective legal regulations. It is just this that is described in theoretical legal discussions as *law in the books*. The factors examined in the LEX Index, while they are relevant for the market opening, are not of decisive character. With reference to the market opening processes of the European rail markets, the formulation of national law in a way that is adequate for the market opening is a necessary but not a sufficient condition. Decisive for the actual market opening are the factors of the second level, that is the ACCESS index.” (IBM and Kirchner :2004:8)

IBM also noted that “while the level of the legislative market access barriers (LEX Index: *law in the books*) is gradually converging, the level of practical market access obstacles (ACCESS Index: *law in action*) continues to show significant differences” (Ibid:2). The ACCESS index measures the regulatory outputs.

The case studies in the thesis uses measurements of regulatory output, such as the IBM ACCESS index, in each of the sectors in order to assess the extent to which governance in the sector, managed via an Agency or by NRAs alone, actually gives rise to effective harmonised regulation. This will contribute to filling the *regulatory* gap in the literature identified by Levi-Faur above.

## **2.13. Constitutional objections to Agency or Commission empowerment**

It might be the case that the explanation for institutional selection lies in a pressure exogenous to the functional cost benefit analysis assumed in principal and agent theory. In an examination of the Commission acting as the member states agent in the development of the regulatory framework for telecommunications, Thatcher argued that the member states and the Commission agreed on the substantive content of the telecommunications rules. He argues that disagreement on the empowerment of either the Commission or an Agency with respect to implementation related to wider constitutional concerns unrelated to the substantive content of regulation (Thatcher:2001:559, 570 and 577). This proposition is pursued in the case studies in the form of one of the alternative hypotheses. It is examined by reviewing whether constitutional justifications are given for Council institutional preferences and whether they should be assessed as a genuine motivation. If the latter were genuinely the case, the constitutional policy would have to be maintained consistently across sectors regardless of variation in distributional conflict.

## **2.14. EC competition law as Commission control over NRAs**

### **2.14.1. Relevance of EC competition law**

The Treaty rules regulating competition policy, as interpreted by the ECJ, directly empowered the European Commission to implement EC competition law (Wilkes and Bartle:2002:168). EC competition law requires that economic undertakings do not abuse positions of market dominance and this can include the provision of access to utility networks (Larouche:2000). EC competition law also potentially applies to state actions such as the extent to which national monopolies are allowed to avoid the rules of competition in order to deliver public services (Soriano:2005:187). They also potentially give the Commission an ability to use competition law powers to punish or condition the economic behaviour of individual undertakings within member states and across all sectors without being subject to controlling comitology. A number of authors have suggested that competition law has played a role in the utility area, either as a “shadow of hierarchy” (Eberlein:2008:83), a practical tool (Sandholz:1999:135) or as a “manifestly unworkable” penalty default mechanism (Sabel and Zeitlin:2008:308). Eberlein’s view is that the threat of corrective action by DG Competition regarding access rules forces

member states/economic actors to adopt regulatory rules that are effective. For Sandholz, the interaction between the Commission and the ECJ gives the Commission the ability to innovate rules which allows it to outflank member states and to force them to regulate effectively even when they do not wish to do so:

“The Commission has submitted directives (under Article 100a<sup>52</sup>, harmonization)... There will be extended Council debates. There will be member state foot dragging. But to the extent that reluctant states inhibit the emergence of pan-EU telecommunications networks and services, they will impose costs on the increasing number of actors who rely on cross-border telecommunications in the EU. And those actors will respond as they have in the past, by pressing for more effective EU-level rules and coordination.” (Op. Cit:163)

Sabel and Zeitlin critique the “shadow of hierarchy” thesis on the basis that competition law cannot positively regulate a sector but argue that it can engage in actions so punitive that market actors and member states are obliged to engage in deliberate supranationalism to save their economic actors (Op cit:308).

#### *2.14.1.1. Extent of the threat*

Member states cannot in theory evade the application of EC competition law to their economic actors (although it should be noted that EC competition law contains provisos relating to state action which the Court has often construed narrowly and this can void competition law of consequences) (Soriano:2005:191). EC competition law can be shown on occasion to have acted in the way that Eberlein and Zeitlin and Sabel suggest – at least to the extent of forcing member states to regulate in order to deal with Commission competition law own-initiative directives removing statutory monopolies (Conant:2001; Eberlein:2008; Ehlermann:1995). It has also subsequently been used to overrule NRA decisions in practice in a limited number of individual telecommunications cases where the Commission has punished telecommunications incumbents for wholesale pricing policies that had been endorsed by their NRAs. However, there are reasons to believe that competition law may not be as powerful a tool for the Commission as these authors

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<sup>52</sup> Now Article 95, it sets out the procedure for adopting internal market legislation.

suggest. Rational choice institutionalists suggest that the Court's support for legal activism is contingent (Garret et al.:1998). Legal commentators have explored the extent to which the Court in practice has been very wary of interfering with member states' organisation of public services (Conant:2001; Soriano:2005) In addition, there are critical elements of economic regulation in network industries which competition law is poorly equipped to tackle in practice and which may render it ineffective (Ehlermann:2000; Larouche:2000:359). The extent to which competition law has been a credible threat is explored in each of the case studies. If it is not a very credible threat, this will help explain why the Commission has institutional preferences as regards the institutions that implement sectoral regulation.

## **2.15. Europeanisation**

This thesis also represents a contribution to the academic literature with respect to two aspects of Europeanisation: the development of institutions at European level and the central penetration of national systems of governance (Olsen:2002:924; Bulmer:2008: 47). Some commentators have understood the EU regulatory frameworks as necessarily having created strengthened institutions at European-level despite member state resistance because the Commission backed by the Court and supported by cross-border transactors could always outflank the member states (Sandholz:1998:135). Others have considered that where member states have set up such regimes, it is because they have elected for either rational or socialised reasons to Europeanise (Levi-Faur:1999; Thatcher:2001; Eising and Jabko:2001). As the case studies for the thesis will show, these studies failed to examine the detail of the legal rules and thus the extent to which institutions at European level had actually been empowered. As a consequence of misunderstanding the legal rules, they assumed impacts at national level which they did not in fact assess in any detail (Levi-Faur:1999:189; Eising and Jabko:2001:743; Thatcher:2001:569). As a consequence of assuming Europeanisation in terms of the creation of European institutions and authoritative rules (Levi-Faur:2004:9) but finding regime patterns that are indistinguishable from the rest of the world, Levi-Faur has concluded that Europeanisation might have an indistinguishable effect from the impacts of globalisation in general (Levi-Faur:2004:25). However, I would argue that he chose to examine the wrong sectors. He chose as his evidence of Europeanisation the creation of

*independent* national regulators in telecommunications and electricity. He then found that institutional arrangements are not much different in Europe than South America. It may well be true that institutional arrangements in European telecommunications and electricity could quite fairly be described as similar to those in operation in a collection of non-federalised countries with a strong tradition of mercantilism and give rise to a wide variety of outcomes at national level. However, that is because not much Europeanisation as defined by Levi-Faur has actually occurred in the European utility sectors. A conclusion that might more accurately be drawn from the case studies in this thesis is that the extent of Europeanisation in the development of the regulatory institutions is a significant variable in determining the extent of central penetration of national systems of governance. However, the extent of the Europeanisation of the institutions and the adoption of authoritative rules is determined by EU legislation; a process that the case studies demonstrate is usually dominated by the member states. The case studies further indicate that member states distributive concerns are a significant determinant of their willingness to vote for Europeanisation. Where distributive effects are low, member states are willing to create institutions such as Agencies that help set binding rules at EU-level. Where distributive effects are potentially high, they create NRAs and discretionary rules.

## **2.16. The existing body of literature and the hypotheses in the thesis**

This table below summarises the literature from which the hypotheses are drawn.

**Table 2.1: Literature from which the hypotheses are drawn**

<i>Literature</i>	<i>Hypothesis</i>
Legislative Opportunity Structure (para 2.2)	<i>1</i>
Principal and Agent theory (para 2.5)	<i>The greater the distributional conflict in a policy area, the less likely the Council is to wish to delegate authority for implementation of regulatory rules to autonomous European level regulatory bodies, either an Agency or the Commission, and the more likely it is to prefer to delegate to NRAs; and vice versa</i>
The independence of NRAs (para 2.8 and 2.9)	
The independence of Agencies (section 2.10)	
The independence of the Commission and Comitology (para 2.11)	

*when distributional conflict is low.*

2

Legislative Opportunity Structure (para 2.2.)  
Principal and Agent theory (para 2.5)  
The independence of NRAs (para 2.8 and 2.9)  
The independence of Agencies (para 2.10)  
The independence of the Commission and Comitology (para 2.11)

*The greater the influence of the Commission and Parliament in the politics of bureaucratic design in a particular sector, the more likely that a supranational regulator (either the Commission alone or in conjunction with an EU Agency) will be tasked with the implementation of regulatory rules; and vice-versa.*

3

The independence of NRAs (para 2.8 and 2.9)  
The independence of Agencies (para 2.10)  
The independence of the Commission and Comitology (para 2.11)  
Implementation (para 2.12)

*EU Agencies will typically lead to more effective implementation than institutional designs that rely only on the activities of NRAs.*

### ***Alternative hypotheses***

4

Principal and Agent theory (para 2.5)  
Constitutional objections (para 2.13)

*The Council will decline to empower Agencies to undertake implementation for constitutional reasons.*

5

Principal and Agent theory (para 2.5)  
Networks of NRAs meet the *regulatory gap* (para 2.9)

*The Council does not have strong preferences with respect to the selection of either NRAs or Agencies because NRAs in networks are the functional equivalent of Agencies.*

6

Principal and Agent theory (para 2.5)

*The Commission does not have a strong*

Competition Law as shadow (para 2.14)

*preference for Agencies over NRAs  
because it can regulate utility sectors using  
competition law.*

## **3. Chapter Three: Theory and methods**

### **3.1. The structure of the chapter**

This chapter is divided into an introduction, a theory section, and a methods section. The introduction summarises the general aims and objectives of the thesis. The theory section models the preferences of the principals regarding NRAs and Agencies in the context of the applicable legislative opportunity structure. A theory regarding the institutional consequences at EU-level of the interaction of the hypothesised legislative preferences of the principles under co-decision is developed. In addition, a prediction as to the post-delegation outcomes caused by variation in institutional selection is hypothesised. The methods section of the chapter sets out the research design and explains how the dependent and independent variables have been operationalised.

### **3.2. Introduction**

#### **3.2.1. Aim of the thesis**

When a decision is made to regulate a sector at EU-level, decision-makers face a range of options in terms of the bodies that can be tasked to deliver the regulation (Thatcher and Coen:2008:57). EU policy-makers can leave the mechanisms for implementation entirely to national discretion or they can choose to delegate to a body defined in the legislation creating an EU competence. Due to the constraints of the legislative opportunity structure discussed in Chapter 2, when they opt to delegate to bodies defined in the legislation, they usually have the choice between three options: the Commission, EU agencies or to *independent* NRAs (potentially organised into networks) or combinations of all three. Moreover, they can delegate to these bodies with varying systems of control and degrees of discretion. In contemporary legislation, the actual choice tends to be between NRAs, alone or organised into a network, and an Agency/Commission. The aim of the thesis is to explain what determines the choice between these two types of design.

### **3.2.2. The principal objectives of the thesis**

The objectives of the thesis are: (i) to test whether distributional conflict between member states and between member states and the Commission and the Parliament causes variation in the selection of regulatory institutions; (ii) to test whether influence of the Commission and the Parliament in the legislative process is likely to enhance the prospect of the selection of supranational institutions; and (iii) to test the respective impact of the selection of either Agencies or NRAs on implementation outcomes.

### **3.3. Theory of principals' preferences**

#### **3.3.1. Introduction**

As discussed in the literature review, the principals – that is the member states, Commission and Parliament – involved in the design of EU regulatory bodies do not have general fixed preferences regarding institutional design in all circumstances.<sup>53</sup> The question that is explored here is whether distributional concerns cause the member states to collectively hold particular preferences with respect to the design of regulatory institutions in specific sectors. However, those preferences will not necessarily wholly determine institutional outcomes. The decision-making rules also privilege other actors. The negotiating strength of the Commission and the Parliament may be enhanced by the degree of implementation power already transferred to the European-level and any contingent reasons, such as a policy crisis, specific to the policy area.

#### **3.3.2. Theory of member state preferences**

##### *3.3.2.1. Likely impacts of distributional concerns*

Rational choice theorists argue that in designing EU regulatory institutions, member states are typically confronted with a tension between their desire to make credible regulatory commitments and their desire to manipulate the distributional consequences of regulatory decisions (Krasner:1991; Moravcsik:1993; Menon:2008:152). The former

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<sup>53</sup> Industry players competing in regulated sectors and their representative associations are similarly ambivalent. One example comprises the collective deliberations of the European Telecom Network Operators' Association in response to the Commission's 2006 Review proposals. In its confidential internal papers the association weighed up the pros and cons for its members of all the possible institutional variants (ETNO:2007).

concern encourages member states to opt for more centralised (i.e. EU level) and independent regulatory bodies. However, as the concern over distributional consequences increases, delegation is less likely to occur and where it does occur member states are likely to want to maintain as much national control as possible to constrain the discretion of EU regulators. Concern with the need to make credible commitments has overridden distributional concerns in some instances, as for instance in the 1990s, when member states enshrined the operational independence of the European Central Bank so as to commit to stable, neutral monetary policy (Ziloli and Selmayr:2000:627). However, in the design of many internal market institutions, outcomes are significantly influenced by member state concerns over the distributional effects of regulation.

3.3.2.2. *Costs and benefits of giving the Commission, guided by comitology, implementation power*

Until the 1990s, when the member states in the Council chose to delegate regulatory tasks to the EU level, they did so by delegating to the EU's primary executive body, the Commission. Given its considerable resources and relative autonomy, delegating to the Commission entails a risk of significant loss of control by the member states. Member states have worked to mitigate this loss of control since the early 1960s, by establishing and gradually strengthening and formalising a system of comitology committees through which the Commission's decisions in exercise of its executive powers must pass (Dogan:1997; Pollack:1997:114-116; Joerges and Vos:1999). However, the value of comitology to an individual member state is potentially dependent on its preferences being and remaining within the winning coalition determined by the voting rules ascribed to the particular committee. Franchino argues that member states might also be dissuaded from giving implementation tasks in complex technical areas to generalist supranational officials because they would not have the requisite skills (Franchino:2007:292). However, this is not likely to be a genuine rationale because control over implementation can be given to the Commission in such areas without raising efficiency concerns. This could be done by according it administrative power to review and veto national

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implementation decisions subject to the advice of an Agency. This would effectively mean it could harness the collective implementation ability of all the national regulatory officials.

*3.3.2.3. Costs and benefits of an Agency (typically with Commission making the formal decision subject to comitology) implementing*

Since the early 1990s, the member states have increasingly delegated regulatory tasks to bodies outside the Commission. The establishment of new regulatory bodies has given member states the opportunity to design oversight and control structures so as to limit the discretion of these bodies. In establishing EU Agencies, Member states have tended to insist on Agency management boards dominated by member state appointees who are engaged in the practice of regulation, giving the member states a greater degree of collective control over regulatory actions than they would have enjoyed had the same regulatory tasks been delegated solely to the Commission (Kelemen:2002:101). Thus, the advantage of an Agency from the member states' perspective is that it does allow for the promotion of harmonised regulation, while entailing less loss of control than delegation directly to the Commission. Nevertheless, like comitology committees, EU Agencies do represent a risk to individual national autonomy in regulatory implementation. First, even though member states collectively dominate the management boards of EU Agencies, any individual member state cannot veto board decisions to protect itself from adverse distributional consequences as the decision-basis is typically qualified majority voting. Second, where the activities potentially require any substantial exercise of regulatory discretion, the current interpretation of EC law requires that the Commission exercise the formal discretion even if the Agency undertakes the preparatory work and makes a recommendation. This creates a potential veto and thus an oversight role for the Commission.

#### 3.3.2.3.1. The Implications of an Agency for a protectionist member state

The consequence of this design is that in a policy area governed by the combination of an Agency and the Commission, a member state which wishes to defect from a common agreed policy can likely only do so if it achieves three conditions: agreement to the defection from at least a blocking minority of national regulators in the Agency; the absence of a veto/contrary decision by the Commission; and, in the likelihood of a Commission veto/contrary decision in response to the proposed defection, the willingness of national ministries to maintain the blocking minority in comitology and for the issue to go to the Council for decision. This is a high threshold and is unlikely to be achieved by any member state which seeks to defect from the policy objectives which formed the common accord of the initial qualified majority which agreed the legislation. In addition, depending on the construction of the empowering legislation, there may also be a risk of opposing member states or economic actors mounting a legal challenge regardless of a Council decision. The issue of lack of technical skills referred to above is unlikely to arise at all, since in the case of an Agency, the ability of the institution can be designed to be the sum of the abilities of all of the national regulators who are likely to comprise its board and working groups.

#### 3.3.2.3.2. The Implications of an Agency for a non-protectionist member state

An Agency is not free of risk from a non-protectionist member state's perspective either. If the majority of member states are protectionist then that will potentially impact on the content of the advice from the NRAs in the Agency and the collective preferences of any comitology committee. The Commission in those circumstances would have the option of meeting the regulatory requirements of the pivotal protectionist member state or vetoing Agency draft decisions (if decision-making in comitology was set at regulatory comitology level). Alternatively, if committee decision-making was set at the advisory threshold, the process would likely become litigious. In either scenario, the non-protectionist member state would be unable to pursue its desired level of regulation, either because decision-making would include the preferences of protectionists or alternatively because it would be blocked. Alternatively, under the advisory comitology procedure, the likelihood of legal disputes, might prevent regulation within any kind of

useful time frame. However, this scenario of an Agency being established to deliver implementation where there is a protectionist majority in the Council is unlikely. The reason for this is that the status quo ante in a newly liberalised sector already largely achieves protectionist member states preferences. Involving the Commission as a veto player over regulatory decisions would at best be risky and in the event that the majority of protectionist member states were eroded over time as a result of privatisations, could ultimately lead to the overthrow of national preferences in the remaining protectionist member states.

#### 3.3.2.4. *Costs and benefits of NRAs implementing*

Other than EU Agencies, *independent* NRAs sometimes organised into EU regulatory networks comprising national regulatory authorities (NRAs) have emerged as the other main EU-level design option for member states. As compared to delegating to the Commission and/or an EU level Agency, entrusting regulatory tasks to an NRA or to an EU network of NRAs preserves greater national autonomy. For member states that are concerned with the distributional consequences of common regulation, a substantial attraction of framework regulatory directives policed purely by national regulators is that this institutional arrangement allows member states to preserve their autonomy as to the actual content of regulation applied within their jurisdiction and thus to control the distributional impact of regulation. Under this scenario both protectionist and non-protectionist member states would be able to pursue their own preferred domestic policies. The European control over their activities is likely to be limited to the standard weak infringement processes (see page 84 of the literature review).

##### 3.3.2.4.1. Counter argument that choice of NRAs implies agreement on the substance and therefore would not be used to defect from the common proposal

The fact that there are EU framework directives occupying particular policy areas has sometimes lead some analysts to assume, without analysing the detailed content, that there is agreement over the aims of the legislation. Indeed, the fact that there is no substantive Commission/Agency role has itself been interpreted as evidence that there is such common accord (Franchino:2007:55). The logic is that where member states are

agreed then they do not empower other institutions because if member states fundamentally agree a policy they will trust each other to implement it. Empowerment of the Commission and/or Agency may be evidence of some potential policy conflict, since they may effectively be being empowered to overcome a minority who might use implementation to defect from the common agreement.

However, it should be noted, logically, that empowerment of NRAs alone can also occur where the votes in Council of member states who are opposed to regulation are also required to pass legislation.<sup>54</sup> An argument could be made that, in this situation, it would be irrational for the pro-regulation member states to agree to any EU-level legislation; if they agree a system in which defection is feasible, do they not create a system where there is no reciprocity between national regulated markets and where their national economic agents will be exposed without reciprocal advantage? While these particular distributional effects are likely to occur, such logic would only reflect the conceptual paradigm of those countries with protectionist aspirations. The lead government negotiator in a utility sector from a pro-liberalisation member state made the following points as to why they would agree market opening directives with inadequate institutional mechanisms. His ministers cared more about domestic consumer benefits than producer interests. In so far as they cared about producer groups, they cared about other national producer groups who used utility inputs and who would benefit both from regulation of the now regulated set of national producers and any additional competition coming from other member states. There was also the possibility the EU rules might nonetheless still allow some net new entry into protected markets and that once that occurred, the political dynamic in the protectionist member states might start to alter, particularly in a context where privatisation appears to be the zeitgeist (Interview:2009).

#### 3.3.2.5. *Hypothesis 1*

The hypothesis that will be used to test these theories empirically is:

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<sup>54</sup> Franchino does not focus on this point but does note in a footnote that should the “extreme” governments approval be required because conflict rises above a certain point in the Council that the negative relationship between [national] discretion and policy conflict is severed (Franchino:2007:55).

*The greater the distributional conflict in a policy area, the less likely the Council is to wish to delegate authority for implementation of regulatory rules to autonomous European level regulatory bodies, either an Agency or the Commission, and the more likely it is to prefer to delegate to NRAs; and vice versa where there is low distributional conflict.*

The hypothesis would be falsified if there was high distributional conflict and member states preferred to give authority over implementation to European-level institutions.

### **3.3.3. The European Commission and European Parliament preferences**

#### *3.3.3.1. Theory of European Commission preferences*

The Commission generally prefers supranational over intergovernmental solutions (Ross:1995:14; Sandholz:1998:161; Nugent:2000:14; Franchino:2007:132). The assumption is that its first preference would be to expand its own regulatory capacity and authority, through increased financing, staffing and grants of regulatory powers (Hussein and Menon:2004:97). This could lead to the assumption that the Commission is likely to be hostile to Agencies, as referred to in paragraph 1.5.5. of the Introductory Chapter. However, if a transfer of implementation power to the Commission alone is not politically feasible, then it should prefer the creation of Agencies since that at least gives it a constrained veto. In general, this does seem to be the pattern.

Since the late 1980s, it has become clear that member state governments are unwilling to countenance any significant expansion of the Commission (Ibid:90). As a consequence, when the Commission was faced with increasing regulatory burdens in the run up to the 1992 target for completion of the Single Market, and was unable to win political support for expanding its own capacities, it turned to promoting the establishment of EU level *independent* Agencies (Kelemen:2002:101). Agencies with as much autonomy from member states as possible and as much influence over the Agency's agenda and decision-making from the Commission are likely to be the Commission's second preference. The Commission will prefer this to the selection of NRAs over which they are unlikely to be given much control.

Consequently, the Commission is likely to promote decentralised networks of national regulators only where the two more centralised solutions have not received support. Its hope being that this might nonetheless create some dynamics for the support of the cross-border undertakings which might then generate demand for more Europeanised institutions in the way hypothesised by Sandholz (Sandholz:1998:153).

### 3.3.3.2. *Theory of Parliament preferences*

The Parliament's preferences with regard to EU regulatory structures are potentially driven by two primary concerns. First, the Parliament has sought to promote its institutional self-interest. The Parliament has no role with respect to NRAs. It potentially does with respect to both the Commission and Agencies and has sought to develop and exercise controls with respect to both. (Kelemen:2002:104). Given the choice between an empowered Commission alone and an Agency, there might be some theoretical grounds for predicting that it might prefer an Agency for three reasons.

The existence of an Agency implies a greater number of actors involved in decision-making, which potentially increases the number of actors that will have insider knowledge and the capacity to trigger the kind of fire-alarm controls that parliamentarians with limited resources are likely to favour (McCubbins and Schwartz:1984:167). The Parliament may also be able to require places on the decision-making board for either it or its allies (Kelemen:2002:109). If Parliament cares about the specific regulatory outcomes then it will be easier to tailor sanctions to the acts of a specific entity. General sanctions against the Commission are likely to become embroiled in much wider issues and make signalling displeasure with respect to the specific Agency action or inaction costly and inefficient. The Parliament has also sought to maximise its popularity with voters by favouring regulatory institutions that it believes promise to yield favourable outcomes for consumers.

These preferences have generally led the Parliament to favour the establishment of transparent, accountable EU regulatory bodies. However, it should be expected that like the other institutions, the Parliament is capable of taking an instrumental approach. Where a more Europeanised structure, because of its design, would actually deliver less

*Europe* (i.e. cross-border competition) and as a consequence less benefits for consumers, then it may decline to support a proposed and apparently European institution<sup>55</sup>.

## Hypothesis 2

The second hypothesis tested in the thesis is:

*The greater the influence of the Commission and Parliament in the politics of bureaucratic design in a particular sector, the more likely that a supranational regulator (either the Commission alone or in conjunction with an EU Agency) will be tasked with the implementation of regulatory rules.*

The hypothesis would be falsified if member states were indifferent to institutional outcomes, there were strong possibilities for agenda setting or negotiating power, and there was no attempt by the Commission or the Parliament to push for effective control over implementation at European level.

## **3.4. The theory of institutional outcomes**

### *3.4.1.1. Introduction*

The first two hypotheses concern the preferences of the legislators. If they are correct, it should also be possible to derive the theoretical outcomes that should arise from their interaction. The likely institutional outcomes to which they should give rise are presented in table form below.

### *3.4.1.2. Distributional concerns*

On the x-axis of table 3.1. below, distributional conflict refers to disagreement as to the economic outcomes which would arise in a particular sector as a consequence of pooling sovereignty and allowing a European body (or bodies) to ensure effective implementation of the general policy position enshrined in common EU legislation. The x-axis is divided into two situations: sectors where there is high distributional conflict and sectors where

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<sup>55</sup> See the case of the Railway Observatory page 223.

there is low distributional conflict. Areas of EU regulation will often entail distributional consequences and therefore some degree of conflict between member states. In reality, the degree of distributional conflict is likely to be a continuous variable. However, if a high level is defined as a situation where there is at least a blocking minority of member states, which would form against the adoption of legislation empowering a supranational institution to implement effective regulation, then it becomes a binary situation. This is the relevant point to adopt, since it determines the type of institution that the Council can select.<sup>56</sup>

#### 3.4.1.3. *Influence of the Commission and the Parliament*

The influence of the Commission and the Parliament is measured on the y-axis. It will be higher or lower depending on the existing degree of delegation to the European level (which is considered here as a structural factor). The assumption is that where there is no existing legislation empowering the Commission to conduct implementation that its negotiating power and that of the Parliament is low. Conversely, where the Commission is already empowered to conduct implementation, the negotiating power of both vis-à-vis the Council is high because withdrawal of the legislation (Commission) or blocking (Parliament) would leave them in a preferable position to any renationalisation of implementation competences.

It might be possible for specific contingent factors relating to a policy area to strengthen the influence of the Commission and the Parliament, for example, a popular political crisis created by regulatory failure on the part of the existing national institutions. It might also occur because of legal activism on the part of the European courts. Some authors would view this as inevitable and should, therefore, be classed as a structural factor (Sandholz:1998:135). However, the role of the courts is predicted to be contingent because the court is also subject to political constraints (Garrett, Kelemen, Schulz:1998).

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<sup>56</sup> Distributional coalitions are not necessarily stable. Conjunctural crises can shift alignments at national level. For example, member state reluctance to allow cross-border interference with national regulation of financial institutions meant that member states had not transferred any substantive decision-making power to either the Commission or to Agencies. This was in a context where all member states bar the UK had extensive state holdings. However, the financial crisis seems to have convinced member states that cross-border banking failures and risks are very unpopular with tax-payers and that the consequences of

In practice, both of these kinds of contingent events appear to be rare. The case studies examine their degree of salience and impact in the sectors analysed in the thesis.

**Table 3.1: Institutional outcomes for the implementation of EU-sectoral regulation**

	y-axis	Influence of Commission and/or Parliament	
x-axis		<b>High</b>	<b>Low</b>
Potential distributional conflict between member states and between member states and the Commission/Parliament	<b>High</b>	Box A:  Commission retains power but possibility of strong network with some Agency like characteristics	Box B:  National Regulatory Authorities (NRAs) wield power within weak pan-European networks, but possibility of weak Agency
	<b>Low</b>	Box C:  Powers left with Commission but possibility of a weak Agency with some network like characteristics	Box D:  EU Agency with draft-decision-making power created.

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offending this group would impose greater costs. Possibly as a consequence of this shift in preferences, financial regulation has in 2010 shifted from Box B to Box D.

### **3.4.2. Explanation for the theoretical outcomes contained in the table**

In *Box A*: in the circumstances of the Commission having existing implementation powers then we could expect the outcome to be that the Commission remains relatively unconstrained by the creation of any additional European body even in a situation where the Commission's individual decisions potentially impact on multiple member states and there is scope for high distributional conflict. A typical feature of agencification is that the Commission has to take utmost account of the Agency and that the Commission's decision must then pass a regulatory committee of national ministries. If the Commission's implementation work is not already subject to scrutiny by a regulatory committee, it is unlikely to agree to this in a later legislative round. We could expect that where the status quo ante favours the Commission that any functional reasons for creating a further European body from a member state's perspective are *reinforced* by distributional concerns. Where there are potentially high distributional concerns, member states are likely to take legislative opportunities to try and create a situation where the Commission's implementation powers are as far as possible subject to review by or anticipated by agenda-setting from national regulatory bodies in an attempt to ensure that the Commission takes member states concerns into account. Conversely, the Commission and the Parliament are likely to oppose the creation of Agencies in this situation and instead favour a less resourced network of national regulators. A likely institutional outcome when these factors interact is a strong network with some Agency-like properties if the Council trades something else which the Commission and/or Parliament seeks.

In *Box B*: Agencies are not the outcome because there are blocking anti-competition member state minorities or even majorities. The institutional status quo ante and conjunctural pressures are insufficient to empower the Commission and Parliament. The Commission and Parliament are likely to favour empowerment of an Agency and/or the Commission. However, the likely outcome here is implementation powers ceded to NRAs. Any networks are simple information sharing venues with no ability to take binding decisions. If an Agency is created, it will have no role in policy-making but will conduct precisely defined executive actions for member state principals alone.

In *Box C*: as in *Box A*, member states are likely to favour the creation of additional agenda-setting bodies on which they have strong representation. The Commission and the Parliament are likely to see this as risking a diminution of the likelihood of pro-integration decisions. As a consequence of their stronger negotiating powers due to the existing institutional structure, if an institution is created its agenda setting powers are likely to be weaker rather than stronger. The likely outcome here is either an Agency or a strong network. If it is an Agency, it is not likely to have formal agenda-setting powers (or any legally enabled equivalent).

In *Box D*: if there are functional needs to be met, all institutions can agree that they are beneficial as they are not overridden by distributional interests. The Commission is formally empowered (so gains competences). The member states achieve the functional benefits and their negotiating position is such that any new European body will be constituted in a way that gives them collective agenda setting power. The Parliament gains oversight of sector implementation that was previously out of bounds to them: both indirectly through their review powers with respect to the Commission and through budgetary and potentially managerial positions with respect to the new body. The likely outcome here is the formation of Agencies.

#### *3.4.2.1. The cases examined in the thesis*

This thesis concentrates on regulatory institutions located in boxes B and D. However, this is not by design. It is a consequence of the fact that the sectors were not selected based on the dependent variable and in the vast majority of legislative cases where Agencies and networks of NRAs are among the palate of choices, the Commission is not already endowed with powers of implementation. This is primarily because there are very few areas where the Commission has direct powers of implementation (Nugent:2002:152; similarly Dehousse:1997:247).

However, at this stage, it may be of interest to the reader to note that the only cases in practice of which I am aware of where there has been a discussion of Agencies and networks that fall into box A and C are competition law (*Box A*) and Food Safety and (to

a limited degree) Environment Agencies (Box C).<sup>57</sup> The design of the competition law network and the Food Agency are discussed briefly in the conclusion to demonstrate that the theory advanced here generates predictions which seem to hold with respect to institutional outcomes in EU sectors other than those investigated in the case studies.

### **3.5. Post-delegation outcomes**

#### **3.5.1. Theory**

The argument here follows a consequential logic. If legislators design regulatory institutions because they favour certain implementation outcomes over others, then we should find that those outcomes do vary depending on the institution adopted.

The findings in respect of the third hypothesis are relevant to an assessment of whether national regulators are *independent* in practice or not. If there is a correlation between distributional issues likely to provoke bias (i.e. state ownership) and variation in implementation between countries where that is present and countries where it is not, this would tend to suggest that NRAs are not independent of concerns regarding the assets held by national ministries. Conversely, if there is no such correlation between institution and patterns of implementation, this may suggest that the motivations for selecting different forms of institution do not derive from national concerns about outcomes.

#### **3.5.2. Hypothesis 3**

*EU Agencies will typically lead to more effective implementation than institutional designs that rely only on the activities of NRAs.*

The hypothesis would be falsified by a finding that national regulators unconstrained by substantive hierarchical authority at European level achieve similar levels of regulatory implementation as sectors overseen by Agencies and/or the Commission. If this hypothesis were falsified it would also cast doubt on the first two hypotheses.

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<sup>57</sup> The Environment Agency is different from most Agencies or networks in that it actually acts with respect to a range of different issues and different sectors. It and the Commission have different roles/powers on different issues and sectors, so it could be placed in more than one box. The bulk of its activities would be located in Box B.

### **3.5.3. Supporting research**

#### *3.5.3.1. Conditions necessary for deliberative supranationalism to occur*

Supporting qualitative research is undertaken to investigate the range of necessary conditions which constructivist theorists argue would cause national regulators participating in regulatory networks to deliver effective implementation (Eberlein and Grande:2005:103; Eberlein and Kerwer:2004:162). Majone also thought that the growth of the regulatory state would lead to a “general trend towards the harmonisation of regulatory approaches” (Majone:1997:143). The case studies examine whether participants in these networks consider whether any of these conditions apply in practice. If they do not believe this to be the case, this may also help explain why member states prefer a EU Framework implemented solely by NRAs over one where Agencies and/or the Commission have a substantive role. If the outcome of selecting NRAs or the alternative were the same, due to the operation of informal networks, then member states should in fact be indifferent between the alternatives.

#### *3.5.3.2. The extent to which ministries influence NRA decision-making*

Further qualitative research was undertaken to ask stakeholders their views as to the extent to which ministries influenced NRAs regulatory decisions. If respondents believe that they do so, it would also help explain why, in certain situations, member states prefer to select this type of institution when they legislate at EU level.

### **3.6. Alternative hypotheses**

The thesis also examines three alternative hypotheses derived from the literature. Insistence from the Council of Ministers on selecting national regulators as opposed to an Agency as implementers of European rules is sometimes seen only as a sovereignty reflex but with no implications for implementation (Thatcher:2001:570). The thesis, therefore, tests whether constitutional objections have been a primary driver (Hypothesis 4). Second, a strand of literature analyses NRAs, often organised into networks, and Agencies as equivalent responses to unidirectional functional pressures for greater market integration (Eberlein and Grande:2005:95; Sabel and Zeitlin:2009). If this were the case, logically member states should over time have no particular preference for one institutional form over another. This view can be represented in the hypothesis that

member states are indifferent to selection between NRAs and Agencies (Hypothesis 5). A third alternative hypothesis is derived from supranational-institutionalist arguments. Sandholz argues that when the Commission is blocked by the member states while in pursuit of market opening that it can innovate legislative rules and outflank the member states (Sandholz:1999:153). Such a view would suggest that the Commission must be content with the varied sectoral institutional outcomes because, if it were not, it would have been able to use its competition law powers to regulate (or threaten to regulate) in any sector where it was not happy with outcomes. The hypothesis drawn from this literature is that the Commission is able to use competition law to regulate each sector (Hypothesis 6).

### **3.7. Research design**

#### **3.7.1. Introduction**

The thesis is based on case studies. It is rooted in a rational-institutionalist framework (Tseblis and Garrett:2000) and uses principal and agent theory to explain why different EU legislators may in certain circumstances have different preferences as to the design and selection of regulatory agents. The thesis examines the pre-delegation preferences of the principals, the legislative acts of delegation and post-delegation outcomes. These are examined through case studies.

#### **3.7.2. The case studies**

In order to answer the research question posed, historical case studies of pre-delegation preferences and delegation outcomes are analysed in three sectors: telecommunications, rail and pharmaceuticals in the period 1990-2010. These comprise three sectors where EU regulatory frameworks have been agreed more or less contemporaneously in order to facilitate market entry and competition.

#### **3.7.3. The merits of a case study approach**

A comparative historical approach permits the application of several methods to tackle the research question. First, historical process tracing at each stage of the legislative process facilitates an accurate identification of the independent and dependent variables at each legislative point. As briefly discussed in Chapter 1, inaccurate categorisation of

the dependent variables has been a feature of some of the literature. Correctly identified values can then be used to compare co-variation of the independent and dependent variables both within and between sectors. Second, process tracing permits us to test whether there is a strict chain of causation between changes in the independent variables and changes in the dependent variable and thus to verify the strength of the probabilistic claim generated by assessments of co-variation. Third, it also permits testing of the potential rival hypotheses on the same basis. Where process-tracing gives rise to indeterminate findings for some hypotheses, it may nonetheless be able to falsify others (George and Bennet:2005:217).

#### **3.7.4. Representative nature of the cases selected**

According to my research, the utility sectors selected for the thesis represent 25 per cent of the total population of sectors where EU Frameworks identify a conflict in national governance and as a consequence require the creation of *independent* regulators.<sup>58</sup> In addition, telecommunications is a sector which has been used as case studies in analyses of Europeanisation and functional pressures and has been deemed to likely to lead to effective institutions (Sandholz:1998:163; Eberlein and Grande: 2005:89; Levi-Faur: 1999 and 2004). If there was a sector in this set that was likely to falsify the hypotheses advanced in the thesis, this sector should be amongst them.

The two Agencies, Medicines and Rail, represented 50 per cent of the regulatory Agencies according to Griller and Orator's identification of "pre-decision making" Agencies at the time the selection was made (Griller and Orator:2010:3). The other two identified by these authors were the Maritime Safety and the Food Agency<sup>59</sup>. Griller and Orater do count the Trade Marks, Plant Variety, Air Safety and Chemicals Agencies as separate full function discretionary decision-makers (Griller and Orater:2010). However, Trade Marks and Plant Variety are often considered to exercise decision-making within such narrow areas that it is considered as part of the exercise of an executive role and not to offend the Meroni doctrine (Geradin and Petit:2004:40). Similarly, while the Air

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<sup>58</sup> See page 64 above.

<sup>59</sup> However, the Food Agency should not be counted amongst them as it does not have formal agenda setting powers – the Commission is not required to consult it and neither the Commission nor the comitology committee are required to take any account of its opinions..

Safety and Chemicals Agencies do have some discretion to make some very narrow decisions, in other areas where issues require a policy-making role, they too are pre-decision making Agencies. Two further pre-decision making Agencies have subsequently been selected. One of these, the new telecoms Agency, falls within one of the sectors already selected to study independent NRAs in the thesis and is as a consequence also analysed.

Taking into account these qualifications, the thesis can, therefore, be said to cover three out of the six current pre-decision making Agencies. Pharmaceutical authorisation is a sector recognised in the literature as having a well-functioning agency (Everson et al:1999:214; Permanand and Vos:2008:14). Neither the rail sector Agency or the new telecommunications Agency have previously been included in any academic study.

### **3.7.5. Number of observations**

The three sectors also give us a higher number of observations for the hypotheses regarding delegation than might be initially presumed. Over time there have been a number of legislative iterations in each of the sectors and the processes are traced through each of these iterations. Where the number of observations is equal to  $n$ , the number of observations in each sector is as follow: pharmaceuticals ( $n=4$ ), rail (access,  $n=6$ , safety,  $n=6$ ), telecommunications ( $n=4$ ).The findings have a higher degree of reliability due to the detailed examination undertaken, but it is still a small  $N$  study with the risks as to reliability to which this gives rise.

### **3.7.6. Homogeneity**

The case studies are comparable since they are all sectors where institutions are ostensibly designed at EU level and empowered by EU directives and regulations to remove barriers to the single market through positive integration. Rail and telecommunications are network industries where the key market-opening issue is wholesale access to bottleneck network infrastructure with monopoly characteristics. Regulation is necessary in order to prevent the exercise of de facto monopoly power by the incumbent with respect to the conditions of access to its network and an institution or institutions are required to deliver this regulation. In pharmaceuticals and rail safety, regulation is necessary in order to ensure that only safe products are placed on the

market. In all three cases, variation in implementation of such regulation between member states is likely to create barriers to cross-border trade.

### **3.7.7. No selection on the dependent variable**

There was no selection on the dependent variable. There was selection on an explanatory variable: the degree of state ownership in a sector. The sector literature suggested that ownership was fairly ubiquitous in rail (Stephens:2004), low in telecommunications (Thatcher:2007) and non-existent in pharmaceuticals (Beltratti et al:2007). In fact, research for the thesis found that it was high in rail and telecommunications and confirmed that it was low in pharmaceuticals. Co-variation can be shown by comparing outcomes in pharmaceuticals with the utility sectors. However, co-variation can also be shown within and between the utility sectors as various forms of regulation which do not have redistributive effects are carved out from the overall body of regulation and supranational institutions designed to implement the policies which will not give rise to distributional conflict.

## **3.8. Method**

### **3.8.1. Operationalising the hypotheses**

The remaining section of this chapter explains how the hypotheses are operationalised.

### **3.8.2. Hypothesis 1: Council preferences**

#### *3.8.2.1. Legislative proposals*

The primary source utilised for the measurement of member states' collective preferences are legislative proposals. Member state collective preferences are recorded in the common positions of the Council which are adopted in response to Commission proposals and amendments of the Parliament. In the case studies analysed in this thesis, the institutional preferences contained in these legislative drafts are examined in detail. This detailed examination has not previously been conducted in any of these policy areas.

The hypothesis seeks to measure the extent to which authority over regulatory implementation is delegated to the national or European level in the common positions rather than simply whether NRAs, Agencies or Commission are created or nominally

empowered. Two different sectors could be regulated by a mix of all three bodies but substantive hierarchical authority in one sector could lie with one institution amongst these three and in another sector primacy could be vested at a different level. To identify which body or bodies have the final say on what regulation is actually imposed on markets requires an examination not only of which institutions are required by legislation but also how the relationships between them are structured by the legislation.

#### 3.8.2.2. *Oral interviews*

Analysis of legislative proposals has been complemented by conducting in-depth semi-structured interviews with a number of experts in each of the sectors. Each interviewee has been asked his or her view of the different positions held by the different member states; the respective positions of the Council, Commission and Parliament; and whether the proposals cover all the matters necessary in order to deliver competition in principle. A total of sixty-seven interviews were conducted. In each sector, where possible, interviews were conducted with the responsible officials from the Commission, national ministries, regulators and companies. Anonymity was offered to interviewees as many of the issues were live, with legislation being undertaken during the period of research in rail and telecommunications. Interviews were undertaken with interviewees from the different interests in order to permit triangulation. Particularly because there was legislation underway in a number of sectors, there was the possibility that there could be a difference between declared positions and true positions.

Anonymity was clearly important for the regulators and ministerial officials who would recheck that it was being observed in the course of the interviews before making specific comments about the relationship between the ministry and the regulator. Companies and their associations, since they operate in environments where these relationships are economically significant, also considered it vital. Some organisations were not prepared to discuss these issues. Quite reasonably, this may sometimes have been because engaging with a researcher was not a priority. However, clearly some considered the issues too sensitive to discuss with an unknown third party. The representative in Brussels of one state owned incumbent company, who had been asked for an interview, wrote: "I understand that you are conducting a scientific work with high guarantees of

confidentiality. However, and due to the sensitiveness of the matter, I have not been able to get a positive answer to your request from my hierarchy [i.e. to grant an interview].”<sup>60</sup>

Providing anonymity could potentially reduce the scientific validity of the interviews. Scientific validity requires that the same experiment can be repeated and verified (King, Keohane and Verba:1994:27). However, while a future researcher cannot necessarily interview the same individuals from the same entities, it is nonetheless, entirely possible for any researcher to ask the same questions of a relevant individual from an entity of each of these types of bodies for each of the sectors.<sup>61</sup> The types of institutions from which interviewees were drawn are listed by type in Annex 3.<sup>62</sup>

### 3.8.2.3. *Additional measures not adopted*

It would have been ideal to obtain the actual preferences of every individual member states in each round of legislation and to have correlated these against the degree of state ownership in that country. These, however, cannot be identified from voting records. Records of the process of negotiation in Council working groups and Coreper are not made. Only the final result of Coreper and full Council are known. However, these usually already embody a negotiated solution that is then approved by unanimity. As a consequence, it is impossible to use formal voting records as a way of measuring individual member state preferences (Heissenberg:2008:270).

Thomas and Stokman in their study of EU legislative proposals examined 66 pieces of legislation and were able to identify the positions of member states by interviewing experts (Thomas and Stokman:2006:31-33). In my interviewing of experts, including those leading for member states and for the Commission, my finding was that while they knew the preference of their own institution or member state, usually that of the member states which were the leading proponents of particular institutional positions, and the general mood of the Council working group, they could not identify the specific positions of the majority of member states – even in current negotiations on which they were working. This is not surprising given the working method of the Council. The Presidency

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<sup>60</sup> Email to the author 22 January 2010

<sup>61</sup> See the questionnaire at Annex 4.

<sup>62</sup> Annex of interviewees by type of organisation.

tends to decide when a measure has enough support without any vocal opposition – rather than calling for a vote (Wallace and Naurin:2010). Thomas and Stokman had the advantage of being able to interview a representative of every member state, which was beyond the scope of my resources.

One could perhaps make the assumption in such a situation that member states, which did not oppose the *mood*, approved it. However, it might simply be that an individual Member State, A, was adopting a particular tactical approach. If a particular Commission institutional preference is considered to face an unshakeable blocking minority then there may be no advantage in backing the Commission; doing so may make it more difficult to achieve agreement on other parts of the text where compromise would be feasible. For example, a member state might want to achieve the incorporation of a particular regulatory rule. Protectionist member states might accept this latter proposal if it was effectively rendered optional because they retained control of implementation and the legal requirement was for deployment or not of the rule to be within the discretion of the NRA. Consequently, it would not seem appropriate to record such silent acquiescence as member state A's first preference.

#### 3.8.2.4. *The independent variable: distributional conflict*

##### 3.8.2.4.1. State ownership

As discussed on page 65 of the literature review, member states have good reasons to be coy about protectionist preferences. It is therefore necessary to find an effective proxy for undeclared sectoral protectionist preferences. State ownership of the regulated entity or entities would seem to be such a proxy. Diminution of state ownership has been identified by Majone as the key variable in the rise of the regulatory state, i.e. a form of governance where the state moves to a position where it is neutral as to the success or failure of individual economic actors and seeks to design institutions to allow it to be a neutral arbiter between economic actors (Majone:1994:80). State ownership militates against such neutrality since it ensures at a minimum a significant financial interest from the state in the regulated entity. It may also reflect a political commitment to sustain a rent-seeking coalition and in many cases the work force may continue to have civil service status and be numerically large and highly unionised.

Annual OECD reports on product market regulation find that the sectors of airline transportation, telecommunications, gas, electricity, postal services, rail transport and road transportation are the sectors most likely to generate economic rents above a normal rate of return (Conway and Nicoletti 2006:5) With the exception of road transport, these are sectors where there continues to be significant state ownership. More generally, it may also reflect a belief in the national economic importance of continued state strategic involvement, for example, to support domestic equipment producers.

All of these factors could push an administration to want to ensure that market opening does not expose any of these relationships to risk by weakening the market position of the national incumbent. An advantage of state ownership as a proxy is that it is feasible to obtain objective differentiating observations. Member states either keep or can provide a record of state holdings in different industries. The assumption is that if the state considers that the economic actor is of special value to it in achieving a “wide range of goals” (Majone:1994:79), then it will seek to retain an influence.

#### 3.8.2.4.2. Qualification of state ownership as a measurement

In the utility sectors, state ownership of the access network alone is not likely to give rise to protectionist concerns. It is state ownership of the downstream customer-facing retail services in conjunction with the access network (otherwise known as vertical integration) that causes a conflict of interest. The regulatory frameworks seek to implement regulation ensuring that competitors to the state-owned retail services obtain access on equal terms to the monopoly network. Where the state owned entity has no retail arm because it is purely a network provider, it would maximise revenue and profitability by maximising access. Its incentive, therefore, would not be to seek to unfairly discriminate against different retail service providers. Consequently, state ownership of non-vertically integrated infrastructure entities in these sectors is not recorded as a proxy of protectionist preferences.

#### 3.8.2.4.3. Possible criticism of state ownership as a measure of preference

The weakness of this factor as a proxy is that some member states may also wish to favour national champions that are not state owned (Arocena:2006 :362-363).<sup>63</sup> This means that using vertically integrated state ownership as a proxy for protectionist preferences will under-record the extent to which protectionist preferences exist. However, if the hypothesis of member state protectionist preferences leading to the selection of national regulatory bodies for the application of positive market integration can be found with an underestimate of observations, this would suggest that the relationship is even stronger.

#### 3.8.2.5. *Measuring the independent variable*

The Organisation for Economic Co-Operation and Development (OECD) maintains a database of sectors in which there is a state holding, although not whether it is vertically integrated or not (Conway and Nicoletti:2006). No other institution holds a record whether public (EU, International Monetary Fund, Worldbank) or private (including the European Centre of Employers and Enterprises providing Public services (CEEP), which represents public enterprises to the EU). Individual member states usually maintain central recordings of their own individual holdings, but this is not always the case. Information has been collected from member states for this thesis and combined with the OECD data in order to put together such a record.<sup>64</sup>

In terms of measuring the independent variable, the original intention had been to set a 25 per cent ownership threshold. This was because this is the level at which it is normally legally considered feasible for a commercial shareholder to be considered to have a material influence over a company.<sup>65</sup> However, research indicated that despite the prohibition under EC law for golden shares, member states have nonetheless sometimes

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<sup>63</sup> Arocena argues that Spanish governments were hostile to competition. They did not intend to fully privatise Telefonica, the Spanish telecommunications incumbent. They sold most of the equity in order to finance Telefonica's expansion into South America but wished to retain a golden share (which they notably used to block KPN, the Dutch operator from buying Telefonica). Telefonica ended up outside formal state control because in a landmark case, the ECJ found the golden share to be illegal.

<sup>64</sup> See Annex 2.

<sup>65</sup> See, for example, the UK Office of Fair Trading merger guidelines (OFT:2003:9).

retained them where they have minority stakes below 25 per cent in companies.<sup>66</sup> Due to the fact that they would generally be considered illegal under EC law,<sup>67</sup> member states do not advertise where low state holdings provide special rights. Consequently, in counting the number of relevant ownerships, all holdings regardless of size are assumed to be relevant to preference formation.

#### 3.8.2.5.1. Alternative measures of protectionism which have been rejected

Alternative proxies that have been considered but discarded are political complexion of parties and the extent of import penetration. The political complexion of governing national parties is not an adequate proxy: both left and right parties may take either a pro-producer or alternatively a pro-consumer anti-monopolist stance. For example, the UK Labour Party strengthened the independence of the UK communications regulator and did not interfere with the regulator's decision to go beyond the 2002 EU Telecommunications Directives and require functional separation of British Telecom. Conversely, the German Christian Democrats have favoured a *regulatory holiday* with respect to Deutsche Telekom's next generation network and passed legislation to give effect to this. This is consistent with Thomson and Stokman's findings with respect to 66 Commission proposals (including 13 internal market proposals) where they found that integration/independence and left/right preferences were a poor predictor of sectoral preferences (Thomson and Stokman:2006:40-41).

Extent of import penetration might potentially be a good measure of the openness of national sectoral markets. However, it cannot be used for some of the key sectoral markets that have been subject to EU market-opening legislation. It cannot be used technically for telecommunications for two reasons.

First, because telecommunications operators are licensed in each individual member state and typically revenues are reported as national revenues even if the holding company is an international one. Second, business service revenues that are sold far more on a cross-

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<sup>66</sup> For example, three member states have retained golden shares in telecommunications (ECTA:2009).

<sup>67</sup> For a discussion of the circumstances when they would be considered legal or illegal see ECJ case C-503/99 Commission versus Belgium. The Commission and Court cannot however require member states to draw down state ownership. Article 295 of the Treaty makes it clear that the member states have sole competence in respect of deciding the forms of property ownership in any sector.

border basis than residential services are ascribed as revenue to the country where the deal is signed. For example, BT's pan-European business revenues are recorded as UK revenue even although the services are supplied in other member states. BT itself cannot apportion business services revenue by country (Interview:2008). It cannot be used for rail or other network utilities because the limited penetration of cross-border service providers can also be a consequence of regulation (or lack of it) in an exporting or transit country rather than the importing country. As a consequence, limited imports would not necessarily indicate domestic protection. For example, one of the most significant barriers to cross-border competition in energy markets is the low available capacity in two-way cross-border connectors (Commission:2006).

### **3.8.3. Hypothesis 2: Commission and Parliamentary influence**

#### *3.8.3.1. Measuring the independent variable: the influence of the Commission and the Parliament*

The influence of the Commission and Parliament may arise due to structural or contingent reasons. These are traced in each case study to see whether they exist. The actual influence can be traced by comparing a range of sources to assess pre-delegation preferences (initial statements and actions of the Commission, initial proposals of the Commission, Parliamentary amendments and rapporteur's reports and final votes of the Parliament, and records of conciliation processes(where available)) with delegation outcomes. Comparison of these recorded preferences with the final legislative outcomes allows for an analysis of the relative influence of the Commission and of Parliament. As with analysis of the Council's preferences, the primary source here is legislative records. In addition, the same experts that were questioned about the Council's preferences have been asked about the Commission and Parliament's.

#### *3.8.3.2. Measuring the dependent variable: power over implementation at European-level*

Whether a supranational regulator has been created is tested by examining which body is attributed effective decision-making power in each legislative iteration in each of the selected case studies. The type of institution that has been accorded primary

responsibility can be identified from the empowering directives and regulations. However, this has to be done carefully. The nature of the powers, the definition of regulatory independence in the sectoral legislation, the voting rules, comitology aspects etc all potentially impact where substantive decision-making power actually lies. A number of authors have noted in studies of EU and US bureaucracy that institutions can be designed to fail (Moe:1991:137; Kelemen: 2002:97; Wilkes:2003:155). We could find that an Agency has been created at EU-level, but the empowering legislation may have been designed to avoid giving it implementing authority in respect of those specific policies where authority would actually be necessary in order to achieve effective implementation. In the latter areas, powers may have been reserved for NRAs alone.

### **3.8.4. Hypothesis 3: the extent to which effective implementation is delivered by Agencies or NRAs**

#### *3.8.4.1. Measuring the independent variable: type of institution*

This is established in each case study as the outcome of legislation.

#### *3.8.4.2. Measuring the dependent variable: effective implementation*

For the purposes of measuring the dependent variable of regulatory variation, the thesis uses scores given by organisations monitoring either national or Agency implementation of the access requirements of the directives.

The scores for rail access and telecommunications were derived by the third-party organisations from in-depth reports of implementation in each of the national regulatory regimes. The scores for rail access come from IBM (IBM:2007) and for

telecommunications from the European Competitive Telecommunications Association (ECTA:2009).<sup>68</sup>

The situation in pharmaceuticals is different since the regime is fully Europeanised to the extent that there is a single decision at European level with immediate operational effect, so regulatory implementation is conducted on an exclusive basis. (Figures on regulatory production there come from the Medicines Agency itself). It is therefore not possible to compare effectiveness within Europe between the Agency and another entity. However, the results can be compared with the figures for clearances that occurred prior to the creation of the Agency when there was a reliance on cooperation between national regulators only in order to achieve mutual recognition.

The situation for rail interoperability is similar, where the regime is fully Europeanised. A comprehensive investigation into the regime took place in 2009 by the Rail Agency itself (ERA:2009).<sup>69</sup>

Rail safety is different again in that there is a mixed regime of EU and national implementation – third-party studies of national implementation to date have only be qualitative and have not applied any scoring of national regimes (NERA:2000). There are no studies yet of the Agency’s effectiveness.

Examining what is actually implemented (or not) by NRAs and Agencies is likely to be a more accurate measure of implementation than some of the measures that have been considered as evidence of implementation. Some authors have suggested that publications by the informal networks of regulators of best practice papers are evidence that networks of independent regulators work towards achieving effective

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<sup>68</sup> I am not aware of any published critique of the IBM report. The IBM report was conducted at Deutsche Bahn’s request. Nonetheless, it is widely treated as the closest there is to a scientific analysis. ECTA is a new entrant organisation but the study is conducted at arm’s length by an economic consultancy and a law firm. As part of the scoring process, the NRAs are able to challenge each of the country records against which scores are awarded. A critique of the ECTA report sponsored by the European Telecommunications Network Operators (ETNO) (the incumbents’ European representative body) can be found at [www.etno.be/Portals/34/Publications/other/Indepen%20Study\\_June%202006.pdf](http://www.etno.be/Portals/34/Publications/other/Indepen%20Study_June%202006.pdf) as at 12.5.2007. Similarly, an ECTA response to the ETNO comment can also be found at [www.ectaportal.com](http://www.ectaportal.com) as of 12.5.2007. However, no ETNO report conducting a detailed country-by-country analysis has been conducted. The ECTA and IBM studies do include institutional elements but the weight of the scores is drawn from aspects of applied regulation.

<sup>69</sup> I am not aware of any critiques of the EMEA or ERA studies of implementation.

implementation (Eberlein and Grande :2005:102). However, the latter is not sufficient to tell us the extent to which they have an impact on what NRAs actually do. The issue is the same as that pointed out in recent research into implementation of EU rules in general: we need to examine application to see whether actual as opposed to paper implementation has occurred (Mastenbroek: 2005: 116, Verluis:2004: 13).

It might be objected that measuring regulatory output is not the correct measure; it does not matter that NRAs are not implementing the same measures as long as they are achieving more or less the same overall results. The regulatory frameworks are designed to prevent the use of market power and so, if they are working in any particular national market, we should find low market power. The traditional proxy for market power is market shares (Gjersam:2004:49). However, one would not want to rely on such a measure alone as an indicator that the company in question is being protected (or not). As a measure, it does not provide information that could be disaggregated to distinguish between incumbents that had high market shares because they were protected and those that had high shares because they were more efficient than new competitors (Boone 2000:549; Tirole:1988) <sup>70</sup>. It could be the case that rather a lot of regulatory protection was necessary for a company to hang on to, say, a 60 per cent market share in one member state, while conversely, intense proactive regulation might produce the same result in another member state because the incumbent was efficient compared to other entrants. This observational equivalence is a recognised phenomenon as far as consideration of reliance on market shares is concerned (Boone:2000:549). Nonetheless, since no measure is likely to be completely probative, there would seem virtue in triangulation. Consequently, where the data is available, statistical analysis of market shares, implementation and state ownership are also conducted in each sector.

The thesis investigates whether the type of institution leads to variation in implementation. The criticism could be made that there will always be variation where there are multiple NRAs and that therefore variation on its own is not an explanation. Consequently, where there are NRAs implementing, the thesis goes a step further and correlates the measure for distributional conflict (state ownership), which will not exist in every member state, with both the measure for effective implementation and with market shares.

### **3.8.5. Cooperation between regulators and relations with ministers**

#### *3.8.5.1. Views of stakeholders on the engagement of ministers in the work of independent regulators*

The main comparative analysis of the independence of European regulators suggests that regulatory outcomes are subject to observational equivalence; they could suggest lack of independence but they could equally be the result of other factors such as constrained resources or lack of knowledge. To look for independence, we need to look at the informal mechanisms that govern the relationships between regulators and politicians (Thatcher:2004:14). Arguably this proposition does not necessarily hold – if it can be shown that there is a statistically relevant relationship between forms of ownership, different forms of regulatory structure and outcomes in terms of effective implementation/market shares and a logical explanation for a causal relationship between them. Nonetheless, there is clearly merit in trying to trace the informal relationships between regulators and politicians. If the hypothesis regarding quantitative outcomes is correct, it should also be supported by any evidence surrounding the relationships between national agents and principals that give rise to those outcomes.

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<sup>70</sup> In theory, it might be possible to look at market share and efficiency together to see where a company has a high market share but is relatively inefficient. This might then indicate protectionism. However, measures of efficiency available for international comparison are problematic. They tend to be based on revenue per employee. Such a comparator may give high productivity figures for de jure or de facto monopoly providers simply because they supply the quasi-totality of the market and monopoly rent raises the profit per employee. For example, Hsiang Chi Tsai et al. find that monopoly suppliers of telecommunications in countries such as China and South Africa are more efficient than any US or European operator, but do not consider the possible biasing effect of market power (Hsiang-Chih et al.:2006). It is highly unlikely that Chinese and South African telecommunications suppliers are efficient in the context of meeting actual demand. Note that multi national corporations buying telecommunications

Consequently, in this thesis, the analysis of implementation in telecommunications and rail is supplemented by interviews with stakeholders from three large EU member states (designated as A, B and C) designed to elicit the extent to which there is perceived to be ministerial influence on the work of regulators. The interviews were semi-structured involving a wide discussion of the national and EU regulatory structure and industry developments relevant to the particular country and sector. However, every single interviewee was asked identical core questions from the same list. In pharmaceuticals, interviews were not conducted with as wide a range of stakeholders as interviews with industry associations and regulators recorded that there were no concerns or indeed any interest in the issue of independence because there was no perceived conflict of interest.

From each country for rail and telecoms, an individual engaged in the application of the EU regulation in the sector from each of four types of entity was interviewed. These entities were the NRAs, the relevant ministry, the regulated incumbent and a new entrant seeking access from the incumbent. A concern prior to conducting the interviews was that interviewees from official institutions might only wish to stick to an official discourse, particularly in the utility sectors where the issue of regulatory independence is a controversial issue. Therefore, it seemed prudent to also ask the *users* of regulation as well as the *suppliers* as to their experiences. These types of stakeholders were those which Coen et al. interviewed for the purposes of triangulation when examining Anglo-German regulatory regimes (Coen et al.:2002:3).

The set of questions contained in Annex 4 were asked of each interviewee<sup>71</sup>. They were designed to ascertain whether ministries were motivated by ownership interests and the extent to which they engaged with the regulator up to and including instructing the regulator to take particular decisions. Interviewees were also asked an indirect question regarding whether state-owned operators lobbied the ministries to affect outcome on regulated access. If the latter did so, it would tend to indicate that they believed that it was worthwhile. The purpose of asking the question was to try and check whether the

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services only consider that they obtain the products they need in the US and parts of the EU (Indepen:2008:23).

<sup>71</sup> The results are recorded in Annexes Five (telecoms), Six (rail) and Seven (pharmaceuticals).

direct question regarding relationships between ministries and regulators simply prompted a response shaped by official discourse.

3.8.5.2. *Supporting research: views of regulatory officials participating in regulatory networks on whether the conditions for deliberative supranationalism hold.*

A second set of questions was reserved for participants in regulatory networks<sup>72</sup>. This was designed to test arguments advanced by some theorists of deliberative supranationalism; they have argued that informal cooperation through networks of national regulators meets the functional need for effective European-level regulation. Eberlein and Grande agree that member states do not want to transfer supranational decision-making in the utilities to the Commission. However, their view is that this is driven by a general bias against the transfer of sovereignty. The implicit assumption is presumably that member states either view it occurring by the “back road” benignly, are indifferent, or cannot halt it because NRAs are independent (Eberlein and Grande:2005:91). If these theories were validated, it would suggest that any patterns discernible in implementation outcomes were accidental and not the intended consequence of institutional design.

The questions were designed to ascertain if each of the theoretical bases advanced by Eberlein and Grande for the operation of deliberative supranationalism actually hold in practice. They argue: (i) networks achieve regulatory transparency and give their members informational advantages over purely national officials; (ii) regulatory officials participating in networks are socialised into networks and this causes them to prioritise their obligations to other participants over their relations with other domestic civil servants (a proposition tested by asking whether this is the case directly, and by asking the likely next job for network participants); (iii) participation in networks requires credible commitments and partly as a function of this and partly as a function of (ii) above, participants feel morally compelled to implement decisions of the network; and (iv) failure to observe credible commitments can lead to exclusion. (Eberlein and Grande:2005:103-4).

A full set of NRA representatives were interviewed from countries A, B and C for rail and telecoms. However, despite repeated requests, it was not possible to obtain participation from the pharmaceutical agencies in countries A and B. Country C participated and a representative from country D was also interviewed.

### **3.9. Conclusion**

The three hypotheses pursued in this thesis are mutually coherent. The first suggests that where at least a blocking minority of member states have a conflicted position regarding ownership and Commission market opening regulation would apply to the owned entities that member states are collectively loath to transfer regulatory authority to a European body. The second hypothesis suggests that European bodies may nonetheless be empowered to the extent that the Commission and the Parliament have agenda setting or negotiating power during the legislative process. The third hypothesis suggests that the degree of regulatory harmonisation varies to the extent to which the regulatory process is effectively Europeanised through giving an Agency and/or the Commission hierarchical regulatory authority.

#### **3.9.1. Hypotheses restated**

The findings with respect to each of these hypotheses, are set out after each legislative round examined in the case studies. This will not apply to Hypothesis 3 as the relevant data to test this hypothesis is not derived from the act of delegation but from post-delegation outcomes. Hypothesis 3 will be examined in a separate section in each case study.

#### **3.9.2. Hypothesis 1**

*The greater the distributional conflict in a policy area, the less likely the Council is to wish to delegate authority for implementation of regulatory rules to autonomous European level regulatory bodies, either an Agency or the Commission, and the more*

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<sup>72</sup> Op cit, footnote 71.

*likely it is to prefer to delegate to NRAs; and vice versa when distributional conflict is low.*

### **3.9.3. Hypothesis 2**

*The greater the influence of the Commission and Parliament in the politics of bureaucratic design in a particular sector, the more likely that a supranational regulator (either the Commission alone or in conjunction with an EU Agency) will be tasked with the implementation of regulatory rules; and vice-versa.*

### **3.9.4. Hypothesis 3**

*EU Agencies will typically lead to more effective implementation than institutional designs that rely only on the activities of NRAs.*

The alternative hypotheses:

### **3.9.5. Hypothesis 4**

*The Council will decline to empower Agencies to undertake implementation for constitutional reasons.*

### **3.9.6. Hypothesis 5**

*The Council does not have strong preferences with respect to the selection of either NRAs or Agencies because NRAs in networks are the functional equivalent of Agencies.*

### **3.9.7. Hypothesis 6**

*The Commission does not have a strong preference for Agencies over NRAs because it can regulate utility sectors using competition law.*

## **4. Chapter 4: Telecommunications network access and institutions**

### **4.1. Introduction**

Telecommunications is the appropriate utility industry to commence the case studies of the EU design of regulatory institutions for the utilities because it was the first of the utility sectors that the Commission tackled, and institutional outcomes here influenced negotiating stances in other sectors. Paragraph 4.2 sets out the reasons why competition law is inadequate and sector specific regulation is required in this sector in order to deliver a single market. Hypothesis 6 is partly dealt with in paragraph 4.2. Paragraph 4.3 examines the extent to which there is distributive conflict in the sector and in particular the degree of state ownership. Paragraph 4.4 examines the institutional proposals and outcomes in EU legislative processes in detail. This section provides empirical data with respect to hypotheses 1 to 6 (except 3).<sup>73</sup> Paragraph 4.5 contains a test of hypothesis 3 and examines the extent to which NRAs have delivered effective implementation. It also examines the current nature of cooperation between regulators and also the perceived interaction between regulators and national ministries and provides empirical data as to the perceptions of stakeholders as to the nature of the institutional relationships.

### **4.2. The need for regulation and harmonisation**

#### **4.2.1. The need for regulation**

Telecommunications regulation can in principle relate to the promotion of any public policy objectives which are achieved by government direction to telecommunications operators. However, this thesis focuses on the aspect of regulation that is key to promoting competition in newly liberalised telecommunications markets. This is the requirement on regulators to ensure that new competitors to the incumbent operators have access to the non-replicable underlying network components over which services such as voice telephony and data services are supplied to customers.

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<sup>73</sup> The detailed legislative preferences of each EU legislator and the outcomes are summarised in table form in Annex Eight.

In order for the new entrants to be able to compete, they must have access to these network components at the same cost, same time and at the same quality of service as the incumbent makes them available to its own retail service arm. Obtaining such services is known as access or *interconnection*, since the incumbent network element purchased by the new entrant is connected to the new entrant network. Such access is justified on the basis that it is economically infeasible for a new entrant to replicate the entire incumbent infrastructure. Some elements of the network may be replicable over time as the entrant gains scale but the local loop or *last mile* which connects premises to points of concentration is generally a natural monopoly. In the absence of constraint, it is irrational for a profit-maximising de facto monopolist to supply monopoly network elements under terms and conditions that allow for competitors to survive (Cave and Crandall:2001:49). Consequently, a regulator is required to police these terms and conditions, and, hence, determine whether competition can actually take place.

#### **4.2.2. The content of regulation**

Interconnection on an equal basis has been pursued by requiring observance of four general principles, described as regulatory requirements in the first interconnection directive and then as remedies in the succeeding directives. These four principles are non-discrimination, transparency, cost-orientation and accounting separation. The three latter principles are, in fact, supporting principles without which the first is unlikely to be achieved. These principles are designed to overcome the incentive to discriminate caused by vertical integration. These principles are fleshed out below in more detail since they are not applicable only to telecommunications but to all the network industries.<sup>74</sup> Vertical integration could also have been dealt with by structurally separating the incumbent operators but policymakers feared that this might weaken national operators vis-à-vis their international competitors (Thatcher:2001:566).

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<sup>74</sup> Setting out a degree of detail with respect to the principles also makes it possible to see why the requirement in the second and third iterations of EC legislation for NRAs to apply at least one remedy (i.e. principle) where there is market power provides an ability for NRAs to defect from the system. Where NRAs wish to defect in a particular market, they can adopt strategies such as imposing a single requirement which becomes inoperable in practice without the others.

#### *4.2.2.1. Non-discrimination*

The incumbent is required to offer interconnect products on a non-discriminatory basis. This means that when a vertically integrated incumbent provides wholesale carriage of telecommunications services to its retail arms, it must do so on the same terms and conditions as it supplies this to other operators. In principle, this means that there is a level playing field for competition at the retail level (Tarrant:2003:275).

#### *4.2.2.2. Transparency*

Transparency is necessary with respect to pricing and with respect to the quality of products provided. This requirement allows competing operators to ensure that the principle of non-discrimination is being observed. Price transparency at the wholesale level permits new entrants to monitor whether incumbent retail services being provided to end-user customers at a price below that being charged for access and interconnection. Transparency of terms and conditions allows stakeholders to verify that the monopoly wholesale provider makes wholesale products available on the same quality basis (for example, broadband speeds or repair times) to others as it does to its retail arm (Tarrant:2003:275).

#### *4.2.2.3. Cost-orientation*

However, because the incumbents are vertically integrated, they have every incentive to allocate the proper costs of the retail arm to their wholesale operations. This can give rise to a price squeeze. It may not matter to the incumbent whether profit is made at the wholesale level or at the retail level. Incumbent retail losses could be recouped at the wholesale level and this would force the new entrant to also offer retail prices below the input prices (i.e. interconnection) charged to it by the incumbent in order to compete at the retail level. Consequently, it is vital that the actual cost of wholesale inputs is assessed so that they cannot be excessively priced (Tarrant:2003:275).

#### *4.2.2.4. Accounting separation*

The only way of ascertaining whether costs are being allocated correctly to wholesale and retail products is for accounting separation to be undertaken. The name itself indicates what is required, the incumbent's costs are split between its wholesale and retail

activities. Many of the activities of a vertically integrated incumbent cross this divide. For example, salespeople can be engaged in selling interconnect products and selling retail products. Likewise, engineers can be engaged in the repair of interconnect products and supporting retail customers. The costs derived from these activities are usually described as *joint and common costs*. NRAs are required by the directives to work up a model indicating how such costs should be split and must then ensure that the incumbents apply them in the construction of their separated accounts (Tarrant:2003:275).

#### 4.2.2.5. *The technical inadequacy of competition law*

Competition law cases could also potentially be used to impose sanctions for excessive pricing of interconnection products and refusal to supply (although a refusal to observe transparency or to undertake accounting separation would not be competition law abuses in themselves).<sup>75</sup> However, the weakness of competition law as a means of controlling incumbents, is that it operates as an *ex post* control of a particular piece of behaviour. This means that it only takes effect once an abuse has occurred, a complaint has been generated and a sanction has been applied. At the least, this creates extended market uncertainty and, at worst, the elimination of the competitor before an investigation is concluded. Furthermore, competition law sanctions specific breaches relating to an individual product. Due to the multiple pricing and technical possibilities, telecommunications products can be altered to regain an unfair advantage without necessarily being caught by a previous ruling. The potential abuse then has to be re-examined before a further competition law remedy can be ordered. The problem is magnified by the large range of network elements that a new European entrant needs in each country in which it operates in order to compete, approximately 70 different types in each member state (Tarrant:2005:11). In principle, under sector-specific telecommunications regulation, the situation is different; the incumbent has to offer a full catalogue of products and their terms and conditions on an annual basis and these are verified on an *ex ante* basis. Competition authorities and courts also find it extremely

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<sup>75</sup> Commission (1998c).

difficult to deal with pricing issues in telecommunications.<sup>76</sup> This is because a decision as to fair pricing will require a selected cost basis and separated accounts prepared in accordance with such a cost basis. Undertaking such an exercise even where a NRA has already made the policy decisions necessary in order to draw up an attribution methodology and to select a cost base is time consuming (taking at least a year) (Tarrant:2005:12). Telecommunications competition law cases have foundered because of the absence of any underlying cost information.<sup>77</sup> A large consensus has developed that competition law is not the solution in these circumstances and there is at least an interim need for sector specific regulation.<sup>78</sup> This was one of the conclusions of the European Competition Law annual conference at the Robert Schuman Centre at the European University Institute dedicated to telecommunications in 1998,<sup>79</sup> and directed by Klaus-Dieter Ehlermann, former Director-General of DG Competition and of the Commission Legal Services. Competition Commissioners have made the same argument.<sup>80</sup> The requirement for ex ante decisions and the complexity of the underlying economic, technical and policy issues means that substantial ongoing surveillance is needed; requiring regulation rather than competition law.

This finding partly falsifies hypothesis 6 since it demonstrates that competition law is inadequate. However, satisfying hypothesis 6 requires it to be shown that the Commission knew and accepted this. As we shall see, this was the case.

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<sup>76</sup> New Zealand was the only OECD country that decided not to create sector specific regulation. In 1990, the newly licensed Clear Communications challenged Telecom NZ's interconnect pricing. The dispute took six years to be resolved in the courts. Each level of appeal took different decisions on the appropriate cost principles. The final decision, bizarrely, held that interconnection prices should compensate Telecom NZ's for lost retail monopoly profit (Tye and Lapeurta:1996:422). The resulting impoverished level of competition with comparatively high prices to consumers and very low take up of broadband eventually led New Zealand to adopt sector specific regulation in 2001.

<sup>77</sup> For example, the three-year investigation by the Commission into KPN's (the Dutch incumbent) mobile termination costs was never completed. One of the difficulties that DG Competition faced was the absence of any useable accounting information. Para 97 of the draft Statement of Objections of 2003 recorded: "In response to the Commission's repeated requests for information on the relationship between price and costs in this case, KPN NV has claimed it is unable to provide cost data for its mobile retail and wholesale services and cannot relate its prices for these services to specific underlying costs" (Commission: 2002a).

<sup>78</sup> A total of three Article 82 cases have been successfully mounted in telecommunications by DG Competition since 1998 and they relied on information generated by regulatory accounting.

<sup>79</sup> Ehlermann, C. (2000:xxxix).

<sup>80</sup> For example, Monti stated in a speech in 2003: "I would like to introduce you to the main features of the new regulatory framework by stressing that, despite liberalisation and the availability of competition law instruments, we have not yet reached market conditions in the electronic communications sector which would allow ex ante regulation to be abandoned" (Commission:2003:1).

### **4.2.3. The need for effective multilateral implementation**

In general, effective multilateral implementation facilitates cross-border competition between telecommunications companies such that the more efficient companies should prevail generating greater consumer surplus. Effective implementation of interconnection regulation is also specifically desirable because it permits the putting together of pan-European retail products. This is particularly important for Europe's growing numbers of cross-border companies in all sectors for whom telecommunications networks provide the bearer capacity for their IT *nervous systems* (Indepen:2007:7; European Commission:2006). Such products can only be put together efficiently by aggregating inputs from multiple national providers at the wholesale layer.

### **4.3. Distributional conflict**

Ministers face a number of competing distributional claims in this sector, which mean that effective implementation of EU rules may not be their priority. These claims include low prices for residential consumers; widespread availability of services; low prices for intensive use of capacity by business users; high employment for employees of national champions; high returns for shareholders (which may include the state itself); and a desire for inward investment from foreign telecommunications companies. However, in many cases they face a situation of conflict of interest when attempting to resolve tensions between these objectives because they are not only the potential rule-makers but are also owners of the regulated companies and often direct employers of the workforce who have retained civil service status.<sup>81</sup>

Although the number of countries with a state owned operator has reduced, telecommunications remains a sector with a high degree of state ownership. During the first legislative round the vast majority of the main fixed national fixed-line operators were state owned. In the most recent round more than half were still owned by the state. Table 4.1 shows state ownership and the proportion of votes held in Council by countries with state ownership.

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<sup>81</sup> For example, the French legislation which permitted the sale of equity in France Telecom, maintained the civil service status of France Telecom employees at the time of privatisation. In 2004, 86 per cent of France Telecom's employees were civil servants (OECD:2004:167). Similarly, 33 per cent of Deutsche Telekom's employees had civil servant status in 2005 (Computer Business Review:2005)

**Table 4.1: state ownership and proportion of votes held by member states with state owned telecoms companies [headings and tables need to be together]**

Telecommunications	No of vertically integrated (VI) incumbents with state ownership > 25%	Weights in Council by countries with state ownership	Proportion of total votes in Council
1998	11	69	78%
2002	16	54	61%
2009	14	178	55%

Source for state ownership: Conway and Nicoletti:2006; Tarrant and Cadman:2009.

Source for voting weights: Wiberg (2005)

There has been a degree of cross-border acquisition. However, the non-domestic operations of incumbents within the EU constitute a relatively insignificant part of their business. The Commission puts the figure at between 5 and 27 per cent of turnover (Commission:2008:2).<sup>82</sup> Industry participants would put it at between three and ten per cent in 2010 (Interviews:2010) and the higher ten per cent figure would only be relevant for a small minority of companies.<sup>83</sup> For most incumbent operators, a pan-European

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<sup>82</sup> Commission (2008:2)

<sup>83</sup> In any event, much of the external merger activity has focused on the acquisition of similar monopoly holding businesses which continue to focus on their national businesses. Deutsche Telekom, for example, buying into national fixed line incumbents in Greece, Hungary, Slovakia and Slovenia. Telefonica of Spain buying the Czech national company and Telecom Italia. France Telecom has bought the Polish national operator. However, France Telecom has a more mixed strategy and has also set up or bought companies to compete head-to-head with national operators in other member states. British Telecom and Teledenmark have pursued a strategy of only setting up operations or purchasing smaller entities to compete with the incumbent national operator.

level-playing field and consequent market share gains in *host* markets would not, at least from a static perspective, compensate for any resulting tightening of regulation in their *home* market and loss of revenue there.

State share holdings have been significant state assets. Annual profits have made large contributions to state income. For example, dividends in May 2009 from Deutsche Telekom were worth US\$1 billion to the German State (Spiegel:2009). The telecom companies also tend, with other utilities, to be amongst the largest corporate employers in any member state,<sup>84</sup> and their workforces also tend to be highly unionised.<sup>85</sup> Illustrative of the distributional conflict is the lobbying positions taken by associations representing the different functional groups on the Commission's 2006 review proposals, which included a number of institutional modifications which would have opened the market up to greater competition, including the transfer of effective control over implementation to an Agency and the Commission. The international association representing telecommunications trade unions issued a joint press release with the association representing telecommunications incumbents opposing the Commission's 2006 Review proposals (UNI and ETNO:2007). Conversely, the association of multi-national business users of telecommunications were supportive of the Commission's proposals,<sup>86</sup> and worked closely with the new entrant association, ECTA (Interviews:2008).

State-owned companies could also be of use because they can be directed by the state to undertake activities that a fully private company might refuse or would only pursue if compelled. They can potentially be required to purchase equipment from other national

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<sup>84</sup> DT had 160,000 employees in 2009 (Spiegel:2009). France Telecom had 216,000 in 2003 of whom 126,000 were employed in France (The Register:2004).

<sup>85</sup> Approximately 70 per cent of Deutsche Telekom's employees were unionized in 2003 (RIETE:2003:21) 25 per cent of France Telecommunications were unionised in 2003 (Moreau:2003:34).

<sup>86</sup> INTUG making very clear their specific institutional preferences for an Agency over a network of regulators (2007:4).

companies or to maintain levels of employment or employment in particular areas.<sup>87</sup> They are also a source of patronage for governments.<sup>88</sup>

A competitive playing field in the EU could potentially mean that the industry would look quite different from the way it does today. Rather than principally comprising of separate vertically integrated entities operating in 27 national markets, there would probably be a greater degree of national vertical disaggregation and of cross-border horizontal integration both at the network and service layers.<sup>89</sup> However, this would potentially mean the reduction in size and scope and, in many cases, the disappearance of companies that are currently perceived as integrated national champions.

Participants in the sector are highly aware that there is a potential tension between government ownership in the sector and the apparent agreed European policy of pro-competition regulation. Spokespeople of potentially conflicted governments publicly deny that there is any bias, while other political actors take a different view. To give three examples:

The German Ambassador to the United States gave a speech in 2005 on clearing up misperceptions about the German telecommunications market: “Misperception number one: the German telecom market is the protected playground of Deutsche Telekom” (German Foreign Office:2005).

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<sup>87</sup> During the 2005 German Federal Elections, Deutsche Telekom threatened that absent a regulatory holiday that it would have to lower investment in Germany and consequently reduce its German workforce. The two main parties then competed to offer a regulatory holiday which was eventually incorporated as a new Article 9a of the Telekommunikationsgesetz. This had the effect that DT’s new fibre access network was unregulated for five years, and therefore not available to competitors on a wholesale basis, and gave DT a substantial first mover advantage. The German Economics Ministry argued that the absence of regulation was compliant with EU rules (EU Business Week:2007). The ECJ decided that it was not in December 2009.

<sup>88</sup> For example, President Sarkozy’s appointment of a long-standing friend and adviser, Stephane Richards, as number two at France Telecom, with the apparent understanding that he will run the company from 2011. The announcement was made by government press spokespeople rather than as a result of normal company processes (Interviews 2009). A former adviser in the French telecommunications ministry cabinet when asked why the French government did not complete the privatisation of France Telecom, replied that the potential receipts for the remaining share holding were not sufficiently large to afford a government such freedom of action elsewhere that they outweighed the cost of no longer being able to call in favours from France Telecom (Interview: 2009).

<sup>89</sup> The economic consultancy, Indepen considers that absent national protectionist measures that there might be a restructuring with national or sub-national network operators running access networks and the number of market players at the retail level reducing to pan-European or global service providers like Google, IBM and some of the bigger national telecommunications operators (Indepen:2008:16).

In a speech to the CEOs of incumbents in 2008, Commissioner Reding identified continued state ownership as an issue in telecommunications and added:

“So if there is no technological or business need for fragmentation of our single European market in the telecommunications field, only one possibility remains: *it is a deliberate policy choice* [emphasis in original]. A choice of telecommunications ministers to have not one but 27 telecommunications markets. Are you as Europe’s telecommunications incumbents really sure that you want to continue to support this policy choice? I know that it may be convenient, in the short term, to enjoy the protection of national rules and regulations. In some cases, a weak national regulator, willing to listen a lot to the national government and to the incumbent and prepared to ignore regulatory developments in neighbouring countries, may be a wonderful thing to have. Perhaps, this will allow you for some time to keep competition from abroad at bay. And to prolong badly needed transformation and modernisation processes a bit longer. But is regulatory fragmentation and national protectionism really in the long term interest of Europe’s telecommunications incumbents?” (Reding:2008:5).

Telecom.com reports the telecommunications technical consultants, Ovum, commenting on the need for an Agency: “Ovum analyst, Matthew Howett, said the creation of the ETMA [the Commission proposal for an Agency] would ensure the independence of national regulation, which in some countries faced too much political intervention from governments” (Telecom.com:2007).

Contrary to the assumptions of Majone, and other authors, discussed in the literature review, the majority of member states have continued to retain controlling shareholdings in their telecommunications operators. There is a widespread belief that this gives rise to a conflict of interest in regulatory arrangements.

## **4.4. Legislative developments**

### **4.4.1. Introduction**

There have been three occasions so far when the European legislative bodies have had to jointly consider which institutions should be empowered to implement pro-competitive access regulation in telecommunications in the EU. These acts of delegation are recorded in 50 legislative documents, which have been reviewed for this chapter. Despite attempts

in each round to increase substantive hierarchical power over implementation at the supranational level, the Commission and Parliament have fallen short of their objectives. There has been some increase in the number of formal powers; however, so far they have either been targeted at issues of subsidiary importance or have been made subject to procedures that are likely to render them ineffective.

Some authors have suggested that the disputes over institutions were derived from general constitutional power struggles and have been divorced from the content of the regulatory policy itself (Thatcher:2001:559; Franchino:2007: 222; Levi-Faur:1999:189). Franchino notes in his case study on telecommunications:

“Scholars have tended to argue that member states broadly shared, with minor exceptions, the substance, principals and direction of the policy. Therefore, as expected, these directives were only modestly constraining for national administrations, though they conferred some powers on the Commission.” Franchino:2007:222)

However, the regulatory objectives and principles contained in the directives are deliberately general and ambiguous. In so far as the European framework is concerned, implementation of these principles and objectives has been reserved to the discretion of NRAs and the nature of the institutions selected and the rules that surround them has limited the extent of the Commission’s involvement. This has allowed each member state to decide how much competition there will be in domestic telecommunications markets. An Agency has been created in the latest legislative package. It might be tempting to view this as the culmination of an evolutionary trend towards more effective regulation.<sup>90</sup>

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<sup>90</sup> A certain amount of spinning by Commission press officials occurred at the conclusion of negotiations, which potentially misled the press. See, for example, the following quote from Euractiv: “The EU executive obtained stronger powers to counter national decisions which could hamper the consistency of the EU internal market. So far, Brussels has been firing blanks by imposing its views by means of non-legally binding recommendations. With the new rules in place, the Commission will keep on issuing recommendations. But its power will be strengthened by the possibility to issue legally-binding decisions in the event that recommendations are not applied after two year a Commission official told journalists. National diplomats confirmed the introduction of the new legal instrument, but played down the significance of the situations in which the Commission will be able to use its new powers. Commission officials, meanwhile, insisted that its competences concern highly-sensitive subjects for telecommunications operators, such as mobile termination rates or optical fibre deployment” (Euractiv 2009).

The reality, if one examines the role of the Agency carefully, is that both it and the Commission are excluded from making decisions with respect to the core of telecommunications access regulation.

The outcome of non-Europeanised implementation has been a product of the fact that agreeing on a European policy for harmonisation requires support of both member states that wish to promote competition and others that are more concerned to support their national state-owned incumbent operator. In the first two legislative rounds, member states that had a conflict of interest (i.e. they owned the entity to be regulated) formed a very large majority. Pro-competition member states did not want harmonised regulatory decisions because they would necessarily reflect a majority view and would potentially undermine the efforts of the pro-competition member states to regulate effectively in their home markets. Protectionist member states feared that a dynamic of privatisation could lead to them eventually occupying a minority position with majority decisions then opening up their home markets to a greater extent than they preferred. Consequently, rather than being distinct from policy concerns, constitutional struggles have in fact been a surrogate for how those general principles and objectives would be deployed; operationalisation would depend on which institutions actually acquired hierarchical direction of regulatory policy.

In order to understand the rationale for the first round of joint legislation, it is necessary to actually begin with the Commission's activities prior to Council and Parliament legislation. In this context, it becomes clearer why member states agreed to set up a regulatory framework ostensibly designed to create competition in telecommunications without creating rules and institutions that would necessarily require that outcome in each member state.

#### **4.4.2. Pre-1998: Commission agenda setting**

##### *4.4.2.1. Introduction*

Pollack has described how the Commission has the capacity to exercise both an informal and formal agenda setting role (Pollack:1997:121). As a number of authors have found, developments prior to 1998 demonstrate the Commission's ability to informally influence member states through advocating a particular policy direction

(Sandholz:1998:148; Schneider:2001:60). As the literature also shows, the Commission used its formal agenda-setting role to innovate in the competition law domain. Indeed, for some authors it is the textbook case of the Commission exploiting its formal agenda-setting role to escape from its principals' controls (Sandholz and Sweet:1998:153). Thatcher has challenged this account and argued that the content of the directives adopted after 1998 show that the Commission could only proceed where the member state principals agreed (Thatcher:2001). However, where I disagree with his analysis is not with his argument that member state principals did have control over the development of regulation but rather in his categorisation of the directives as representing an agreement on regulatory content which can be separated from an agreement on institutions designed to deliver implementation (Thatcher:2001:559). Thatcher's analysis did not identify the regulatory threat incorporated in the Commission's own-initiative Full Competition Directive and which forced the member states to legislate in order to contain attempts at competition law innovation.

#### 4.4.2.2. *Pre-1998 developments*

##### 4.4.2.2.1. Early developments

Telecommunications was not a sector that was specifically identified as coming within Community competence in the EC Treaty. In the 1950s telecommunications was a de jure monopoly in virtually every country in the world and, in the vast majority, the sector was occupied by a state-owned entity. It was only in the 1980s, beginning in the US, that the sector began to be liberalised. The first EC member state to liberalise was the UK, which set up a duopoly in 1984 and moved to a fully open domestic market in 1991.

The Commission began advocating liberalisation and re-regulation in the early 1980s,<sup>91</sup> and in 1987 published an influential green paper. The green paper argued that the monopolies of the state-owned operators should be reduced to the minimum necessary to fund their public service mission (and it was accepted at this stage that this meant that voice telephony and infrastructure provision should remain a monopoly). The Commission argued that high telecommunications costs to businesses and in particular

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<sup>91</sup> Although DG Information Society itself was not created until 1986.

high cross-border charges had the effect of undermining the single market and putting European multi-nationals at a disadvantage to their Japanese and US competitors (Commission:1987). The latter were benefiting from liberalisation processes commenced earlier in the 1980s.

Commission attempts to galvanise action by the Council of Ministers were unsuccessful, although all the academic analysis agrees that the Commission was important in fuelling the advocates of domestic change in France and Germany. Schneider, for example, although he sees telecommunications reform as part of a global movement, nonetheless recognises that “a major driving force in Europe was the missionary impetus for liberalisation and privatization on the part of the European Commission” (Schneider:2001:60; Sandholz:1998:161-162; Schmidt:1999: 247; Thatcher:2007:200).

#### 4.4.2.2.2. Commission innovation and own-initiative legislation

The Commission’s response to the inactivity of the member states was to issue a series of Article 86(ex 90) Directives, beginning in 1988, based on its competition law powers under the EC Treaty.<sup>92</sup> These unilaterally required the member states to open a series of telecommunications markets. France, supported by a number of other member states, appealed the first two directives regarding, respectively, the liberalisation of terminal equipment (for example, handsets and fax machines) and the liberalisation of data services to the European Court of Justice on the basis that the Commission was overstepping its powers. The Court’s approval of the Commission innovative use of Article 86 has been cited as evidence of the ECJ’s non contingent support for the expansion of Commission competences in a way that was unanticipated by the member state principals (Schmidt:1999:244; Sandholz:1998:163).

Other studies have highlighted that only a small number of member states took part in the appeal (and that one of the member states appealing, Germany, was signalling that while it was hostile to the means chosen it was actually in favour of the policy in the

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<sup>92</sup> Article 86(2) states that national monopolies must comply with the competition rules unless that would compromise their ability to conduct their public service mission. Article 86(3) gives the Commission the ability to issue its own directives without further authorisation in order to ensure compliance with Article 86.

telecommunications sector).<sup>93</sup> However, a political compromise was reached in 1989: the Council would not appeal further liberalisation directives as long as liberalisation was matched by reregulation under Council and European Parliament directives which would be initiated by the Commission (Thatcher:2001:568). This re-regulation granted the powers of implementation to NRAs. As legal scholars Nihoul and Rodford note: “As they [the member states] did not win the judicial debate against the Commission, the member states decided to adopt measures of their own. Their intention was to regulate the market themselves” (Nihoul and Rodford:2004:37).

Further Article 86 Directives were adopted and gradually extended deeper into the network, requiring the liberalisation of mobile services, cable services, satellite services and ultimately, in 1996, the liberalisation of voice telephony (where, at the time, the vast bulk of revenues were earned)<sup>94</sup> and the underlying fixed network infrastructure.

#### 4.4.2.2.3. Further Commission innovation: own-initiative legislation to give the Commission regulatory powers

The Article 86 (ex 90) liberalisation directives opened the market. This meant that the opened market would be subject to the general competition rules and in particular Article 82, which deals with abuse of a dominant position. However, for the reasons discussed in the previous section on competition law in the sector,<sup>95</sup> the Commission could not rely on its own competition law powers under Article 82 alone to effectively regulate the sector. And, even if competition law had, hypothetically, been adequate, it is also the case that the Commission simply did not have the resources to act as Europe’s telecommunications’ regulator. There were perhaps 40 case officers available in DG Information Society and probably less than 20 in DG Competition (Kiessling and Blondeel:1998:592). This compares with the more than a 1,000 directly employed on economic regulatory issues in the regulators of ten member states surveyed by ECTA in 2003 (this total does not include national officials in national competition authorities working on telecommunications issues) (ECTA:2004).

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<sup>93</sup> Belgium, France, Greece and Italy with respect to both directives and with Germany with respect to the terminal equipment directive (Schneider (2001:63).

<sup>94</sup> 85 per cent of revenues on average (Thatcher:2001:566).

<sup>95</sup> See 132 above.

Consequently, the Commission was aware that competition required more than just liberalisation.<sup>96</sup> However, their steps to address this indicate the limits of the Commission's formal agenda-setting powers. The 1996 Commission own-initiative Article 86 Full Competition Directive moved beyond a requirement for the simple lifting of monopoly requirements and included articles imposing ex ante regulatory requirements for the interconnection of new entrant and incumbent networks.<sup>97</sup> DG Competition officials justified this with innovative use of legal doctrine, arguing that the Article 86 Directives (market opening directives) would have no effect in practice without accompanying regulatory requirements such as accounting separation. They proposed that the *principle of effectiveness* be applied to this situation.

*Effectiveness* was a legal principle that had been developed by the Court to require that member state procedures (administrative or legal) did not render the exercise of rights conferred by Community law excessively difficult or impossible.<sup>98</sup> However, this had been limited to requiring amendment of national legal procedure only. It was a huge step to attempt to extend this to including a right to adopt further Commission legislation because it was needed to ensure that a first piece of Commission legislation was effective.

#### 4.4.2.2.4. Council counter-reaction

The Council apparently collectively threatened a further round of court appeals in response to the Full Liberalisation Directive, as member states did not want DG Competition to be setting regulatory conditions that applied to the incumbents.<sup>99</sup> (Tarrant:2005:16). From the Council's perspective, presumably it would also have represented an alarmingly wide attempt to extend the principle in *Peterbroeck* and with

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<sup>96</sup> Herbert Ungerer, the author of the 1987 Green Paper and a member of the DG Competition Telecommunications Unit, for example, recognised this in a speech in 1996: "The *big bang* lifting of restrictions on the provision of public networks and voice telephony is set for January 1 1998. This is a great step forward indeed, but meaningless without the concomitant regulatory preparation in terms of licensing procedures, interconnection regime" Ungerer (1996).

<sup>97</sup> Article 4(a)-(d) Commission (1996)

<sup>98</sup> A summary of the case law is found in the *Peterbroeck* (1995) at para. 12 . Case C-312/93 *Peterbroeck, Van Campenhout SCS & Cie v. Belgian State* [1995] ECR I-4599.

potential to act as a precedent for other sectors. They were, however, prepared to agree further Open Network Provision (ONP) Directives that would cover the same issues, but where the responsible institutions would be NRAs. According to interviews with officials in Tarrant, the Commission went ahead with this *deal* and initiated further ONP legislation because it thought that it was unlikely to win if the dispute went to the ECJ (Tarrant:2005:16).

The Commission's Legal Services were apparently advising that while the Commission had the ability to use the Article 86 competition powers to issue directives requiring that monopolies be abolished on the basis that a monopoly was not necessary for the companies to deliver public service requirements, it did not have the power to set in place ex-ante regulatory conditions in order to render the market opening effective (Ibid ). The latter could only be only be constructed as Article 95 Directives,<sup>100</sup> since the issue was regulation of the internal market, which required a qualified majority vote in Council and co-decision by the Parliament.

However, the member states also did not appeal the Full Competition Directive, presumably because there was a risk in doing so that the Court might back the Commission,<sup>101</sup> and the Council would then have to engage in the costs of attempting to rein in the Court at the next intergovernmental conference if it wished to reassert control (including finding unanimity in the Council). Given the lack of resources available to the Commission, the Article of the Full Competition Directive which requires interconnection rules was to an extent a bluff to encourage the Member States to pass ONP legislation including the regulatory principles of non-discrimination, transparency,

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<sup>99</sup> If sector-specific regulation became a sui generis sub-category of competition law then DG Competition had the direct ability through its general powers to enforce competition law to require compliance by individual companies and to fine abuses at the conclusion of administrative proceedings or potentially to require structural separation.

<sup>100</sup> Article 95 of the Treaty allows for the adoption of measures "for the approximation of the provisions laid down by law, regulation or administrative action in member states which have as their object the establishment and functioning of the single market."

cost orientation and accounting separation. The text of the Commission Article 86 (ex 90) Directive in effect offered repeal of the regulatory section if the Council passed a directive that covered the same area. Article 4(a) (5) states:

“The measures provided for in paragraphs 1 to 4 [requiring interconnection] shall apply for a period of 5 years from the date of the effective abolition of special and exclusive rights [i.e. a monopoly] for the provision of voice telephony granted to the telecommunications organisation. The Commission shall, however, review this Article if the European Parliament and the Council adopt a Directive harmonising interconnection conditions before the end of this period.”<sup>102</sup>

#### 4.4.2.2.5. Other motivations for member states to support legislation

The forces in favour of liberalisation (in terms of market opening not necessarily in terms of effectively competitive markets) included not just the Commission and the more liberal member states but also governments of some of the apparently more recalcitrant member states and the management of the incumbents (Thatcher:2001:564). The latter were keen to obtain operational freedom and needed substantial funds, which governments were not keen to finance, in order to upgrade networks with new digital technology. They were also being blocked by the US regulator, the Federal Communications Commission, from entering the US market unless their countries allowed reciprocal access for US companies and set up regulatory regimes with independent regulators,<sup>103</sup> and effective regulation was also insisted upon by the US as a component for inclusion of telecommunications in the GATS/WTO agreement of 1996 (Naftel and Spiwak: 2000:108). Offering seamless global services was believed to be

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<sup>101</sup> The Court’s finding in the appeal against the Services Directive as to the extent to which the Commission could impose positive requirements on the member states through Article 90 (now 86) was ambiguous. The Court had confirmed in the appeal against the Services Directive that a provision requiring the separation of regulatory functions from the provision of services did not comprise a legislative act because it interpreted existing Treaty articles and left the national authority a wide choice as to the method of achieving the separation. (ECR (1992) I-5865). However, whether it would have considered the more constraining regulatory requirements in the Full Competition Directive to have overstepped that boundary remains unknown.

<sup>102</sup> Article 4(a)(5) Commission (1996).

<sup>103</sup> FCC approves Sprint Alliance with France Telecom and Deutsche Telekom subject to strict conditions [http://www.fcc.gov/Bureaus/International/News\\_Releases/1996/nrin5026.txt](http://www.fcc.gov/Bureaus/International/News_Releases/1996/nrin5026.txt). as of 10.8.2008. Two of the conditions were that (i) if France and Germany failed to agree the EU directives; or, (ii) if they failed to set up NRAs, consent would be rescinded.

necessary in order to win contracts from multi-national customers and exclusion from the US business market would render such business offers unsaleable. Liberalisation was also supported by telephony and data dependent companies that sought lower costs.

#### 4.4.2.2.6. Empirical results and the hypotheses<sup>104</sup>

Hypothesis 1: Although not a choice between an Agency and an NRA, the Council refused to accept that the Commission could use competition law to define regulatory rules and give itself implementation powers and pressured the Commission to bring forward legislation empowering NRAs. However, whether the cause of this preference is distributional conflict cannot be confirmed. Investigation at EU-level has not elicited any evidence as to the formation of national preferences. The result is indeterminate.

Hypothesis 2: Confirmed in this round, where the Commission took the position that it could unilaterally legislate. It empowered only itself to implement. The Parliament had no role.

Alternative hypotheses:

Hypothesis 4: Although not an Agency, the finding supports hypothesis 4. The Council did advance the design of the Treaty as the reason why the Commission could not award itself regulatory powers.

Hypothesis 5: Not applicable as informal networks of NRAs were yet to be constituted.

Hypothesis 6: These findings falsify one of the alternative hypotheses, hypothesis 6. This is because they show that the Commission did not believe that it could regulate the sector using existing competition law.

### **4.4.3. 1998 Framework**

#### *4.4.3.1. Introduction*

The first attempt to deal with access and interconnection involving the Council, Parliament and Commission comprised the negotiations over the Framework and Access

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<sup>104</sup> Hypothesis 3 regarding implementation is dealt with separately at page 176.

and Interconnection directives (Commission:1997 and 1998). The legislative basis was qualified majority voting and co-decision.

The Commission attempted to use its informal agenda-setting powers to encourage support for a Euroregulator. The institutional structures of the latter were never defined. It is unclear whether Bangemann, the Information Society Commissioner, sought to create an EU Agency or whether he was using this as a rhetorical device to create a demand for a function which the Commission could then offer to fulfil. Majone thought there was an intention to create some kind of Agency (Majone:2002:316).

#### *4.4.3.2. The Euroregulator*

The concept was floated through a group of industrialists who were acting as informal advisors to Bangemann (Information Society Forum:1994). In 1995, Bangemann commissioned a report on a possible European regulator by NERA economic consultants (NERA:1997). This comprised of research into the attitudes of stakeholders to the adoption of a Euroregulator and a discussion of the different institutional possibilities by Denton Hall Solicitors. In 1997, Bangemann briefed the press on the need for a European Communications Act that would include a single European regulator for the converging telecommunications and media industries (Financial Times:1997). Bartle quotes Communications Week International to the effect that the Commission's strategy was to attain greater legitimacy for the issue by first gaining the support of the Parliament and avoiding direct confrontation with the Council (Bartle:1999:6). UK officials got the impression that this was shadowboxing, since no proposal ever manifested itself.<sup>105</sup>

Overwhelming opposition from all member states meant that the Euroregulator was not included in the proposals. The survey of stakeholders including national officials conducted for the Commission by NERA found:

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<sup>105</sup> Letter from Neil McMillan DTI to OFTEL: "You will recall the speculation on how seriously to take Commission commitment to a Euroregulator when it was announced at the end of July that Bangemann was appointing de Benedetti as chairman of a working party under the Mark 2 Bangemann Group to look at a Euro-regulator. This is after much hinting by Bangemann that he was still attached to the idea at the last two Councils" (DTI:1996c).

“Regulators and policy makers were mostly against the creation of a new European Regulatory body, arguing that it would create a new layer of regulatory bureaucracy and that, if this body were given any real powers at the expense of the NRAs, it would also contravene the principle of subsidiarity.” NERA (1997:21)

The real reason for hostility was that the member states were concerned that a European regulatory body might follow policies that were not favourable to domestic circumstances. OFTEL officials, for example, were hostile to the idea of a Euroregulator because they were concerned that any feasible European body would likely represent lowest common denominator regulatory positions. An OFTEL paper directly written to oppose the Euroregulator and circulated to all the European telecommunications ministries reveals this concern: “It is important that headroom for national variation exists [...] to reflect the different stages in the development of telecommunications markets in member states. In this context, it is important that individual NRAs can go further and faster, if necessary” (OFTEL:1996:para9).

The same point was made in an interview with the then Director-General:

“At the point in time when the issue of the Euroregulator came up, we were careering down the path of substantially reducing interconnection rates. OFTEL was way ahead of the game. We were deeply hostile to anything that might have allowed European recalcitrants like France and Germany to jointly determine our policy and undermine our good works. In fact, we were not convinced that the latter two were really serious about competition in telecommunications.” (Interview for Tarrant (2005:43))

Conversely, Portuguese officials, for example, had the opposite concern: a Euroregulator might oblige them to regulate more strictly than they would otherwise have chosen. The then Head of the International Section at the Portuguese regulator said in an interview:

“Portugal would have been opposed unless it was a simple matter of coordination or a specific task with which we agreed. We would have been opposed to any federal regulatory body, particularly as at the time we were seeking a derogation from opening to competition.” (Ibid)

A unanimous position on the part of industry might possibly have encouraged the Commission and the Parliament to take a stronger advocacy position for a Euroregulator. However, such unanimity was structurally impossible. New entrants and incumbents could only have supported a Euroregulator for mutually contradictory reasons. The apparently majority position in favour of a Euroregulator recorded by NERA would have dissolved once the institutional composition had been clarified. A genuinely independent or Commission-directed body would have forfeited the support of most incumbents; and decision-making dominated by national ministries would have forfeited new entrant support.

The surveys of stakeholders conducted by NERA for the Commission revealed a trend towards the Commission's obscure proposals (a result which the consultants were of course being employed to deliver). The NERA report records that 19 out of 23 new entrants that responded were in favour of a Euroregulator, while four out of eight incumbents who responded were in favour (Ibid:24).

The point that obscurity hid underlying functional conflict is illuminated by a reply that companies which declined to answer the specific question gave to NERA:

“Other respondents stated that they found it difficult to assess the possible added value of a European regulator for different regulatory activities without first having details of the institutional framework and structure that would support a new ERA [European Regulatory Authority]” (Ibid,v).

Those in favour of an independent European level regulator were not however willing to spend much lobbying capital in its favour. Pan-European new entrants took the view that the Council would never create a body with a design that would allow it to promote competition. (Tarrant:2005:45)

#### *4.4.3.3. Commission proposals*

The draft legislation tabled was designed to obtain qualified majority support and thus appeared to delegate implementation to the member states. However, in the absence of the possibility of a Euroregulator, the Commission sought, on the one hand, to require the independence of the NRAs in the 1998 directives so that they would act as promoters of

fair competition and not favour the incumbents; on the other hand, it sought to give itself powers to both set the bounds of discretion applied by NRAs and to use disputes between cross-border operators to police their work (Commission:1995).

However, with respect to the national controls over the NRAs, there were clear negotiating limits to what the Commission could suggest. Member states added a recital clarifying that their control over NRAs was outside the purview of the Commission: “This requirement for independence is without prejudice to the institutional autonomy and constitutional obligations of the member states” (European Parliament and Council:1997b: recital 9).

There was not an extensive debate in the Council Working Group concerning the nature of independence (Tarrant:2005:18), since the maximum the Commission had felt able to include in the original draft was a requirement that the incumbent did not continue to be its own regulator and that the NRA should not be the body that held the state ownership of the incumbent.<sup>106</sup> Member states were relaxed about these requirements since the first meant the state rather than the operator, which might be privatised in the future, would remain in control of regulation. The second limit was not believed to be very constraining. The Commission would have to prove that inappropriate considerations were being taken into account inside the national administrative structure, proving this was not perceived as very feasible (Tarrant:2005:18). Identifying that this had occurred would be particularly difficult as the principles of the directive were so general, making it difficult to judge what would constitute an inappropriate outcome, which might in theory have resulted from an inappropriate instruction. In any event, the narrow definition of independence and the lack of definition of NRA meant that tasks could in fact be allocated in any way member states chose – between multiple bodies or even to ministries. Supervision of retail tariffs of the incumbent in France was, for example, allocated to the Industry Ministry.

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<sup>106</sup> Article 1(5) of 97/51 on independence of NRAs stated:“National regulatory authorities shall be legally distinct from and functionally independent of all organisations providing telecommunications networks, equipment or services; member states that retain ownership or a significant degree of control of organisations providing telecommunications networks and/or services shall ensure effective structural separation of the regulatory function from activities associated with ownership or control” (European Parliament and Council: 1997b).

The Commission constructed annexes of proposed mandatory elements that ex ante national rules would need to require in interconnection terms and conditions. These were very generally described and not very constraining in this first iteration (Commission:1995). However, the Commission's draft would also have given it the unilateral ability to revise these, subject only to taking the utmost account of advice from a ministerial committee (Ibid). It also sought to be the adjudicator in dispute resolution where an operator from one member state was involved in an interconnection dispute with an operator in another member state; a proposal which would effectively have made it the Euroregulator (Ibid). The Commission also sought a power to issue binding guidelines on accounting separation (Ibid) which would in practice have strongly constrained national regulatory decisions on the price of access; aside from quality of supply issues, the other key regulatory issue. These powers would have so limited the discretion of NRAs that the issue of whether they were independent of ministries or not would probably not have mattered. All these controls were designed to ensure that the Commission became the effective principal of the NRAs.

#### 4.4.3.4. *Parliament's preferences*

The Parliament's main objective was either the creation of a separate Euroregulator or the ability of the Commission to make effective decisions concerning implementation (Parliament:1996); the rapporteur stating that in the absence of such a body that in his view there was little chance of the creation of a single market:

“In your rapporteur's opinion, only a genuine European regulatory authority is in a position to make completely sure that a genuine European market develops which functions, after the fashion of the planned networks, seamlessly in the interests of all citizens. For that reason, your rapporteur believes it is necessary that the value which Parliament attaches to the establishment, ultimately at least, of such an authority be restated.” Parliament (1996)

It supported the Commission's proposals regarding controls over the NRAs.

#### 4.4.3.5. *Council preferences*

The hostility of member states to the concept of the Euroregulator can be seen in the reaction of the Council to a proposed compromise parliamentary second-reading amendment to the Interconnection Directive on the subject (Parliament:1996). This amendment merely called for the Commission to review the need for a Euroregulator when the new directives came up for review. The Council Working Group refused to accept this by unanimity (Council:1996:para 3; Council:1996:63). The Council eventually abandoned this objection because it threatened agreement on the entire package and was only of symbolic rather than substantive value: the Commission could in any event include whatever elements it chose for its own review.

Consistent with its opposition to the Euroregulator, the Council declined to vest the Commission with any substantive implementation powers in the field of access whatsoever. The Commission was not given any role in the arbitration of cross-border disputes, which was to be coordinated by NRAs instead. (In any event, a slight technical amendment in the Council Working Group was adopted so as to render this incapable of ever actually applying in practice).<sup>107</sup> The Council removed the power of the Commission to create binding guidelines on accounting separation (Council:1996).

Asked by the UK delegation why he supported the general principle of non-discrimination but would not vote for a key mechanism to deliver it, the French delegate to the Council Working Group said: “We are not ready for Anglo-Saxon competition. We will agree to the requirement for non-discrimination. We will not agree to accounting separation except in principle. Consequently, one will not know whether there is non-discrimination or not. Perhaps in a few years our policies will change.” Cited in Tarrant (2003:277)

The only implementation powers the Council was prepared to concede to the Commission in the Interconnection Directive were to make modifications to annexes

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<sup>107</sup> A Council amendment allowed the provision to apply only where “such dispute does not fall within the responsibility of a single national regulatory authority.” Points of interconnection necessarily fall within the jurisdiction of a single national authority as cross-border interconnection always takes place physically at an exchange located within the territory of a single Member State. The author of the thesis in his capacity as member of the UK delegation to the Council Working Group drafted the amendment.

IV,V and VII relating to accounting systems and interconnection terms and conditions (Council:1996). However, these annexes were amended to specifically state that the contents were lists of examples rather than mandatory requirements (Council:1996). This highly limited potential activity was itself subjected to supervision by a regulatory committee of representatives of national ministries as opposed to the advisory committee proposed by the Commission (Council:1996). Sabel and Zeitlin (2009:281) and Eberlein and Grande (2005:101) incorrectly identify the existence of this comitology as evidence that the committee had substantive issues on which to decide.

The Council was content to proceed with the Commission definition of independent NRAs (Council:1996).

The Council's changes meant that there was no empowerment of any supranational institution.

#### *4.4.3.6. Legislative process*

The member states negotiated the directive in order to override DG Competition, who, as discussed on page 142 above, obtained the ability to regulate (at least until there was a legal challenge), if a Parliament and Council directive was not agreed. This was not a strong negotiating position as the Commission itself did not believe that the Court would back it. This meant that the true status quo on national versus supranational implementation was actually closer to the preferences of the protectionist member states than the temporary status quo under which DG Competition was empowered to apply general regulatory principles for access. Aggregating member state preferences by state ownership, the Commission and Parliament were obliged to meet the requirements of member states with state-owned entities in order to avoid a blocking majority. Seventy-eight per cent of the votes in Council were held by member states with state-owned incumbents. The member states were willing to adopt the regulatory principles contained in very general terms in the Commission own-initiative directive but substitute NRAs for DG Competition. All the member states could live with this as it left each free to apply the regulatory principles as they wished at national level and they did not have to take the risk of a court case against the DG Competition proposals.

#### 4.4.3.7. *Outcomes in detail*

The outcome was the absence of any supranational implementation authority. Discretion was vested in NRAs, but national regulators which were defined in such a way as to ensure that they were not independent of ministries (and, indeed, could be part of ministries) (European Parliament and Council:1997b:Article 1(5)). Very general principles and a confusion of loosely defined objectives were also agreed, rendering infringement procedures difficult. (Article 1.1 (European Parliament and Council 1997b:Article 1.1)).

The opinion of a leading lawyer in this field interviewed for the thesis is that the directives do not have direct effect as they are not sufficiently clear and precise ( BT apparently also obtained legal advice from Devereux Chambers to the same effect (Interview:2008). It would be feasible to bring a case based on indirect effect (i.e. interpreting national law as if it were compliant with EC law) and finding state liability for damages for a complete failure to implement a provision. However, the vagueness of the requirements in the directive meant that once a member state has done something, even if unlikely to be very effective then it would be likely to have been found in

compliance (Tarrant:2005:27). As a consequence, neither the Commission nor private parties have brought many infringement cases on access issues.<sup>108</sup>

Some authors consider that the principles in the EU Telecommunications Directive are prescriptive (Levi-Faur:1999:189, Schmidt:1999: 245; Thatcher:2001:569; Franchino:2010:222 ). In fact, the member states ensured, in the Council Working Group, that the Directives did not contain any constraining principles. For example, while the Interconnection Directive contains elements that NRAs should take into account when dealing with costs, member states would not agree the relevant cost-base, which made the requirement for cost-based wholesale prices meaningless. As leading telecommunications economists Cave and Crandall note:

“Cost orientation turned out, however, to be an excessively vague phrase, permitting excessive interconnection charges [...]. The interconnection directive took a rather catholic view of cost standards, citing ‘fully distributed costs, long run incremental costs (LRIC), marginal costs, stand-alone costs, embedded direct costs’. Each of these can [also] be measured [...] on the basis of a historic or forward-looking basis”. (Cave and Crandall:2001:50)

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<sup>108</sup> Excluding cases of failure to transpose, only six completed cases in the period 1998-2010 can be said to relate even broadly to the content of access regulation. None at all look at the detail of interconnection regimes. Two of these cases, C-146/00 and C-384-99, relate to the national systems that require contributions from new entrants to the universal service *burden*. The French scheme was struck down for having no costing justification at all and for trying to include France Telecom’s mobile service as a universal service beneficiary. The Belgian scheme was struck down for requiring new entrants to provide subsidised calls to media organisations. C-438/04 relates to a dispute as to the costs that mobile networks could include for number portability. The court found that NRAs had a great deal of discretion under the directive and that the Belgian scheme whereby the regulator set a maximum tariff rather than one based on costs was within their discretion unless the new entrants could show that excess charges were being made; an impossible endeavour as neither the accounts nor the attribution model are published to third parties in Belgium (and there is some doubt as to whether they really exist). There are three cases relating to the general principle of access to fixed networks. Case C79/00 was based on an appeal by Telefonica, the Spanish incumbent, against the NRA for imposing ex ante conditions on more than one type of interconnection product at the same time, which the Interconnection Directive clearly required. Given its complete unlikelihood to succeed, it would appear to have been mounted to achieve alternative aims other than targeting the actual rule implemented, such as forcing new entrants to meet prudential requirements by retaining financial provisions for higher prices in the event of Telefonica winning the case. The second, C55/06, was based on an appeal by Arcor, a new entrant, against the cost basis applied by the German NRA. The ECJ held that the wording in the interconnection directive meant that the NRA had “broad discretion”. The other, C424/07, was an infringement action against the German government for granting a regulatory holiday to Deutsche Telekom’s fibre network. The German government lost because the blanket legislative requirement for no regulation meant that the regulator’s discretion had been removed altogether.

#### *4.4.3.8. Empirical results and the hypotheses*

Hypothesis 1: The result is indeterminate but consistent with the hypothesis. The Council rejects the option of a Euroregulator and it does so in the context of extensive state ownership. However, the result is indeterminate since there is no traceable evidence at EU-level concerning national policy formation.

Hypothesis 2: The hypothesis is confirmed. Both the Commission and the Parliament push for the Euroregulator. When this proposal is clearly not going to be successful, they both push for the Commission to be given extensive controls over NRAs and to have the ability to decide interconnection disputes. However, they are unsuccessful. Their negotiating power is based only on the content of the DG Competition directive. They accept NRAs as sole empowered institutions because the adoption of the regulatory rules for access is considered a step forward.

Alternative hypotheses:

Hypothesis 4: This alternative hypothesis also appears to be confirmed as the Council do advance (and incorporate references to subsidiarity) into the directive as justification for institutional selection.

Hypothesis 5: Not applicable as informal networks of NRAs are yet to be constituted.

Hypothesis 6: This hypothesis is falsified. The Commission's first preference appears to have been for a Euroregulator over NRAs. Its second preference was for it to receive ex ante and ex post controls over NRAs, turning it into the effective principal as far as NRAs were concerned. It accepts NRAs when no other choice is possible. The draft legislation is proposed in the first place because the Commission recognises that competition law is not adequate for regulation.

#### **4.4.4. The 2002 legislation**

##### *4.4.4.1. Background to the negotiations*

DG Information Society wished to use the 1999 Review to increase supranational control over the NRAs (Tarrant:2005:47). It knew from the previous round that the Parliament favoured supranational control. It knew that member states were hostile. However, there

had been some technological developments, unexpected in 1998, which could potentially have interacted with the design of the earlier directives and had the possible effect of over-regulating incumbents. These developments were expected to be more extensive in the future, potentially making it more of an issue. This meant that member states did want new legislation and this “impatience” (Pollack:1997:124) increased the Commission and Parliament’s negotiating strength.

This had arisen because under the 1998 directives regulatory obligations applied once an operator was found to have significant market power (defined as a 25 per cent share) on two pre-defined *regulatory markets* (defined as interconnection traffic and as voice services provided over a fixed network). These definitions were so all encompassing that it meant that the incumbents were automatically regulated and in respect of most actual product markets.

To tempt the member states, the Commission offered a package that gave the NRAs greater flexibility over the application of the EU regulatory framework (Commission:1999b). The Commission also highlighted that it did not intend to pursue the Euroregulator,<sup>109</sup> a promise that was easy to make since the Euroregulator had never been defined.

Flexibility was to be achieved by making the imposition of regulatory remedies dependent on a competition law market analysis. Defining markets on a competition law basis also meant that competing technologies, if they took root, could also be taken into account when assessing the need to regulate the telecommunications incumbent. In 1999, it was thought that the development of the internet would allow a range of competing technologies such as cable television, shared copper electricity lines, satellite and wireless services to become competing networks.<sup>110</sup> Unless the EU Framework was

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<sup>109</sup> The Communication on the 1999 Review stated: “The Commission is not persuaded that a regulatory body at Community level would currently add sufficient value to justify the likely costs. The Commission therefore does not propose to establish a European Regulatory Authority for communications services at this time” Commission (1999b:9)

<sup>110</sup> With the exception of cable television (which tends to be geographically limited to areas of high population density), and despite being technologically viable, none of these other alternative networks turned out to be economically viable against the existing copper network once it was upgraded with broadband DSL technology . (Indepen:2007: Part 2, Chapter 5)

amended, NRAs would have to continue regulating the incumbents even if they were being bypassed by these other technologies.

The Commission sought the support of the Parliament and those member states that it hoped might be swayed by arguments that the Commission needed controls over NRAs regulatory decisions in order to ensure that the proposed new flexibility was not abused. The Communication on the 1999 Review referred to the findings of the Fifth Implementation Report. These showed “inconsistent application of certain provisions of telecommunications legislation is harming the development of effective competition and the deployment of pan-European services.”<sup>111</sup> There was a very high risk of increased inconsistency under the proposed new regime.

Under the 1998 Framework, the Commission could have threatened a member state with infringement proceedings in the absence of automatic application of the regulatory principles to the operations of an operator with significant market power (although, it would as discussed above have had difficulty due to the lack of detail incorporated in the principles in dealing with poor quality regulation as opposed to a complete absence of regulation).<sup>112</sup>

Under the new regime, it would also have to prove that the national regulator had not selected an appropriate remedy and would have to demonstrate this against an even more length list of potentially contradictory objectives than under the 1998 directives.<sup>113</sup> To give one example of how the objectives contained in Article 8 of the Framework Directive could be construed as conflicting, one of the Articles, 8(2)(b), requires NRAs to ensure that there is no distortion or restriction of competition, another, Article 8(2)(c),

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<sup>111</sup> Commission (1999:9) The Fifth Implementation Report contains a summary review of the main messages for the review. The first three messages were:-

“The comparatively low level of harmonisation in particular of the Community licensing and interconnection regimes represents a barrier to the single market.

The wide divergences in the way in which Community rules are implemented at national level raise further barriers. The NRAs are close to national markets and perform an essential task in assisting in achieving uniform implementation of the Community framework. Their role is hampered, however, by disparities in the powers and resources with which they are equipped, the way in which regulatory tasks are shared with other bodies, and differences in the procedures in place. NRAs need to be more active in particular in securing interconnection agreements.” Commission (1999:2).

<sup>112</sup> See page 155.

<sup>113</sup> The Framework Directive contains 14 regulatory objectives: Article 8, European Parliament and Council (2002a)

requires NRAs to encourage efficient investment in infrastructure and to promote innovation (European Parliament and Council:2002). Under the first, one would ensure interconnection and, under the second, an argument could be made that efficient investment would be maximised by future inter-modal competition and thus interconnection should not be granted since it reduces monopoly profits that would otherwise provoke innovation in the long run. An incumbent-led debate is taking place over precisely this issue in the context of the regulation of broadband and fibre networks.<sup>114</sup>

#### 4.4.4.2. *The Commission's specific institutional revisions*

The nature of the powers that the Commission sought in relation to the NRAs would once again have put it in a position equivalent to a principal. The Commission sought the changes set out below.

The Commission proposed a requirement in the new Framework directive for NRA decision-making to be made fully independent of ministries. The Communication stated:

“The Commission continues to have a number of concerns with regard to the effectiveness of some of these arrangements, and will strengthen existing legal provisions to ensure that [...] the independent national regulator can undertake its role of supervision of the market free from political interference, without prejudice to the government's responsibility for national policy.”  
Commission (1999b:54)

The Commission proposed the following text to meet this concern: “Member states shall ensure that national regulatory authorities are able to act freely, without further authorisation or control from any other agency or body” (Presidency:2001a:6). By this it meant agencies and bodies at national level.

The Commission also proposed that it should have the ability to veto NRA decisions with respect to market definition, findings of market power and, regulatory obligations, all on

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<sup>114</sup> See the European Telecommunications Network Operators submission to the ERG in the context of the ERG Remedies paper at <http://www.erg.eu.int>. ETNO represents the incumbents at European level. This

an ex ante basis, wherever the Commission considered them not to comply with EC law (Presidency:2001a:10). This would be by reference to a new set of very general objectives. While these would give NRAs wide scope for making decisions,<sup>115</sup> by going last in the executive decision-making process, it would actually have given the Commission enormous scope to make the final policy decisions (Commission:2002a:Article 8). The very general objectives would have made it unlikely for the court to overturn a Commission decision as long as it could be argued to fall within the objectives.

The Commission argued for the formation of a committee of NRA representatives to advise it with respect to the exercise of its vetoes (Commisison:2000). The combination of the veto and a forum for regular interaction between the Commission and the national regulators might make it more difficult for national ministries to influence the decisions of regulators. This would have been a step in the direction of an Agency. In effect, a two-level game would have been created with respect to national regulation. NRAs would possibly have been able to have any decisions with which they disagreed but which had been imposed on them by ministers overturned at EU level and could then blame it on their peers in other NRAs and the Commission.

The Commission also proposed that it should have the ability to issue individual harmonisation measures whenever it considered that inconsistent NRA decisions taken under any aspect of the new framework threatened the single market, although adoption would still remain subject to the scrutiny of a regulatory committee of member state representatives (but NRAs rather than ministries) (Presidency:2001:17).

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schumpeterian argument has also been mounted by the German Ministry to justify a regulatory holiday for Deutsche Telekom's fibre network.

<sup>115</sup> The Commission published a document summarising the results of the public consultation on the 1999 Review and noted: "There was broad support for setting out the objectives and principles explicitly in Community legislation, although there was some concern that the objectives and principles were too general to be of use in testing the validity of decisions by national regulators. Many telecoms operators felt that since the proposed regulatory principles could conflict with one another, there was a need to give clear guidance as to the order of importance of these principles" Commission (2000a:7).

#### 4.4.4.3. *The reaction of opponents*

Member states and market players were quick to appreciate the significant European oversight that was being proposed. Deutsche Telekom, for example, stated in its submission to the consultation:

“The achievement of an open and competitive European internal market for communications requires the right balance of institutional powers and responsibilities. The Commission has received strong support for its proposal not to introduce a Euroregulator, and all parties agree that such centralisation of regulatory functions would not be effective. On the contrary, the Commission has clearly stated its belief that implementation of the regulatory framework should take place as close as possible to the markets. However taken together, the proposals ...amount to a centralisation of decision-making in the Commission’s hands which is comparable to the introduction of a Euroregulator and which has the same disadvantages.” Deutsche Telekom (2002:2)

The member states argued that the proposals were a breach of the Community method and also one that the Commission was ill equipped to undertake. The UK, for example, arguing:

“Permitting the Commission to veto NRA decisions would be tantamount to giving it a judicial role, which is the remit of the courts. This would appear to bypass the mechanisms established in the Treaty for challenging member states’ implementation of Community law.<sup>116</sup> It is not the place of secondary legislation, such as the Framework Directive, to circumvent these procedures, nor for the executive to assume the position of the judiciary.” Department for Trade and Industry (2000b:1)

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<sup>116</sup> UK authorities were in fact fully aware of the inadequacies of the Article 226 procedure. An internal OFTEL memorandum records a discussion between OFTEL and DTI and DG Information Society where the UK authorities complained about the lack of the deterrent effect of Article 169 procedures. (OFTEL:1995:1).

#### 4.4.4.4. *The overall industry reaction*

The Commission also did its best to get industry on its side, carrying out extensive consultations.<sup>117</sup> Most incumbents were against a Commission veto on remedies (but not all),<sup>118</sup> whereas new entrants responded favourably to the consultation on the proposed regulatory structure contained in the framework directive. Thirteen out of the 17 new entrants did not claim confidentiality,<sup>119</sup> and, hence, their comments are published on the DG Information Society website backing the Commission proposals.<sup>120</sup> Although most wanted some kind of filter whereby only major decisions would be subject to veto. If every decision of the regulator had to be screened, this would overwhelm the Commission and slow down overall regulatory decision-making. The four others made no comment on the proposals. However, the pleas of the cross-border transactors, such as Viatel and United Pan-Europe Communications (UPC) did not move the Council, although they were important in encouraging the Parliament to support the Commission's proposals (Interviews with Nick Clegg, Malcolm Harbour and Mel Reed MEPs, Tarrant:2005:54).

#### 4.4.4.5. *Parliament's preferences*

The focus of the Parliament was almost exclusively on the institutional aspects of the new package. The parliamentary delegation's preparatory notes for an informal triologue that occurred during conciliation recorded:

“The Council did not take into account the internal market dimension of the regulatory framework and their common position did not provide for a mechanism impeding a NRA

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<sup>117</sup> The approach in this sector is cited as best practice in the Commission's White Paper on Governance (Commission:2001:16).

<sup>118</sup> Those incumbents that calculated that any supranational control would only be accepted if subject to ministerial control through comitology would then have calculated that regulation would be set at the qualified majority voting pivot point. If their NRA would otherwise have set stricter regulation, they would be better off.

<sup>119</sup> All submissions on the 1999 Review can be found at: <http://europa.eu.int/IPSOC/infosoc/telecompolicy/review99/comments> as at 23.03.2007.

<sup>120</sup> See, for example, the comments of Viatel and UPC.

Viatel: “Viatel welcomes the move by the Commission to harmonise the regulatory framework for electronics communications throughout the EU. As a pan-European network operator, lack of harmonisation is currently one of the biggest problems we face. (2000).

to take a decision which would endanger the proper functioning of the market.”  
Presidency (2001b)

Nick Clegg MEP, rapporteur on the Framework Directive to the Industry Committee said in an interview:

“The European Parliament’s focus was institutional priority as opposed to sectoral interest as such. Article 6<sup>121</sup> [Article 7 in the text that was adopted] was the acid test for the Parliament. The Council’s proposals would have run a coach and horse through the new framework. There was a keen sense of a test of wills. Member states needed to be put in their place. In practice, the executive prerogatives of the Commission have been rolled back too much and member states have become judge and jury on executive action.” Tarrant (2005:54)

#### *4.4.4.6. Legislative model*

The legislative rules remained the same as in the first round. Co-decision with qualified majority voting in Council. The salient issues were one dimensional in this round. The debate was over institutional issues. The preferences were very similar to the last round, with a slight reduction in the proportion of the vote (to 61%) held by member states with state owned incumbents. The only difference between the two rounds was that the Commission and Parliament’s negotiating position was slightly stronger due to a substantive need for a change to the regulatory framework on the part of member states. However, this need was limited because the actual impact of the directives was dependent on which bodies implemented. Consequently, the Commission and Parliament were unable once again to find a coalition that would empower a supranational entity.

#### *4.4.4.7. Outcomes in detail*

The outcome of the second occasion for joint legislation was a transfer of some competencies to the Commission: but not the one that really mattered. In exchange for

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UPC: “It seems to UPC that, in order to promote a harmonised framework across the EU, to the considerable benefit of the single market and of European Commission consumers and operators, the Commission should, in the end, have a power to block decisions of NRAs” (UPC:2000:3-4).

<sup>121</sup> The provision providing for Commission vetoes.

increased discretion for NRAs with respect to the imposition of regulation, by the removal of automacity for the application of regulation, the Commission was given the power to examine the NRA's market analysis and identification of an operator as having market power, the procedural step leading to regulation or its removal.<sup>122</sup> This was a compromise forced on the Council by the European Parliament. The Parliament's negotiating power was strengthened by the fact that the drafting of the 1998 directives had left member states unable to deregulate, at least formally, individual product markets as they became competitive; a problem that simply had not been considered in the 1998 negotiations. However, the degree of leverage was limited, since member states could always operate national implementation in such a way that the actual regulation imposed (i.e. access remedies) was not too much of a hindrance.

The Council was successful in refusing to give the Commission the ability to review the content of the actual regulation decided on by the NRAs. A former senior Commission official viewed the outcome as follows:

“When we lost the ability to veto remedies, we had lost everything in terms of achieving harmonisation in interconnection. However, obtaining the vetoes on market definition and significant market power were a huge step in institutional terms. It had never been achieved in any other sector. It was worth having the directive for this. Also we made sure the next review was a few years away. This potentially meant that if we could still show huge discrepancy in [the quality of interconnection in] 2006 that we could ask for the power again and it would be incremental in institutional terms to what we had already been given.” Tarrant (2005:59)

The actual lack of significance of the vetoes obtained by the Commission is indicated by the fact that member states only required advisory comitology to be put in place. The limited nature of the veto has been missed in existing analyses of the legislation (Sabel and Zeitlin:2010:281;Thatcher:2007:134).

The Council also refused to countenance draft articles for the new directives which would increase the independence of NRAs from ministries and vetoed the proposition

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<sup>122</sup> Article 7 (European Parliament and Council 2002a)

that a committee of national regulators advise the Commission on review of NRA decisions (Presidency:2001).

The general harmonisation decision power was limited to numbering only (an insignificant issue) and was not permitted to cover access issues<sup>123</sup>.

#### 4.4.4.8. *Empirical results and the hypotheses*

Hypothesis 1: Indeterminate. The Council's strong preference was to not give the Commission any implementation power and the Commission's dropping of the Euroregulator concept met with member state approval. This is in the continuing context of widespread state ownership. However, the result is indeterminate as it is not possible to trace the process by which national preference is derived from state ownership.

Hypothesis 2: Confirmed. The Commission and Parliament use the negotiating power derived from the need on the part of member states to reform the framework in order to achieve some (weak) supranational control over implementation.

Hypothesis 4: This alternative hypothesis is falsified. The Council does agree to cede some supranational control to the Commission. If this was genuinely a constitutional issue (i.e. cross-sectoral issue) then that should have superseded any sectoral concerns, particularly when, overall, the new legislation could only be categorised as marginally useful to Member States as opposed to vital.

Hypothesis 5: This alternative hypothesis is falsified. The Council remained hostile to the creation of an Agency and retained a strong preference for NRAs to be the only bodies undertaking the implementation of remedies.

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<sup>123</sup> Note that no decision has ever been made by the Commission under this process. According to an interview with a former DG Information Society Commission official, the Commission believes that any attempt to use this power would be vetoed. In addition, the reason why it had been limited to numbering was that in pre-legislative discussions, member states had asked that if the Commission needed such a power, what was the nature of the intended objective? The Commission had felt that the only example that would not have led to the power being deleted was numbering, member states responded by limiting its scope to the example provided (Interview:2006)

Hypothesis 6: Falsified. Competition law has already been confirmed in previous rounds as not being adequate and no successful EC competition law cases were mounted in the sector between 1998 and 2002.

#### **4.4.5. 2009 Legislation**

##### *4.4.5.1. Background*

The 2006 Review saw a further attempt by the Commission to gain control over implementation. This was justified in its view as a consequence of a review of national implementation that found:

“A number of inconsistencies have emerged in the remedies imposed in a given market situation by different NRAs. For example, accounting separation has been implemented effectively in only a few countries; naked bitstream and wholesale ethernet services are available in less than ten countries; and non-discrimination remains ineffectively enforced. In particular, there are considerable variations between member states in applying certain regulatory obligations such as scope of access obligations and price control.” Commission (2006:67).

This time the Commission formally proposed an Agency and set out its proposals in detail in a draft regulation. It emphasised the importance of this authority in setting the terms of debate:

“The newly created European authority would play an important role in the market review procedures. It would provide technical expertise and advice to the Commission, in particular as regards the consistent application of regulatory remedies. The Commission would have to take the utmost account of the Authority’s advice before any withdrawal of draft remedies [i.e. veto applied by the Commission] is required.” Commission (2006:74)

The Commission would nonetheless retain its legally required executive role as the decision-maker under Article 7 of the Framework Directive, subject to comitology. The proposed step forward compared to 2002 was that review of remedies would now take place at European-level alongside reviews of market definition and findings of significant market power. In addition, the Commission sought the ability to issue binding decisions

in particular (undefined) areas if necessary to deliver the single market. Once again, it also sought to increase the independence from national ministries of the NRAs with which it would have to work in the Agency.

#### *4.4.5.2. Commission proposals*

The Commission's proposals with respect to the institutional structure of the Agency were designed to create a powerful agenda-setting executive director who would be answerable to a college that was not formed on a one-country-one-vote basis. It was intended that one half of the administrative board would comprise of technocrats appointed by the Commission and the other half would be selected by the Council. They would appoint the executive director (for a renewable five-year period). The decision making threshold would be three-quarters majority which would mean that the Council members would not collectively be able to direct the executive director without support from the Commission appointees. The executive director's policy proposals would have to be cleared by a college of regulators (the Board of Regulators). The Board of Regulators would take decision by simple majority only, making it easier to get the executive director's draft decisions through. The body was intended to have a staff of approximately 100 (larger than some of the national regulatory bodies) (Commission:2007).

The Commission also proposed that an intra-Agency Board of Appeal be formed, comprising of current or former heads of NRAs (Commission:2007). However, its functions were limited to that of numbering, so it was a very limited proposal. It is not clear why the Commission proposed this, or proposed such a limited scope, and why, when it was rejected by the Parliament, the Commission did not insist on retaining it as it did with other parts of its proposals.

Rittberger and Wonka consider that internal Boards of Appeal strengthen Agencies as they are more likely to favour the Agencies perspective (Rittberger and Wonka:2010). However, it is unclear what value such an administrative Board of Appeal would have since it would not be a legal body (and nor could it exclude legal challenges). It would effectively be only a second administrative filter within the Agency. This body would

have no ability to rule on decisions once they passed to the Commission and to comitology.

The Agency would be partly funded from the Community budget and partly funded by NRA donations (Commission:2007).

The Commission's draft extended its power under Article 7 to veto remedies. In addition, it added a power that would permit it, where an NRA's notification was vetoed, to require the NRA to put in place a particular remedy within a specified time frame (Commission:2007).

With respect to harmonisation decisions, the Commission returned to its proposals of the previous two legislative rounds: where there was an issue with inconsistent implementation of regulators approaches which was creating a barrier to the single market then the Commission could adopt a decision (subject to a regulatory committee), <sup>124</sup> or a recommendation (subject to an advisory committee) (Commission:2007).

On independence of NRAs, the Commission again sought, as in the previous legislative round, to get a clause stating: "National regulatory authorities shall not seek or take instructions". It also sought a clause stating: "Member states shall ensure that National Regulatory Authorities have adequate financial and human resources to carry out the tasks assigned to them and they have separate annual budgets. The budgets shall be made public" (Commission:2007).

The Commission also sought non-institutional amendments to increase the potential scope of the regulation available to NRAs. One amendment was designed to give NRAs the power to require functional separation, which was a power to structure the organisation of a company, to mimic vertical separation and thereby reinforce incentives to behave in a non-discriminatory fashion. The other amendment was designed to remove some phrasing in part of the 2002 directives that referred to *metallic* networks and, therefore, could be argued to prevent regulation of fibre networks (if an NRA was looking for an excuse not to do so).

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<sup>124</sup> Immediate binding effect in national law on the parties to whom it is directed.

#### 4.4.5.3. *Industry reaction*

The incumbent association argued that access regulation should be replaced with a reliance on competition law alone; the appeal of competition law was its relative ineffectiveness (Interview:2008). In the absence of such a development, their preference was for the maintenance of the existing institutional structure. Interestingly, their confidential preparatory documents prior to the commencement of the review note that they would be willing to switch in favour of a Commission veto in the unlikely event that the Commission indicated that it would take a deregulatory stance (i.e. that the Commission would use the veto against remedies that forced effective regulation) (ETNO:2005:22). Conversely, the association of multi-national business users of telecommunications were supportive of the Commission's proposals.<sup>125</sup> ECTA, the new entrant association, favoured a Commission veto only if it were exercised after a collective NRA position, as in its view, this would lock both institutions into producing effective regulatory decisions (Interview:2008; ECTA: 2006:2). A view that parallels the findings of Gehring and Krapohl as to how the Medicines Agency works in practice (Gehring and Krapohl:2007).

#### 4.4.5.4. *The Parliament's preferences*

The Parliament was concerned that the Commission directed by Reding, the Information Society Commissioner, was too political (Interview: 2007). Consequently, it was not a fan of increasing the Commission's powers vis-à-vis the NRAs while it remained very sceptical of the role of ministries. Consequently, the Parliament wanted to increase the collective independence of the NRAs towards both. With respect to the potential veto on remedies, it decided to increase the decisional importance of the Agency. Its first reading amendments gave the Agency a greater role: if it validated the NRA notification then the latter could proceed. If both the Commission and the Agency had serious doubts then after taking utmost account of the Agency's opinion, the Commission could amend the NRAs decision (Parliament:2007). This effectively gave the Agency a veto over the Commission.

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<sup>125</sup> INTUG making clear specific institutional preferences for an Agency over a network of regulators (2007:4).

The Commission found this unacceptable and in breach of its legally required role under the Meroni doctrine: “The mechanism whereby [the Body] could confirm in the face of the Commission’s serious doubts, that the remedy is appropriate and effective, thereby enabling the NRA concerned to adopt the proposed remedy requires revision [...]and would allow [the Body] to usurp the Commission’s role as guardian of the Treaty” (Commission:2008:13). The Commission would not, therefore, accept this amendment.

In line with its views on the role of the Agency and its independence, the Parliament struck out the administrative board from the Agency structure, leaving the Board of Regulators in sole control; removed the executive director from an agenda-setting position (also renaming the position Administrative Manager) and reset the voting threshold at qualified majority. (A position the Commission attempted to reverse: it’s revised proposal insisting on the need for an administrative board in order to “safeguard the Community interest” (Commission:2008)). The Parliament removed this at second reading (Parliament:2008). The Parliament did not think the Agency should have a role with respect to numbering so struck out the Board of Appeal as irrelevant. Consistent with these changes, where the Agency would not be an agenda setter vis-à-vis the participating NRAs, it also proposed resetting staff levels at approximately 25 (Parliament:2007).

The Parliament did take a strong view that there should be Community funding of the Agency since that would give it a role (Interview:2007) but was prepared to accept that some of the funding could also come from NRAs (Parliament:2007).

Consistent with its view on the use of harmonisation decisions in the previous round, the Parliament argued that since this was a potentially quasi-legislative power it should not necessarily be excluded from an ability to review any use of the power. It was in favour of the power but amended the process so that it was more involved by giving itself scrutiny powers under the new comitology procedures (Parliament:2007).

On independence, the Parliament supported the Commission’s text (Parliament:2007). It also supported the changes regarding regulatory scope (Parliament:2007).

#### 4.4.5.5. *Council preferences*

With respect to the veto on remedies, the Council in its common position insisted on the status quo ante (Council:2007).

The Council agreed with empowerment of the Agency but, in a way that was more likely to act as a constraint on the Commission than on NRAs. It would have the ability to advise the Commission on the existing vetoes on market definition and on significant market power; and the Commission would have to take utmost account of this advice (Council:2008). The Agency would, like the Commission, have no substantive role with respect to remedies. In terms of structure, the Council's common position also envisaged one board, staffed exclusively by heads of NRAs and voting by qualified majority (rather than simple majority). The executive director was downgraded to an administrative manager on a three year (renewable) appointment. In addition, his or her role was not to lead on policy, and he or she would report to a management committee not to the Board of Regulators. His or her function would be to provide administrative support to the Board of Regulators, not to take decisions with the assent of the Board as the Commission's proposals envisaged (Council:2008).

The Council was happy to go along with the Parliament's structuring of the Agency, except that it removed any community funding. If the Council obtained its way with respect to remedies, the consequence would be that the institution which remained would essentially be the existing network of regulators, the European Regulators Group, with an ability to set the agenda vis-à-vis the Commission with regard to vetoes on market definition and findings of significant market power. Indeed, in its common position, the Council actually states, given the amendments that it and the Parliament had made, the new body should not be named the European Electronic Communications Markets Authority, as proposed by the Commission, but the Group of European Regulators for telecommunications; the mere reordering of the existing title of the network a rather accurate depiction of their overall purpose (Council:2008).

The Council's initial view on harmonisation decisions was to reject the ability to go beyond a recommendation (Council:2008).

The Council was happy to structure the Agency in the way proposed by the Parliament (Council:2008)

The Council qualified the redefinition of independence to allow *supervision*. It also struck out an obligation to adequately resource NRAs (Council:2008).

The Council could accept the changes with respect to regulatory scope as long as they were implemented by NRAs and therefore were effectively discretionary (Council:2008)

Thatcher and Coen suggest that the NRAs themselves were significant advocates in shaping the institutional design (2008:808). It is possible to identify the ERG's (European Regulators Group) collective position as it was sent in a letter to the Commissioner and published on the ERG website (ERG:2007). However, it not possible to know how much suasion it carried for the legislators and the extent to which it reflected national ministries' views in the first place. In the letter, the ERG argued against a Commission veto over remedies but argued that in the areas where the Commission already had a veto that the ERG should be given agenda-setting power (Ibid).

#### 4.4.5.6. *Legislative model*

The procedural rules were qualified majority voting in Council and co-decision. The Commission and Parliament had no structural or contingent negotiating leverage. On this occasion, 55 per cent of the votes in Council were held by member states with state-owned entities. The Commission tried to get some of the pro-competition member states to break ranks on Council unanimity (necessary to prevent amendment of the Commission proposals). However, a representative from one of these member states said he could not see the point. The consequence would be that there would be no qualified majority for adoption. In his view, while the institutional developments were “pretty much a waste of time” and “no real change”, his member state thought that the increase in regulatory scope was potentially marginally useful and so the new rules were a slight improvement on the old ones and, therefore, worth adopting (Interview:2009).

#### 4.4.5.7. *Outcomes in detail*

The Commission's proposal to become an effective principal with respect to remedies, supported by an Agency comprising of the national regulatory authorities, was not substantively successful. However, in conciliation, the Council's absolute unwillingness to concede any role for the Agency or the Commission on remedies confronted a requirement on the part of the Parliament that there needed to be some kind of oversight from a Community perspective and that it needed to be involved in this as well as the Commission.

The compromise was that the Commission could issue either recommendations or decisions. However, the latter, which is a procedure which could in theory impact on defecting NRAs, is so heavily qualified that interviewees in the Commission suspected that it was unlikely ever to be a relevant process (Interviews:2009).

The rules agreed in conciliation are: a draft decision can only be issued two years after a recommendation on the same subject; the draft decision may not refer to any specific notifications issued by NRAs; the decision must demonstrate that it is necessary to overcome barriers to the single market; the Commission must take utmost account of the opinion of the Agency; the proposed decision is subject to regulatory ministerial comitology; and, the proposal must pass scrutiny in the Parliament. A contentious market review decision on market definition or a finding of market power might take a maximum of six months (formal plus informal elements) to be dealt with. The quickest this process might take would be at least five years, assuming all parties actually wanted it to be adopted, otherwise it could take substantially longer.

In addition, the Agency has been constructed in a way that means that it is the voice of the NRAs collectively and decisions will be set at the level where they reflect a three-quarters majority rather than the Commission's attempt to set the threshold at a simple majority. In addition, under the Commission's proposals, the vote was on a proposal from the Executive Director who was protected from displacement by being supervised by a separate administrative board which was 50 per cent appointed by the Commission and voted by three-quarters majority. The Executive Director is now only the Administrative Manager and the Agency and its 27 staff will be located in Riga, one of the furthest from and most poorly connected European capitals to Brussels. Jokes have

been made amongst telecommunications lobbyists in Brussels that had Russia been in the EU that the Council would have agreed amongst themselves to locate it in Siberia (Interviews:2009).

The Commission also returned to the issue of NRA independence. The Council was only able to agree compromise wording, which is ambiguous but appears to potentially retain the ability of ministries to direct NRAs. The obligation to provide sufficient resources was removed.

#### 4.4.5.8. *Empirical results and the hypotheses*

Hypothesis 1: The Council's preference is once again for delegation to NRAs. It holds to its position not to substantively empower an Agency and the Commission in conciliation. It agrees to transfer some nominal power to the Commission but subjects it to so many qualifications that it is unlikely to be a relevant power. This is in the context of 55 per cent of the vote in Council being held by member states with a state-owned operator. However, the result is indeterminate since we cannot observe the process of national ministerial preference formation at EU-level.

Hypothesis 2: Confirmed. The Commission and the Parliament have no negotiating power in this round. So although an Agency is created, as the Parliament and the Commission advocated, neither the Agency nor the Commission gain any power over the implementation of remedies. While the Commission is given a general power of decision, this is subjected to so many procedural steps that even if it is ever used, it is unlikely to have any bearing on competition in the market.

Hypothesis 4: Falsified. The Council did not object to creating an Agency on constitutional grounds, but ensured that it was not empowered where this would have any substantive effect.

Hypothesis 5: Falsified. The Independent Regulators Group (IRG) and ERG are both operative. The Council still has a strong preference for NRAs to take decisions on regulatory remedies alone and exclude an Agency and/or the Commission

Hypothesis 6: Falsified. Between 2002 and 2009, the Commission did succeed in concluding a limited number of abuse cases. However, these successes were built on the

existence of regulated accounts which competition law investigations could not have generated.

## **4.5. Regulatory implementation**

In this sector, two tests of regulatory implementation are deployed. One is a qualitative assessment of two product areas. The other is a quantitative analysis of overall implementation in the sector.

### **4.5.1. Variation in the quality of implementation in two key product areas**

We can take the ERG's own audit of wholesale broadband access in order to assess how much regulatory harmonisation there has been in practice. Wholesale broadband access is the key input for competition in broadband retail markets and is, therefore, a reasonable product to test for variation. Wholesale broadband access has been found to be a market power product, for at least some geographical markets, in every member state. Once market power is found NRAs are obliged to adopt proportionate remedies. The optional remedies are described in principle form in the access directive: non-discrimination, transparency, cost-orientation and accounting separation. They are set out in much greater detail in the ERG Remedies Paper (ERG:2008). While these might legitimately vary in detailed content, it is difficult to conceive of any justification for them to vary in type.

The ERG's own overall conclusion of the audit of its members' practices was that current practice was largely in conformity with best practice " despite the fact that many national decision-making processes pre-dated the adoption of the CP [ERG Common Position], the state of conformity was high in most member states of the EU/EEA" (ERG: 2008:1). However, the ERG did note that while most NRAs were able to answer that they had an effective regime in place, stakeholders had a different perception (ERG:2008:2).

Even using the limited facts reported by each NRA (the audit was not conducted by any arm's length grouping), it is clear from the detail of the ERG's initial report that the picture was in fact far from consistent. For example, with respect to the provision of key performance indicators (KPIs) (implementation in practice of the transparency principle regarding quality of supply), ERG members self-reported that only 11 of them had them in place and, of the 11, only nine allowed a comparison of the conditions of supply that

the incumbent made to itself as compared to the conditions of supply it made to others (which is in fact the whole point of KPIs) (ERG:2008b:4).

The ERG's own recommendation on remedies states that:

“As the quality of service is particularly difficult to observe for an NRA, an objective according to Article 10 Access Directive may be backed by an obligation of transparency according to Article 9 Access Directive. This may be done in the form of an obligation to offer Service Level Agreements (SLAs) and periodically reporting performance abilities to the NRA and where appropriate to other operators. Such key performance indicators could be reported for services provided to other operators as well as for self-provided services, to monitor compliance with the non-discrimination obligation.” ERG (2006:92)

Typically for an ERG document, the regulatory policy is described in optional terms; the reality is that without specified comparative information, the regulator will have no idea whether non-discrimination is being implemented in practice or not.

A more rigorous investigation of the same products and conducted a year later by BT for a joint report by Indepen consultants for BT and for the European business users associations examined wholesale broadband access. (Indepen:2008) It also investigated a separate product line, wholesale leased lines, in order to verify that variation was not simply a feature of wholesale broadband access.<sup>126</sup> Wholesale leased lines are the key product for competition in business services. These analyses confirm that while there was usually a headline requirement for non-discrimination in place, the extent to which regulation was fleshed out in order to make it work in practice, and in the ways recommended by the ERG itself, was extremely varied (Indepen:2008:38-48). Of the countries recorded, the incumbents in six are state owned and, as can be seen in Tables 4.2 and 4.3, the regulatory obligations on them tend to be amongst the inferior ones.

Tables 4.2 and 4.3 record first whether there is in principle a requirement for non-discrimination with respect to the product in each country. The second row examines

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<sup>126</sup> The country names A-H are not revealed in the report as BT's intention was to persuade not name and shame (Interview:2009). However, only one of the eight is a country outside the EU-15, and the eight countries are amongst the largest markets. I have used the UK in the last column of tables 4.2 and 4.3. as a comparator.

whether or not the headline requirement has actually been mandated with respect to the particular product. The rows examining KPIs break down the extent to which the KPI obligation is a meaningful one or not. The last row indicates whether as a consequence the product is actually effectively regulated for quality considerations in each country. With respect to the separate issue of price, prices for terminating segments of leased lines indicate that there is variation of up to 300 per cent in prices compared to the lowest price and in most cases the prices are probably being charged to new entrants at between 30 and 50 per cent above cost (Indepen:2008:40). This is a concrete outcome of ECTA's finding that many countries have not implemented the accounting separation requirements, which have now been in the directives since 1998 (ECTA: 2009).<sup>127</sup>

**Table 4.2: Wholesale broadband access<sup>128</sup>**

Country	A	B	C	D	E	F	G	H	UK
Product regulated	Partial	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Regulation Implemented	Partial	Yes	No	Partial	Yes	No	Partial	Yes	Yes
KPI regulated	Partial	Yes	No	Yes	Yes	No	Yes	Yes	Yes
KPI published	No	Yes	No	Yes	Yes	No	Yes	No	Yes
KPI measures internal versus external supply	No	No	No	No	No	No	Yes	Yes	Yes
Effective	No	No	No	No	No	No	Yes	In theory, but	Yes

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<sup>127</sup> The Interconnection Directive contained the rather odd provision that there is a requirement to publish the separated accounts unless there is a contrary provision of national law – i.e it subordinates EC law to provisions of national law. Most countries have not published the accounts nor the methodology of their construction (also required to be published and without exception) which makes it impossible to say whether what is being done is capable of ensuring that prices are cost orientated. The pricing outcomes suggest that in a number of countries that they are not working very well.

<sup>128</sup> ATM bitstream except for Country B where only IP Stream is regulated.

regulation								unverifiable	
State owned	Yes	Yes	Yes	No	Yes	Yes	No	Yes	No

Source: *Indepen* (2008:44)

**Table 4.3: Terminating segments of leased lines<sup>129</sup>**

Country	A	B	C	D	E	F	G	H	UK
Product	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Regulated									
Regulation Implemented	Partial	Yes	No	Yes	Yes	No	Yes	Partial	Yes
KPI	No	Yes	No	Yes	Yes	No	Yes	Yes	Yes
KPI published	No	Yes	No	Yes	Yes	No	No	No	Yes
KPI measures internal versus external	No	No	No	No	No	No	No	Yes	Yes
Effective regulation	No	No	No	No	No	No	No	In theory, but unverifiable	Yes
State owned	Yes	Yes	Yes	No	Yes	Yes	No	Yes	No

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<sup>129</sup> These are 2M/Bit 5km terminating segments which are the most common type. The *Indepen* report also examines supply conditions for 34 M/Bit 5km terminating segments. Source for table 4.3. is *Indepen* (2008:39-41)

#### 4.5.2. Overall implementation

If we look at overall implementation using the ECTA scores for regulatory effectiveness in 2009 (which is out of a total of 400) and correlate this with state ownership and market shares then we find that mean scores for the regulatory regime are higher and that the regulated company has a lower market share where the company is not state owned (see table 4.4. below). However, the test is a small *N* one and the figures are not significant.<sup>130</sup> The ECTA scorecard measures regulatory scores based on answers to 118 questions grouped in five sections: overall institutional environment, key enablers for market entry and network roll out, the NRA's regulatory processes, application of regulation by the NRA, and regulatory and market outcomes (ECTA:2009).

**Table 4.4 Correlating type of ownership structure with scores for regulatory effectiveness and with market shares**

<b>Telecommunications</b>			Incumbent market share
		ECTA score	Mean: broadband & calls
State owned	Mean	269.7	59%
	<i>Observations</i>	12.0	12.0
	<i>Standard deviation</i>	35.7	7.0
Non-state owned	Mean	301.2	55%
	<i>Observations</i>	6.0	6.0
	<i>Standard deviation</i>	69.5	8.0
Significance	z-test	29.7%	38.7%

Source: Tarrant and Cadman (2009)

<sup>130</sup> Note that when all of the sectors are pooled, providing a larger N, the findings become significant. See pages 340 and 341 of the Conclusion.

### **4.5.3. Empirical findings and the hypothesis**

The empirical findings are indeterminate because we cannot compare the activities of NRAs and an Agency within the sector as the hypothesis would require. However, the findings show that there is widespread variation in the quality of implementation when NRAs are empowered. This suggests that deliberative supranationalism does not overcome national policy preferences. This finding of variation in outcomes will be compared with results from sectors where there are Agencies and this is done in the conclusion. The qualitative analysis of the two products in section 4.5.1. suggests that implementation is weak where the NRA is regulating a state-owned entity and only (but not always) effective where it is privately owned. Quantitative analysis suggests that NRAs with state owned entities have lower scores regarding regulatory effectiveness. This might in turn suggest that member states with state owned entities have a preference for NRAs because this is their preferred outcome.

### **4.5.4. Supporting research of perceptions of informal networks and of independence from ministries**

#### *4.5.4.1. Deliberative supranationalism and networks of regulators*

This section discusses the formal rules that apply in the network of NRAs. It then sets out the views of NRAs as to the functioning of these networks. Responses from a wider group of stakeholders as to the extent of ministerial influence on NRAs are then set out.

#### *4.5.4.2. Networks of telecommunications regulators*

The IRG was created by the NRAs and started meeting on an annual basis in 1997. Since 2002, there has been coordination of national regulators at EU-level through the ERG. Some have seen this as a potential mechanism for NRAs to bypass the political level obstacle to harmonisation (Eberlein and Grande:2005:89 ). The ERG is an institution that brings the European Commission and the NRAs together. It was not a creation of the Directives regulating the sector, the Council collectively having struck out a draft article creating such a body from the Framework Directive on the basis that as an actor it would be a potential competitor for the comitology body on which ministries sit (Presidency:2001). Rather, it is a body created by a Commission decision permitting a

range of national regulatory authorities to “advise and assist” the Commission with respect to the latter’s duties under the directives (Commission:2002:Article 3). The Commission effectively building on the existing Independent Regulators’ Group, which is the same body absent the Commission and which continues to exist in parallel to the ERG.

#### 4.5.4.3. *Formal powers of the ERG and IRG*

The ERG has no powers to make decisions that are binding on its members.<sup>131</sup> Assuming it could make substantive collective positions, it might be considered to potentially have the power to do so indirectly via *advice*, which it provided to the Commission and upon which the Commission then acted. However, such an indirect power would be subject to the limitations set in the directives to the Commission’s own powers. As discussed in paragraph 4.4.5.7., the Commission’s discretion to set regulatory policy in pursuit of harmonisation has been circumscribed. Alternatively, as the NRAs are the bodies which are those required formally to make the regulatory policy decisions at national level under the EU Framework, it has been argued that it could act as a venue for harmonisation through coordination and mutual education (Eberlein and Grande:2005:101). While national regulators meeting under the auspices of IRG/ERG do produce best practice papers, these have typically been drafted in a very general way and members have not regarded them as morally binding.

Some comments on IRG/ERG best practice papers made in questions posed for the thesis:<sup>132</sup>

“IRG PIBs [best practice papers] are a result of compromise between organisations of very different size, mindset and legal background. Therefore, they are usually very vaguely worded, carefully avoiding the critical issues. However, even in cases where the

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<sup>131</sup> Article 4.1 ERG (2003), although Article 4.2. states that on an exceptional basis decisions can be made on a two-thirds basis. Article 4.4. states that the positions or opinions of the Group shall not be binding on its members, but that members shall take the utmost account of such positions or opinions. At Madeira in 2006, the ERG removed the description of majority voting as exceptional but the non-binding nature of decisions was preserved (Interview with NRA official:2007).

<sup>132</sup> However, note that these answers were provided in 2006, prior to the ERG beginning self-audits. The ERG would no doubt argue that this has altered, although the Indepen and ECTA reviews of outcomes would suggest not.

final document becomes a truly useful tool for the regulator (i.e. the ERG Remedies Paper), it is not a legally binding document, therefore, it is only implemented in light of the local market situation.”

“Implementation of ERG/IRG PIBS is a possibility if in accordance with national priorities but not an obligation.”

“If a recommendation/opinion/common position runs up against a domestic political imperative then it’s useless. It might help where a mere official at the ministry is querying the policy of a national regulator and he or she can say that it is in line with the collective view of national regulators. There is no sanction, social or otherwise, for failure to comply with a recommendation/opinion. Everyone recognises that they could find themselves in a position where they do not wish to apply for a PIB etc for domestic reasons. ERG has been mandated to look at the extent to which NRAs do apply opinions et al. However, expect it to be half-hearted. Can’t imagine that the large number of countries that do not apply significant parts will agree a methodology that will point this out.”

The detail of the best practice papers did improve in the course of 2006-8, and the ERG also conducted a self-audit of implementation in wholesale broadband access. However, there is a possibility that this was conducted as an attempt to deny that the Commission’s legislative pursuit of hierarchical power in the 2006 Review was necessary. It was noticeable that the ERG’s self-audit concluded that NRAs mostly met ERG best practice in the particular product area, which according to some operators was simply not a realistic appraisal.<sup>133</sup> The ERG also met informally to review NRA market analyses when they were under threat from veto by the Commission. According to participants and to Commission officials, the work done in the area of market analysis was of real quality (Interviews:2008). The latter developments might suggest that European networks work where there is either European-level decision-making capacity or the threat of it, which is not the case with respect to remedies.

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<sup>133</sup> See for example, BT’s survey of broadband regulation in a number of countries. Indepen (2007: Part 3, Chapter7:20)

The Commission's view of the work of the ERG and thus its advocacy of the need for an Agency was based on the following assessment: "All ERG common positions are factually based on consensus, making such common positions difficult and slow to achieve. They are indeed impossible to achieve where there are substantial differences of opinion or interest between the different regulators. The loose cooperation that results has not allowed its comments to go beyond rather general statements in a number of important and controversial areas." Commission (2006:5)

#### *4.5.4.4. Conditions necessary for deliberative supranationalism*

Eberlein and Grande suggest six conditions which were necessary for deliberative supranationalism to operate and thus to allow NRAs to informally set regulatory rules and bypass the political unwillingness to empower supranational institutions. These conditions were turned into questions (see Annex Four). They were asked of officials from NRAs in three large member states. The answers were very clear as to the extent to which none of the necessary conditions apply. The responses are recorded in Annex Five.

#### *4.5.4.5. Responses from interviewees regarding interactions between ministries and regulators*

Interviewees from three member states from a wider selection of stakeholders have also been asked questions in semi-structured interviews to see whether there are any indications that the activities of regulators has been affected by state ownership. Their comments indicate that most of the stakeholders interviewed thought that there is some degree of engagement by ministries in the two countries with state ownership (countries A and B) and that this appears to be qualitatively different from a country where there is no state ownership (country C), see Annex Five.

#### *4.5.4.6. Conclusion*

The views of NRA officials suggest that the activities of IRG and ERG are unlikely to provide a counter pressure to ministerial influence. The views of stakeholders suggest that where there is state ownership that there is also a degree of ministerial influence.

## **4.6. Findings with respect to the hypotheses**

### **4.6.1. Hypothesis 1**

Hypothesis 1 states:

*The greater the distributional conflict in a policy area, the less likely the Council is to delegate regulatory authority to autonomous European level regulatory bodies, and the more likely they are to delegate to bodies (such as NRAs) more subject to control by national governments.*

There are four observations of Council positions.

In the first, the Council refuses to accept the Commission legislating to give itself autonomous regulatory powers.

In the second, member state officials made it clear to NERA, surveying on the Commission's behalf, that they will not accept a Euroregulator. Member states subsequently refuse to give the Commission any ex ante or ex post powers in the Directives vis-à-vis the NRAs that they will empower.

On the third occasion, they do transfer, some unimportant control powers over NRAs to the Commission – but do so because they need legislation to a certain, but not very pressured, extent.

On the fourth occasion, they subject the powers already granted to the Commission to agenda setting by an Agency. However, they approve a hollowed out Agency, which will have no ability to develop any preferences of its own. They remove or qualify provisions in the directive which would reduce the controls over NRAs by national governments.

On each occasion, a majority of national governments had ownership in state-owned operators. The results are, however, indeterminate from a process tracing perspective - a chain of causation from ownership to legislative preference can only be inferred not proven. It is nonetheless clear that a null hypothesis, which suggested that in the context of high-distributional conflict, member states would prefer to give control over implementation to European-level institutions, receives no support.

#### **4.6.2. Hypothesis 2**

Hypothesis 2 states:

*The greater the influence of the Commission and Parliament in the politics of bureaucratic design in a particular sector, the more likely that a supranational regulator (either the Commission alone or in conjunction with an EU Agency) will be tasked with delivering regulation; and vice-versa.*

The four observations of the Commission reveal that on each occasion its preferences are for greater control over implementation at European level.

On the first occasion, the Commission seeks to give itself regulatory powers through competition law.

On the second, its first preference, and that of the Parliament too, is either a Euroregulator or the European Commission.

On the third, both favour giving the Commission control powers.

On the fourth, they both favour joint management between an Agency and the Commission, with the Parliament preferring at first reading to make the Agency the stronger veto player but wanted the Commission to have an effective back-stop decision-making power which would be binding on all NRAs.

The Commission and Parliament's influence over the content of directives varies between rounds. The leverage provided by Commission own-initiative competition directives is sufficient to force the member states to agree to legislation in the first round, despite their being a majority with distributional concerns which are antipathetic to the Commission's objectives.

However, in joint legislative rounds two and four, the Commission have no structural basis for overcoming blocking groups of member states within the legislative negotiation. In round three, they have a limited structural advantage (due to the automaticity of regulation at low market share thresholds) due to potential exogenous changes in technology. At no stage, are there any sufficient exogenous changes to give the

Commission and the Parliament enough negotiating power to oblige blocking groups of member states to accept hierarchic supranational control over regulation.

The outcomes confirm hypothesis 2: the Commission and Parliament in each legislative round push for greater supranational control over implementation. In the one legislative round where they have some structural influence, they achieve control over procedural elements for the Commission. The null hypothesis would require that there be no attempt by the Commission or the Parliament to push for effective market opening regulatory authority at European level; however, efforts in this sector have been consistent.

#### **4.6.3. Hypothesis 3**

Hypothesis 3 states:

*EU Agencies will typically lead to more effective implementation than institutional designs that rely only on the activities of NRAs.*

The findings with respect to variation in the quality of regulatory implementation provide empirical data that will allow comparison between the outcome of NRA implementation in this sector and the outcomes in other sectors where Agencies have been empowered. The results nonetheless indicate that implementation tends to be carried out less effectively where the regulated entity is state owned and as a consequence the markets shares of state owned entities appear to be higher on average. However, the results are not significant and the sample is necessarily small N. The results do become significant when energy, rail and telecommunications figures are aggregated.<sup>134</sup>

#### **4.6.4. Hypothesis 4**

Hypothesis 4 states:

*The Council will decline to empower Agencies to undertake implementation for constitutional reasons.*

The empirical findings in the fourth legislative round lead to a rejection of this hypothesis. The Council is prepared to create an Agency in this sector (but refuses to

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<sup>134</sup> See pages 340 and 341.

empower it to deal with the core area of regulatory remedies – the actual content of regulation). Constitutional principle is not raised by the Council collectively with respect to the areas where the Agency is empowered.

#### **4.6.5. Hypothesis 5**

Hypothesis 5 states:

*The Council does not have a strong preference with respect to the selection of either NRAs or Agencies because informal networks of NRAs are the functional equivalent of Agencies.*

In each joint legislative round the member states have a clear preference for NRAs over an Agency as regards the content of regulation. The findings with respect to the views of NRA officials as regards the implications of belonging to a network do not suggest that they are likely to be the functional equivalent of an Agency. These findings also indicate the absence of any of the theorised conditions considered necessary to give rise to deliberative supranationalism.

#### **4.6.6. Hypothesis 6**

Hypothesis 6 states:

*The Commission does not have a strong preference for Agencies over NRAs because it can regulate utility sectors using competition law.*

This hypothesis is rejected in round one. In rounds two and three, the Commission preferred an Agency over NRAs. In round two, its first preference was the Euroregulator. In round three, it proposed a form of interaction with a network of regulators that would have been the equivalent of an Agency. In round four, it proposed a full function Agency. Both practically and as a matter of law, the Commission did not believe that it could regulate the utility sectors using competition law.

## **5. Chapter 5: Institutions and network access and interoperability/safety regulation in rail**

### **5.1. Introduction**

Rail provides a particularly interesting case study because alongside negotiations over the regulation of economic access, there were parallel negotiations over the regulation of interoperability and safety issues. Institutional design for each of these aspects has evolved in contrasting directions: access regulation is delegated to national regulatory authorities, while interoperability and safety regulation is subsumed within a European Agency.

This chapter first of all sets out in paragraphs 5.2 to 5.6 the reasons why regulation and harmonisation might be required in this sector in order to deliver a single market. Paragraph 5.6 examines the extent to which there is the likelihood of disagreement as to distributional outcomes and in particular the degree of state ownership. Paragraph 5.7 examines the institutional proposals and outcomes in EU rail access legislative processes in detail. Paragraph 5.8 examines preferences and outcomes with respect to interoperability and safety in detail<sup>135</sup>. Analysing the material for the previous two sections required the review of 116 legislative documents. Paragraph 5.9 analyses the extent to which harmonised regulation has been delivered in access and in interoperability and safety. It also examines stakeholders' perceptions of the current nature of cooperation between regulators and also the perceived interaction between regulators and national ministries. Chapter 5 concludes with an assessment of the extent to which developments in the rail sector meet the hypotheses explored in the thesis.

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<sup>135</sup> Annex Nine contains tables summarising the principals' preferences and outcomes.

## **5.2. The need for regulation and harmonisation**

### **5.2.1. The need for regulation**

This section describes the aspects of regulation that are key to promoting competition in newly liberalised rail markets: network access and interoperability/rail safety. It sets out what regulation in these areas is intended to achieve and the activities that need to be effectively regulated for markets to be opened in practice. It explains why the existing competition law powers of the EU are not effective substitutes for sector-specific regulation. It points out why an absence of harmonisation of regulation at EU level and institutional mechanisms for delivering it jeopardise market opening.

### **5.2.2. The objectives of access regulation**

Access regulation is intended to ensure that new competitors to the incumbent operators have access to the non-replicable underlying network components over which passenger and freight services are supplied to customers (i.e. access to rail track and ancillary services such as power supply and stations). In order for the new entrants to be able to compete, they must have access to these network components at the same cost, same time and at the same quality of service as the network provider makes them available to other service providers including its own retail service arm. As Stephens, the leading academic specialist on the EC transport policy, notes: “Any rights of access would be valueless if the incumbent national railway could either refuse to license the intruder or make its operations uneconomic by means of excessive charges, or by offering it unreasonably slow or circuitous train paths.” Stephens (2004: 98)

Such access is justified from the perspective of developing competition and the single market on the basis that it is economically infeasible for a new entrant to replicate the incumbent infrastructure. In the absence of constraint, it is irrational for a profit-maximising de facto monopolist to supply monopoly network elements under terms and conditions that allow for competitors to survive (Stehmann and Zellhoeffer:2004:345). Consequently, a regulator is required to police these terms and conditions and hence determines whether competition can actually take place.

### **5.2.3. The objectives of interoperability and safety regulation**

Regulation of interoperability and safety is in part intended to ensure that de jure authorisation of companies from other member states is not frustrated in practice by technical incompatibilities between track and train set equipment or by variations in the organisation of safety procedures within companies caused by different home-nation requirements. Service providers from one member state entering another could be inappropriately refused a safety certificate for failing to meet interoperability/safety requirements or, in the absence of verification, their management systems and equipment might be actively dangerous.

Interoperability is defined as “the capability to operate on any stretch of the rail network without any difference. In other words, the focus is on making the different technical systems on the EU's railways work together.”<sup>136</sup> This requires that the technology (for example, manufacturing standards and operational rules) and safety regulations (for example, speed limits, braking times and training qualifications) have to at least be sufficiently similar to allow equipment and personnel established in one member state to provide service safely in another.

Interoperability and safety are overlapping categories in the EU legislation as one of the main drivers of national legislation impacting on national manufacturing standards and operating rules for rail has been safety considerations. However, other non-rail related considerations have also had significant impacts on the characteristics of the technologies deployed at national level and thus of their interoperability. As a consequence, the categories in which the EU seeks to develop rail harmonisation cover safety, reliability and availability, health, environment and technical compatibility (Kema:2007:58). For example, under the latter heading, the EU has to look at rules around spectrum allocation for rail communication systems. National rules on spectrum for wireless use were not developed with cross-border rail as a primary consideration. However, differences arising from national spectrum plans have led to incompatibility in the spectrum allocated for locomotive signalling systems and this has meant that on-board equipment from one

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<sup>136</sup> [http://europa.eu/legislation\\_summaries/transport/rail\\_transport/124015\\_en.htm](http://europa.eu/legislation_summaries/transport/rail_transport/124015_en.htm) as of 8.08.2010.

member state may operate at incompatible frequencies with track systems in other member states (Pellegrin:2008:113).

In many member states, historically, safety measures were decided and managed by the same entity that provided rail services. Once competition was introduced this meant that there was a risk of safety measures being used for the purposes of indirect discrimination to protect home markets (Lundstroem:2002:11). Interoperability had usually been negotiated between the rail entity and national or international manufacturers and there was a risk of national variation being deliberately prolonged in order to secure domestic protection (Joint Strategy for Rail Research:2001:6).

However, safety measures, I would argue, are potentially less attractive as a means of protecting national incumbents than access measures for two reasons. First, safety rules that are not harmonised and non-interoperable equipment prevent exports as well as imports. If country X defects from the spirit of economic access rules, then Country X's rail operator can nonetheless operate on the market of country Y where the latter regulates access effectively because the methods of discrimination revolve around charging rules and routing with respect to the same interoperable equipment. If either country X or Y defects from the pursuit of common safety and interoperability rules, however, then there is no possibility of trade at all due to technical incompatibility.

This theoretical argument would appear to be supported by the preferences of the country that was the leading antagonist to liberalisation. France, which was deeply hostile to Europe having competence in the field of rail access (Chabalier:2006:6), was a leading proponent of EU regulation of interoperability and safety, particularly with respect to high-speed passenger trains (Douillet and Lehmkuhl:2001:121).

Second, locking national equipment manufacturers into the production of sui generic equipment also prevents them from accessing export markets elsewhere within Europe and reduces the economies of scale that could be available and would assist in competing on wider global markets; a point the Commission has frequently made in its advocacy documents (see, for example, Commission:1990:53).

The difference between institutional outcomes in EU frameworks for access and safety issues arguably arises from this difference in the potential effects of lack of regulatory

implementation. The same rail organisations are involved in each case, so the same degree of state ownership exists. One might then ask whether for theoretical purposes state ownership should not promote identical outcomes? This is not the case because the simultaneous existence of two issue areas which could potentially block markets, but one having the characteristic of potentially only blocking imports, made it advantageous for potential defectors from market opening to shield their operator from distributional consequences through access regulation. Where both safety and access regulation are required, the former is necessary but it is not sufficient to deliver competition within each national market. Control over access regulation potentially allows national authorities to free ride whereas safety regulation has to be uniform to work at all.

### **5.3. The content of regulation**

#### **5.3.1. The content of rail access regulation**

Rail access regulation seeks to apply the same four general principles of economic regulation as regulation in other network utility sectors, such as telecommunications: non-discrimination, transparency, cost-orientation and accounting separation. In order to permit competition, these principles should apply to both the network and any non-replicable facilities that are necessary in order to use the rail track in practice, such as power supply.

In addition, similar to the energy sector and to a lesser extent on telecoms, there has been debate in the rail sector (also reflected in European legislative negotiations) about going beyond accounting separation and requiring actual structural separation of the network provider and the provider of rail services (OECD:2005:9). This would make policing of the four general principles far easier in practice. The allocation of costs and accounting separation would not be artificial paper constructs attempting to mimic the transactions that would occur if a vertically integrated company were separate but would simply happen in practice. It could also potentially eliminate the interest of the network owner in conducting any unfair discrimination between different rail providers, if it facilitated state divestment of the services arm.

### **5.3.2. The content of interoperability and safety regulation**

Interoperability and safety regulation has sought to create mechanisms for agreeing, applying and enforcing standards and processes so that equipment and personnel can be deployed on a cross-border basis. For example, in order for locomotives to cross national borders there needs to be agreed standards for track-to-locomotive signalling for use in the manufacture of trackside and cabin equipment.

Harmonisation processes will have impacts over a variable time period due to the different possible replacement cycles of the systems and processes on which they impact. Locomotives and wagons, for example, have a lifespan of 30 to 40 years whereas the lifespan of track would be nearer a century (Commission:2009:8).

## **5.4. The marginal relevance of competition law cases**

### **5.4.1. Theoretical possibility of using competition law for access issues**

Competition law cases could, in theory, also be used to impose sanctions for excessive pricing of access to rail slots or refusal to supply them on a non-discriminatory basis. As in other sectors, state-owned and vertically-integrated incumbents sometimes argue that sector-specific access EU regulation is therefore unnecessary as the Commission already has supranational powers. It is therefore necessary to point out why EC competition law has not acted as a source of “shadow” hierarchy (Heritier and Lehmkuhl:2008), potentially pushing national regulatory authorities to be more active in order to avoid being displaced. If it were the case that there was an active shadow power and no displacement of decision-making is taking place, then the argument may be made that in the absence of any enforcement action by DG Competition that there cannot actually be any access problems (Interview with incumbent representative:2007).

### **5.4.2. Practical impossibility of using competition law for interoperability and safety issues**

Interoperability and safety standards are adopted by government authorities. Competition law primarily targets the behaviour of economic actors. In practice, even where standard setting is conducted on an anti-competitive basis, competition law authorities are unlikely to have the capacity to adjudicate. In the Microsoft case, for example, where the latter was required by DG Competition to make some source codes available, a separate

independent adjudicator had to be appointed (Commission:2005). Unlike economic access issues, no party has ever suggested that DG Competition should deal with interoperability and safety issues in rail.

#### **5.4.3. Technical weakness of competition law in dealing with economic access to rail**

The weakness of competition law is that it operates as an *ex post* control of a particular piece of behaviour. This means that it only takes effect once an abuse has occurred, a complaint has been generated and a sanction has been applied. At the least, this creates extended market uncertainty and at worst, the elimination of the competitor before an investigation is concluded. While problematic, this is unlikely to be fatal on a more “normal” dominated markets where competition law holds sway and where typically the dominant company may have around a 50 per cent market share. In contrast, on the dominated utility markets, the vertically-integrated incumbent begins competition with 100 per cent of the retail market and 100 per cent of the wholesale network market, which is essential for competition on the retail market.

Furthermore, standard competition law behavioural sanctions deal with specific breaches relating to an individual product. Due to the multiple pricing and technical possibilities, rail products (like telecommunications products) can be altered to regain an unfair advantage without necessarily being caught by a previous ruling. For a discussion of the theoretical manipulations available to an incumbent rail operator see Weidmann (2008) or for an analysis of the difficulties faced by new entrants on the German market, see Slack and Vogt (2007). In an interview for Coen et al. an official at the Bundeskartellamt, the German competition authority, revealed: “There are endless possibilities for the DBAG [Deutsche Bahn] to discriminate against new market accessants [sic], and these are very hard for the cartel office to pinpoint” (Coen et al:2002:41) .

A hypothetical comparison of the potential effectiveness of a sector specific regulator vis-à-vis a general competition authority can be constructed using the example of slots (i.e. capacity made available at a certain time for a certain duration by a rail network provider on a certain route between a starting and a terminating destination). A regulator

independent of the rail company would receive all requests from all rail companies and allocate slots on an objective non-discriminatory basis. Where there were conflicting requests, it would put forward alternative routes on a fair basis (or verify that this had been done if conducted by another entity).<sup>137</sup> This would all occur prior to any of the journeys taking place. In a situation where a competition authority tried to deal with slot allocation, it would have to begin an investigation or receive a complaint after the alleged discrimination had taken place. It would have to find records that allowed it to show that the alleged events had occurred and that this discrimination was unfair. If regulation does not require the creation of a documented process, there may be little evidence with which a competition authority can work.

#### **5.4.4. No application of EC competition law in practice**

One interviewee representing logistic users of rail noted that national and European competition agencies had been not been very active in this sector. He put this down not only to the difficulty of using competition law to regulate vertically-integrated companies but also to the relative lack of implementation of the sector-specific directives. This had the effect that there were very few countries with robust new entrants capable of complaining to authorities and taking cases. (Interview: December 2007). A new entrant to country A interviewed for the thesis said: “We do not use competition law as we are too small, the revenge [of incumbent of country A] would be too drastic and we would have to wait two years for any result.” (Interview: May 2009). In any event, there are no EC competition law cases whatsoever in which the EC has sanctioned abuse of access to network slots.

Other aspects of competition law have had limited influence. There are no EC rail law textbooks and in EC transport law textbooks, rail takes up a tiny section (Greaves:2000). In Faull and Nikpay’s comprehensive 1,844-page guide to EC competition law, practice in rail has a couple of paragraphs only (Faull and Nikpay:2007). As the *International Railway Journal* has put it, there is “little case law to guide the parties” (International Railway Journal:2002). Competition Commissioner Monti noted in 2002, perhaps rather

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<sup>137</sup> A new entrant in country A complained that the incumbent often turns down their requests for slots and will not tell them if there are other alternative windows of opportunity within a near time frame (Interview:

generously: “Up to the present, Commission activity in the railway sector, in terms of both merger control and anti-trust law enforcement, has been relatively low” (Monti:2002:2).

## **5.5. The need for harmonization**

### **5.5.1. Introduction**

Effective harmonisation of access and interoperability/safety regulation is potentially desirable in both passenger and freight rail because, in general, harmonisation facilitates competition between rail companies at the service level within national markets such that the more efficient companies should prevail, generating greater consumer surplus. In addition, like the other utility sectors, the absence of harmonisation between member states at the infrastructure layer also substantially prevents the deployment of certain cross-border pan-European services at the service layer. In other words, there are impacts in general on pricing and also on the availability of certain specific services for consumers at all.

### **5.5.2. The collapsing freight market**

In the case of rail, the absence of effective harmonisation jeopardises the existence of rail freight altogether. In rail, freight services generally become competitive with road haulage at distances of around 600km (Zomer and Islam:2008:2). Currently, the average haul in the EU is about 270 km which implies that it tends to be used only for certain marginal specialised goods within member states where road haulage is not practical (Thompson:2008:20). Without the ability to compete across borders and thus the restriction of freight providers to the delivery of national services, rail freight has become largely irrelevant to the needs of European businesses. In fact, the carriage of freight in the EU has declined in volume terms from 32 per cent in 1970 (Commission:1990:9) to eight per cent in 2003 (Commission:2007:4). The Commission’s 1997 White Paper put it as follows: “The national focus of railways has left them handicapped when dealing with this [freight] traffic although they are potentially well suited to carry it.” (Commission:1997:3-4).

What could be achieved is indicated by an example from the Netherlands. There, the Dutch state financed a specific dedicated freight route to connect Rotterdam to the German rail network. This was to assist Rotterdam in its competition with Hamburg as a major port facility for German manufacturing. The Dutch state also privatised the freight operations of the domestic incumbent, which was sold to Deutsche Bahn. As a consequence, seven-eighths of Dutch rail freight is international traffic. The OECD considers that the actions of the Dutch government were driven by the centrality of Rotterdam and Schiphol to the overall Dutch economy, apparently responsible for 20 per cent of Dutch GDP (OECD:2007:367); a concern that would rank more highly than the interests of the rail incumbent. Internationally, it is notable that in the US, 40 per cent of freight by volume goes by rail (Stehmann and Zellhofer:2004:329).

### **5.5.3. Impacts on international passenger services**

Similarly, for passenger services including international journeys, rail services have declined as a percentage of passenger journeys from ten per cent to six per cent between 1970 and 2003 (Commission:2007:4). Again, for certain densities of demand and certain distances, rail could be expected to out-compete airlines for international passengers but is currently not doing so except on some specialised routes, such as the Eurostar route (Di Pietrantonio and Pelkamns:2004:32).

## **5.6. Distributional conflict**

### **5.6.1. Competing pressures on ministers**

Ministers face a number of competing distributional claims in this sector: pressure for low prices for rail passengers; pressure for low prices for freight users; pressure for widespread geographic availability of services at high frequencies, where there is a trade off between passenger and freight usage; pressure for high employment for employees of national champions; pressure to reduce subsidies from the state for the national railway undertaking; and sometimes a desire for inward investment from foreign rail companies.

However, in many cases, governments face a situation of conflict of interest in attempting to resolve tensions between these objectives because they are not only the

potential rule-makers, but are also owners of the regulated companies and often direct employers of the workforce who have retained civil service status.<sup>138</sup>

### **5.6.2. Degree of state ownership in rail**

The degree of state ownership is highest in this sector of all the sectors examined in this thesis. IBM's survey of the EU rail sector includes an analysis of ownership in each member state (IBM:2007). It reveals that in only three EU member states does the state not own companies providing freight services and in only one does the state not own companies providing passenger services.<sup>139</sup> In every member state of the EU, the state owns the rail network,<sup>140</sup> and typically they are vertically integrated with state-owned passenger and freight services. In five member states, the publicly owned infrastructure and train operating assets are held in separate companies. However, this may not make any difference to anti-competitive coordination given the links between the separate companies. Sometimes, the service companies are nominally operated separately from the track company but are brought together by holding companies (Germany) or by setting up the separate infrastructure company as a shell that purchases services from the vertically integrated company (France) (IBM:2007). For the purpose of assessing voting strengths, if the state owns both entities in the vertical chain, the company is treated as vertically integrated. The degree of state ownership in table 5.1. is calculated using freight. If it were calculated on the basis of passenger rail then the UK is the only country without 100 per cent state ownership.

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<sup>138</sup> For example, 166,000 of SNCF's employees have civil service status (Accenture:2010:2) and 45,000 of Deutsche Bahn's (Schmidt:2008:3).

<sup>139</sup> Although, subsequently, the state has been obliged to take back a failing franchise in the UK on a temporary basis.

<sup>140</sup> In the UK, Network Rail has the status of a private company but its equity is wholly owned by the state.

**Table 5.1 State ownership and the proportion of votes in the Council of Ministers held by Member States with ownership interests in rail**

Rail	No of vertically integrated incumbents with state ownership	Weights in European Council by countries with state ownership	Proportion of total votes in council %
1991	12	76	100
1995	14	79	89
2001	12	69	78
2004	12	69	78
2007	22	265	83
2008	22	265	83

Source for ownership: Conway and Nicholetti:2006; Tarrant and Cadman:2009.

Source for votes: Wiberg:2005.

### **5.6.3. Degree of cross-border trade**

There are no published figures of which sector interviewees were aware. Pressed to estimate a figure, they thought that it might be approximately five per cent of industry revenues (Interviews:2010).

### **5.6.4. The debt problem in rail**

An additional complicating factor applying to state-owned actors in the rail sector, compared even to other utility sectors, lies in the state's financial entanglement with rail companies. This takes two forms: annual subsidies for the provision of loss-making

services and investment for new infrastructure; and the risk of potential state liability for railway debt. The total annual size of subsidies in the EU is £75 billion, split equally between fare reduction programmes and infrastructure investment (European Environment Agency:2007:8).<sup>141</sup> There is also an enormous level of debt owed by rail companies. This is likely to have been a significant additional factor making member states extremely cautious about opening the sector to competitive processes. Losing their monopoly could make it difficult for these companies to fund their participation in a competitive marketplace. If they struggled to survive on a genuinely open market, they might also be unable ever to repay that debt and it would ultimately revert to the state. The total debt of railway companies in 1994 was the equivalent of 112,543 billion euros, approximately two per cent of national debt in most EU countries (Holvad:2006:25). In Germany, it was the equivalent of 1.8 per cent of GDP, France 2.6 per cent and Italy five per cent (Perkins:2005:5). The debts were so large because governments post-1945 were reluctant to annoy voters by cutting unprofitable routes and they were equally reluctant to make budgetary allocations that fully covered the costs of providing services that were unprofitable (Stehmann and Zellhofer: 2004:328)

#### **5.6.5. Evidence of railway companies being used for the pursuit of public goods**

The difficulty that state-owned rail undertakings had in covering their costs was exacerbated by public goods other than the provision of rail services which state-owned rail companies could be directed to pursue, activities that a fully private company might refuse or would only pursue if compelled by legislation. For example, they could potentially be directed by their owner (the state) to purchase equipment from other national companies or to maintain levels of employment in particular areas. In periods of high unemployment, for example, French governments would require SNCF to employ

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<sup>141</sup> In an interview for the thesis in June 2008, an official at the Ministry of Transport for country B said that the Minister had refused to accept a proposal by the *independent* regulator to introduce a price cap on infrastructure charges and regulatory cost-accounting. These are standard regulatory mechanisms for controlling monopoly pricing. This is an indication that state ownership and investment was interfering with the independence of the regulator. The official said: “We do not need a price cap, prices are set by the market and are non-discriminatory so should not impact on competition. We have invested a huge amount in infrastructure and the investment of the state must be respected.” There is no reason why a price cap on infrastructure and a close control over the flows of funds within the regulated company would not respect investment unless repayment is achieved through the general performance of the vertically-integrated

more people (Douillet and Lehmkuhl:2001:104). This is alleged to be a common practice amongst member states (Perkins: 2005:9). Coen et al. cite a senior representative of Deutsche Bahn with respect to governmental pressures to maintain workforce numbers: “Speaking about the reduction of personnel, a member of the Deutsche Bahn AG’s management board frankly admitted that 4 years after their transformation into a joint stock company, the railways were not yet a place as free of politics as other enterprises” (Boelhoff and Coen:2001:155). In other words, in this sector, the state often does not appear to have ceased to use the railway for multiple goals which was one of the characteristics that Majone identified with the “regulatory state”(Majone:1994:89).

#### **5.6.6. Hostility of unions to liberalisation**

The introduction of competition was not, however, just a problem in that it might jeopardise the member states’ ability to use railway companies to pursue general public policy objectives. It also meant that there were large workforces that felt threatened by market opening. Furthermore, their representatives could see what had happened to the numbers employed on US railways post-liberalisation, where employee numbers dropped from 458,332 to 157,699 between 1980 and 2004 despite rail actually growing the percentage and volume of freight it carried (McCullough:2006:311).<sup>142</sup> Typically, European rail operators have very large workforces. For example, in 2008 SNCF and Deutsche Bahn respectively employed 178,000 and 174,000 people, the large majority of whom were unionised (Traxler and Adam:2008).

National and European railways’ workers representatives have been consistently hostile to market opening. For example, the European Transport Workers’ Federation passed a resolution in 2005 stating: “This ETF Congress notes with concern the EU Commission’s focus on liberalisation of all services, including transport. Privatisation and deregulation of transport services – road, rail, air, ports and sea – poses major threats to job security, wages and collective bargaining agreements affecting our members in these industries” (ETF:2005). Nor did they necessarily stick to resolutions. The Confederation General des

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company (i.e. via dividends and the share price) as opposed to a return tied to the specific performance of the monopoly infrastructure asset (for example, via a loan or a bond).

<sup>142</sup> The references are to freight rather than passenger services as the US railways have always been primarily focused on the carriage of freight.

Travailleurs (“CGT”) blockaded railway lines to prevent the first attempt to run a non-SNCF freight train in France (Chabalier:2006:14) and fears of liberalisation were a major cause of the 1995 French railway strike leading to the eventual fall of the Juppe government (Chabalier:2005:12).

#### **5.6.7. Likely industrial consequences of genuine competition**

A competitive playing field in the EU could potentially mean that the industry would be structured differently. Rather than principally comprising of separate vertically-integrated entities operating in 27 national markets, there would probably be a greater degree of national vertical disaggregation and of cross-border horizontal integration, both at the network and service layers. The chairman of a logistics organisation interviewed for the thesis took the view that: “If we had a genuine continental market [for rail services], then we would have 4-5 sizable rail companies and 50-100 regional or local ones” (Interview: December 2007). However, this would potentially mean the reduction in size and scope and in some cases the disappearance of companies that are currently perceived as integrated national champions. This would mean that politicians and electorates would have to cease to identify the public service with the particular current national provider.

#### **5.6.8. Perceptions of conflicts of interest**

Participants in and commentators on the sector are highly aware that there is a potential tension between government ownership in the sector and the apparent agreed European policy of pro-competition regulation. Spokesman of potentially conflicted governments publicly may (but possibly not very firmly) deny there is any bias, while other commentators take a different view. To give a few examples:

Georg Jarzembowski, MEP for Hamburg, member and speaker of the EPP-ED Group (Christian Democrats) in the Committee on Transport and Tourism, and rapporteur of the Parliament for railway issues until 2009, wrote:

“Typically, the national governments were, and partly still are, the owners of national railway companies that control the national railway networks and that at the same time run the operating services. For that reason the member states were, and partly still are,

reluctant to accept the principle of the single internal market for the railway sector.”  
(Jarzembowski:2006:299)

“The harsh reality is that very little has been achieved in practice so far and most of the new laws are simply being ignored by governments and national railways which are intent upon retaining their domestic monopolies at the expense of potential competitors and customers alike.”  
(International Railway Journal:2003)

“Transport ministers remain fundamentally defensive when it comes to the protection of their railway industries, especially their passenger services.” (Stevens:2004:90)

“Railways policy is very political. Very salient to central political objectives. It is very convenient for governments to be able to direct rail companies to ends that will get them votes.”

Commission official (Interview:December2008).

On having his office dissolved by ministerial fiat, the Hungarian rail regulator sent the following by email to all rail NRAs in the EU:

“The new minority government today has decided to abolish the Hungarian Rail Office by decree. The decision will be effective from 1 July 2008. My presidential appointment, which is a fix-term appointment from 1 January 2006-31 December 2011 was also terminated by the Decree. Although the decision is not constitutional, this is not the first example for such an act [...] since the energy regulators experienced a similar act in 2003 which was only reversed by the Constitutional Court in 2007 [...].Regulation [sic]a state-owned, failing monopoly is a difficult task, I am not the first regulator who becomes inconvenient for a government and I am afraid that not the last either .”<sup>143</sup>

Interview with Ministerial official, country B:

“We can have influence. But it is not possible to influence on day-to-day decisions, these are more or less independent [...]. But there is a tension between the concept of a

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<sup>143</sup> Original with author of the thesis. See also Railway Market “Hungarian Rail Office, mission terminated” (2008).

national champion and a real free market. I cannot see following the free market being the general view in Europe, most people have a national vertically-integrated incumbent for which they have ownership responsibility; cannot even assume for [country B].”

Interview with regulator, also a Ministerial official, country A:

“I am not independent, but how can the Minister be independent of himself? I’m located inside the Ministry, in the same physical premises. I am schizophrenic, I review [incumbent] spending decisions which are approved by the Ministry as well as do arbitrations.”

## **5.7. Legislative developments in EU rail access regulation**

### **5.7.1. Introduction**

There have been six occasions so far when the European legislative bodies have considered rail access regulation and could have considered which institutions should be empowered to implement it (and two cases of legislation still under consideration). In this section the preferences of the different European legislative institutions are reviewed on each of these occasions.<sup>144</sup> The positions of each EU legislator and the outcomes are also summarised in table form in Annex Nine.

#### *5.7.1.1. Existing academic studies of the railway sector*

There are no academic studies focusing on the selection of regulatory institutions in EU legislation in this field. Thatcher’s comparative work on internationalisation and economic institutions does not examine the sector but suggests in its conclusion that research might find that rail comprises a further case where harmonisation of formal national institutions and regulatory practice occurs (Thatcher:2007:261).

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<sup>144</sup> In this sector it has not been possible to trace the views of economic actors in step with each legislative phase. DG Tren has not published the views it receives in response to consultations. In respect of the current discussions on a possible recast package, discussed on pages 238 and 239, it is feasible, as the House of Lords EU Committee interviewed a number of the protagonists. DG Tren have published a summary of consultation responses on their website. However, it aggregates all responses, public and private and it is not possible to identify the positions of different actors, or types of actors: [http://ec.europa.eu/transport/rail/consultations/doc/2008\\_11\\_30\\_rail\\_recast\\_package1\\_overview.pdf](http://ec.europa.eu/transport/rail/consultations/doc/2008_11_30_rail_recast_package1_overview.pdf) as of 8.8.2010.

There is, however, quite a large body of work that discusses rail legislation in general. Almost all are unanimous in stressing the extent to which the directives to date have had a poor purchase on the actual practice of access regulation. The leading academic analysis of EU transport policy concludes its section on rail with:

“Even when all the relevant Community legislation is in place, and implemented within the member states, there will still be substantial barriers to break down as a consequence of incompatible infrastructures, not to mention hostile cultures in some countries, and wide scope for these obstacles to be deployed to protect the national railway from unwelcome incursions into its traditional territory. It could be many years before a competitive internal market in rail services becomes a reality.” Stevens (2004:102)

Kerwer and Teutsch note that: “The non-compulsory nature of the CRP [Community Rail Policy] is illustrated by the fact that the single member states apply the rules in quite different ways and to different degrees without infringing EC law, depending on the national context” (Kerwer and Teutsch:2001:44).

Van Elburg and Holvad consider: “The vagueness and compromise character of EU standards has allowed for substantial differences in implementation. Member states that actually do not favour the rationale behind the rules can easily find tools to jeopardise adequate implementation in real life.”  
Van Elburg and Holvad (2004: 110)

There is one partial exception in the work of Knill and Lehmkuhl, who, while recognising that the 1991 directive has no constraining effect on member states,<sup>145</sup> argue that it had an ideological or “system building force” (Knill and Lehmkuhl:2000). They noted that three member states introduced railway reforms that went beyond the 1991 directive and, since that largely occurred after the adoption of the directive, then the directives must have been the causal force. However, their work contains no actual analysis of the political processes in the three member states (Germany, UK and Netherlands) to show that the EU legislation played any particular role. Furthermore,

their article also noted that reforms did not occur in a number of EU member states, which would just as equally suggest that the EU legislation does not necessarily have a “system building force” (Ibid). Lodge criticised their work on these bases. He examined the actual process of national railway reform in two of the same member states, Germany and the UK, and found “little evidence of European regulation in shaping regulatory choice beyond, at best, providing additional support for positions already held at the domestic level” (Lodge:2000:14).

### **5.7.2. Pre-1991: Commission agenda setting**

The attempt to tackle market opening in rail was part of a wider focus on transport. It was argued that the lack of harmonisation was contributing to a failure of the single market (Ross:1998:26 and 50). The 1985 *White Paper on the Completion of the Single Market* identified issues in transport as a major barrier to trade and the Maastricht Treaty moved transport from unanimity voting to qualified majority voting (Ibid:51).

In the transport sector, the Commission initially focussed on liberalising road haulage, where it achieved agreement in 1988, before it turned to railways. Its success in achieving market opening in domestic and international road haulage potentially put pressure for some kind of response in the rail sector. The foreseeable price reductions in road haulage were likely to aggravate the decline in rail freight with consequent further impacts on losses in rail and increases in debt (Di Petrantinio and Pelkmans:2004:16).

Member states did recognise the threat that liberalisation of road haulage would have for rail. The European Conference of Ministers of Transport, for example, noting: “European railways are in a particularly difficult competitive situation which could become almost desperate unless vigorous action is taken immediately” (ECMT:1985:8).

However, the conclusion drawn by most countries was that only limited action was either feasible or necessary: they would corporatise their railway operations in order to separate railway operations from the general government administrative structure and set up cost

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<sup>145</sup> “The 1991 Directive contains hardly any serious challenges to the well-established railway policies of the member states at domestic level. The directive has a non-compulsory nature and a sufficiently ambiguous texture in order to give domestic implementers far-reaching flexibility and discretion in the way in which they comply with its modest requirements” (Knill and Lehmkuhl:2000:70).

accounting systems in order to obtain controls over escalating losses. The intention was that a more commercial form of organisation at national level would deliver better results (Stevens:2004:1997).

Unlike telecommunications, the Commission did not begin the liberalisation process by pressuring the member states using competition law. In telecommunications, the Commission was able to obtain the support of the Court for specific cases and then to adopt the innovation of Commission own-initiative competition law directives in order to dismantle all member state monopolies and to threaten to become their sole regulator. In telecommunications, as discussed in the previous chapter<sup>146</sup>, it was clear, including to the ECJ, that member states were split into pro-liberalisation and anti-liberalisation camps and that many member states were not opposed to Commission and Court legal activism. This was not the situation in rail.

On the contrary, it was clear from a historical perspective that member states had explicitly intended that competition law would not apply in the transport sector. It had been excluded by Regulation 141/1962, which exempted all transport from the application of general competition law on the grounds that in transport it was necessary that companies should cooperate rather than compete. Later member states revised 1017/68 to exempt “technical agreements” in, inter alia, the rail sector from being found to be restrictive of competition

After the disappointment of the first rail directive<sup>147</sup>, the Commission did try to launch a path breaking competition law action. However, unlike telecommunications, the ECJ did not back the Commission. The Court’s logic for not doing so was highly tortured and contradicted the rationale it had given in cases in the telecommunications sector. It would appear in this case that the Court took cognisance of potential member state unanimity against Community activism – one of the factors that it has been argued shape ECJ decisions (Garret et al:1998:151). In *European Night Services*<sup>148</sup>, the Commission noted that four national incumbent operators had set up a joint venture to provide cross-border passenger night services. The Commission argued that Article 85 (now Article 81)

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<sup>146</sup> See page 142 above.

<sup>147</sup> See page 214 below.

applied because the downstream railways undertakings were discriminating in favour of their joint venture by making access, locomotives and other services available solely to their own joint venture.

The railways argued that EC competition law rules had to be interpreted in the light of regulation 017/68 above and the first rail directive, which restricted access to the international groupings of the existing licensed companies (state-owned everywhere except the UK). The UK, at that time the only state with a privatised rail entity and the lead supporter of the Commission with respect to legal activism in telecommunications, intervened to support the railway companies against the Commission.<sup>149</sup> This may have indicated to the Court that member states would be unanimously hostile. The Commission argued that 1017/68 had to be interpreted in the light of general EC competition law based on the treaty and that secondary EC legislation could not exclude this. The text of 1017/68 is very ambiguous – it bans restrictive agreements except where they are “technical” without defining what constitutes an acceptable “technical agreement”. Nonetheless, the Commission was attempting to overturn the accepted understanding of 1017/68 (Stevens:2004:93).

The Court decided that it was unnecessary to examine whether the agreement was restrictive or not or whether EC competition law had superiority over a sector-specific directive (which the Commission pointed out they had accepted in a range of other non-rail transport cases).<sup>150</sup> Instead the Court, through some extremely strained logic, held that there were no other current competitors to the European Night Services, therefore there was no market and that, consequently, there could be no abuse, as this required a market. This completely begged the question as to why there was no market, i.e. member

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<sup>148</sup> ([1998] ECR II-3141).

<sup>149</sup> The services provided to the joint venture included access to the Channel Tunnel. A requirement to provide open access to the tunnel would have increased the competition to Eurostar, potentially decreasing its profitability and making it harder for it to repay its debt to the UK government.

<sup>150</sup> See Case 167/73 *Commission v France* [1974] ECR 359 and Joined Cases 209/84 to 213/84 *Ministère Public v Asjes and Others* [1986] ECR 1425).

states and their railways would not provide access or services to anyone except their own subsidiaries.<sup>151</sup>

The consequence was that the Commission's negotiating hand in rail was far weaker than it was in telecommunications. It could not follow its precedent in telecommunications and threaten to regulate through its own-initiative directives if the member states would not agree to a Council directive that regulated access.

### **5.7.3. 1991 EC directive**

#### *5.7.3.1. Background to the negotiations*

The Commission published a *Communication on Community Railway Policy* in 1990, which argued that there would need to be action to respond to the coming liberalisation of road-haulage sector and air in Europe. The Commission pointed out that rail freight had been in freefall even when competing with a non-liberalised road haulage sector: its share falling from 32 per cent in 1970 to less than ten per cent in 1987 (Commission:1990:9). It could be expected that from 1993, the effect of single market measures for road "will be to make road haulage more efficient and an even stronger competitor for the railways (Ibid:12).

#### *5.7.3.2. Commission proposals*

The Commission's proposals reflected the need to obtain unanimous support for a Council directive. At this point, every single member state had vertically-integrated state railways.

Consequently, the Commission sought only to modify the relationship between the state and the railway undertakings and to remodel the structure of the nationalised railway undertakings so as to make their activities more transparent.

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<sup>151</sup> Joined cases T-374/94, T-375/94, T-384/94 and T-388/94 15 September 1994. In two further non-access but related cases, the Court came to contrasting decisions. In one case, they decided that discriminatory pricing by Deutsche Bahn to encourage customers to use port facilities in Germany as opposed to other member states was an abuse (Deutsche Bahn v Commission, T 229/94 of 21 October 1997). In the other, they decided that the protection of regulation 1017/68 extended to a common agreement amongst railway undertakings to prevent travel agents selling rail tickets from advertising competing modes of transport (Commission v Union Internationale des Chemins de Fer C-264/95 of 11 March 1997).

The Commission did not seek to require member states to open markets to competition but proposed to leave the option to individual member states. Where a member state licensed an undertaking it should ensure that a licensee could request access to infrastructure and that access should be provided on an undefined *equitable* basis. Member states were required to provide access to international groupings (i.e. joint ventures between the existing national railway undertakings for the provision of international services) where the national railway undertaking, which was a member of the joint venture, had been granted access. These access provisions simply reflected the existing status quo (Commission:1990).

In terms of modifying the relationship between the state and the railway undertakings, the member states would be obliged to ensure that the assets, budgets and accounts of the railway undertakings were separated out from the general accounts of the state. Member states were required to take measures to ensure that railway undertakings were managed according to a vague objective of “the principles which apply to commercial companies.”(Commission:1990) The national railway undertakings would have been obliged to split into two separate divisions, one providing infrastructure and one providing services (Commission:1990).

Institutionally, the Commission proposed no direct role for itself with respect to implementation. The only power it proposed was a power to request information and in that respect it should be assisted by an advisory committee (Commission:1990). An interview suggests that this is not because the Commission would not have liked to have sought delegated authority in an ideal world, but rather because it was not considered a realistic objective. As a former Commission rail official put it:

“We were interested in the concept of a Euroregulator in 1991 but never proposed it. It was never discussed outside the Commission. Reason was didn’t believe there was any chance that national ministries would accept it. Particularly as didn’t see how you could distinguish in reality between cross-border and national traffic – borders were just nominal lines and once you started regulating slots and prices for traffic that moved between two countries, it necessarily had a knock on effect for purely national slots and prices within each relevant country [which meant that a Euroregulator would supplant national Ministries].” (Interview:December 2007)

#### 5.7.3.3. *Parliament's preferences*

The Parliament's role was limited by the Treaty to a consultative one. It nonetheless took a more radical market-opening stance than the Commission. Its amendments to the recitals advocated that any undertaking should be able to request authorisation to provide services within a member state (with the exception of urban, suburban and regional services, which essentially meant that it was in favour of the liberalisation of national and international passenger and freight services). In addition, once an operator was licensed in any one member state, then it should be able to require mutual recognition in any other member state. However, its amendments to the actual articles only extended the necessary access rights to make any licence meaningful to transit (but not cabotage<sup>152</sup>) rights across a third member state between two member states in which an undertaking had already been granted access rights (Parliament:1991). The Commission amended its proposals to take on board the Parliament's amendments on transit (Commission:1991).

The Parliament also supported the Commission's proposals to restructure the relationship between the railway undertakings and the state, and to split the vertical unitary structure of the railway undertakings (Parliament:1991).

On the institutional design of implementation, the Parliament proposed that if there was evidence that operators were unable to achieve market access then the Commission should be empowered to propose a Council regulation with regards to access regulation. According to the motivating recital, the Parliament took the view that regulatory decisions needed to be harmonised (Parliament:1991).

#### 5.7.3.4. *Council preferences*

Kerwer and Teustch note that the only supporters of liberalisation were the Netherlands and the UK (Kerwer and Teutsch: 2001:46). The requirement for unanimity meant that the Council's position could at most be to make liberalisation optional within each member state.

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<sup>152</sup> Cabotage occurs when the provider of a dedicated international service is also permitted to offer services on the same train to any customers that wish to use the international train to travel between two stops within one country.

The Council's position was that authorisation policy should indeed be set by each member state and consequently removed the relevant article from the directive altogether including the requirement for *equitable* access. Mutual recognition of undertakings already licensed in one member state was limited to international groupings where members of the grouping were already licensed in the same member state (Council:1991). In practical terms, this meant that a new entrant to a liberalised market could only gain hypothetical exposure to another market through a joint venture for international services, if it were able to agree the creation of one with a state-owned entity elsewhere in Europe.

Transit (but not cabotage) for the same groupings across member states with no participating company were to be permitted where this was necessary to provide services between the two countries whose undertakings were part of the international grouping (Council:1991). To give a hypothetical example, an international joint venture between the French national rail service and the Dutch national rail service could be licensed to provide services in the Netherlands and France based on the equipment and existing licences held by its Dutch and French members. The international grouping could provide services between Amsterdam and Paris via Belgium but could not pick up customers in Belgium unless the Belgian national rail service opted to become a party to the international grouping.

Combined logistics companies, which had been licensed, were also permitted to request access to networks to provide international cross-border freight services. Combined logistics are freight services in which one company provides transport for one set of freight via multiple modes, for example, rail, road haulage and maritime services. This was a miniscule market. However, in addition, member states included a clause limiting licensing to those undertakings with their own locomotives. The effect of this clause was that the only combined logistics companies that might take advantage of this opportunity would be the subsidiaries of the existing rail companies. Lyons, incorrectly, describes the directive "as obliging Member States to open access to a very limited range services" (Lyons:2001:77). In fact, the directive did not require the opening of access at all – it merely recognised that member states could liberalise if they chose to do so.

The Council agreed the restructuring of the relationship between rail companies and the state to create more transparency. However, they refused a mandatory requirement to turn their rail companies into two separate divisions, making this optional and, instead, agreed a requirement for accounting separation, without any specification as to the content of the requirement, between the different activities (Council:1991).

With respect to the institutional arrangement, the Council sought to use the Committee proposed by the Commission to impose a novel sector-specific constraint on the Commission's general power to pursue infringement actions. The Council proposed that any Commission draft measures be reviewed by the committee prior to adoption and the Commission would be required to take "utmost account" of them (Council:1991). Normally, the Commission can adopt infringement procedures without any prior consultation.

#### *5.7.3.5. Legislative process*

The decision-base was unanimity with consultation for the Parliament only. Every member state had a vertically-integrated, state-owned operator, although the Netherlands and the UK were looking to engage in some form of liberalisation and privatisation. Given the near unanimity against full liberalisation and the limit on the Parliament's role to that of consultation, there was no scope for the Commission to construct coalitions of support amongst legislative principals in order to pursue ambitious market opening measures and institutional mechanisms to deliver them.

#### *5.7.3.6. Outcomes*

The only element of the draft directive, which did not give member states full discretion, was the requirement to act to put in place accounting separation. However, there was no binding detail in the directive as to the structuring of the accounting separation. Kerwer and Teutsch examine community rail policy in the 1990s and aptly describe it as "non-compulsory"(Kerwer and Teutsch:2001:43), which is "due to the limited legal obligations and the ambiguity of the directive inaugurating the new railway policy" (Kerwer and Teutsch:2001:45).

An examination of the overall construction of the directive reveals that despite the fact that an advisory committee is selected as the form of governance for implementation, this cannot be interpreted as evidence that member states were relaxed about the Commission having a role.<sup>153</sup> In fact, the directive gives the Commission no sector-specific implementation powers at all and it is in respect of such implementation powers that comitology normally applies. In this particular case, the Council amended the role of the Advisory Committee so that it was given an atypical surveillance role with respect to any attempt by the Commission to use its general Treaty powers to deal with infringements of the directive. The committee was given the role of reviewing draft Commission infringement decisions and the Commission was obliged through the “utmost account” requirement to give written reasons for departing from the views of the national ministries. Given the construction of the directive, this could only have consisted of Commission actions against failures to implement accounting separation.<sup>154</sup>

#### 5.7.3.7. *Empirical results and the hypotheses*

Hypothesis 1: National ministries are the preferred bodies and the Council’s acute sensitivity to supranational influence in this sector is demonstrated by their agreeing a control over the normal infringement process. As far as I am aware, this is unique in EC law. However, the result is indeterminate, while there is ubiquitous state ownership, the process whereby this translates into legislative preferences cannot be shown.

Hypothesis 2: Confirmed. The Commission and Parliament have negligible influence, and there are not any implementation powers transferred to the supranational level. The Commission’s own preference was for a Euroregulator but this was not raised formally because officials did not think it was politically saleable.

Hypothesis 3: This is tested by data that is derived from post-delegation outcomes, see page 258 below.

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue.

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<sup>153</sup> An advisory committee is the weakest form of comitology control (see page 81 above).

<sup>154</sup> See page 261 below as to the extent to which the vague rules in the directive combined with unpropitious institutional design lead to very little implementation of accounting separation.

Hypothesis 5: Indeterminate. There is no recorded discussion of the issue, and the directive is silent as to the responsible member state authorities.

Hypothesis 6: Indeterminate. The Commission had not yet tried to use competition law.

#### **5.7.4. 1995: Licensing and infrastructure charging directives**

##### *5.7.4.1. Introduction*

In this second set of legislation, the Commission attempted to get legislation requiring market opening of freight and passenger at both national and international level. This was done in the shadow of the European Night Services case (an access case), which was launched simultaneously.

##### *5.7.4.2. Commission preferences*

The Commission proposed two directives that were intended to open up the railway markets to full competition. The draft Licensing and the draft Infrastructure and Charging Directives were intended to apply to all of the national infrastructures and services (exclusions would apply only to urban, suburban and regional services which used distinct networks which were not shared with international services). Any railway undertaking that had its own locomotives and which was established in any member state should be able to require mutual recognition and request a licence to operate and request access from the infrastructure operator in any other member state.

Focusing on rules that required formal market opening, the Commission did not also try and propose institutional measures in addition. The Licensing body and the body which set access charges and allocated capacity (i.e. train slots) could be whichever body the member states selected (Commission: 1994a; Commission:1994b).

A Commission official said of these directives:

“[They] were so vague as to be meaningless. But [it is] an incredibly political subject and I suspect that this is the reason why NRAs as opposed to EU institutions were empowered to conduct access implementation. We did have internal discussions on a Euroregulator, but never external as no chance it would fly: would have been going too

far. European implementation would not just have been a step too far rather it would have been a step massively too far, partly because national implementation accommodated those member states that were most reluctant to open their markets and to put their national railway operators at risk.” Interview (February 2010)

#### *5.7.4.3. Parliament preferences*

The Parliament was also in favour of opening the railways and supported the Commission. On the institutional side, they went further than the Commission’s initial proposals and their amendments would have required that the licensing body and the body controlling access be independent of the national rail company. They also amended the requirement to own locomotives to include those that were leased or rented, which would have allowed scope for logistics companies that were not subsidiaries of the existing railway companies to enter the market.

At Parliament’s instigation, the Commission amended the proposal to say that the regulatory bodies needed to be independent of the rail operator (Parliament:1994a; Parliament 1994b).

#### *5.7.4.4. Council preferences*

The Council rejected all the substantive proposals to preserve the status quo ante. The only concession was that licensing and access decisions should be appealable. Although the text applying this to access decisions potentially allows the appeal to be limited to an administrative body, such as a ministry. This was unlike licensing issues (principally safety matters) which member states were willing to open up to judicial supervision (Council:1994a and 1994b).

The Commission’s competition law investigation does not appear to have been considered a credible threat. The Council appeared not to consider that the Commission’s competition law challenge cast any shadow over legislative proceedings. Their conclusion that it did not turned out to be correct in practice. This might suggest that member states predict that the Court will not act where member states have a unanimous position. Contemporaneously, this also turned out to be correct in energy where the Commission tried to use the threat of competition law to try and achieve market opening

and access regulation. The member states did not seek to substantively meet the Commission and Parliament's preferences there either (Conant:2002:47). When the Court eventually heard the cases, it did not back DG Competition.<sup>155</sup>

#### 5.7.4.5. *Legislative process*

The legislative process remained the same as in 1991. The only change in preferences was on the part of the UK, which had now privatised and vertically separated its rail activities.

#### 5.7.4.6. *Outcome*

The final text fully reflected Council preferences. The changes with respect to 1991 are that where a member state opted to liberalise then decisions on access should be appealable to an independent but unspecified body, and decisions on safety should be appealable to a court. The former is, of course, more susceptible to political control. Independence was not defined. The 1991 advisory committee remained in place with its supervisory role in respect to any potential Commission infringement measures.

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<sup>155</sup> In energy, DG Competition referred five member states (France, Ireland, Italy, Netherlands and Spain) for the infringement of Treaty obligations to the ECJ due to their import and export monopolies. The ECJ did not rule against any of the import and export monopolies. The ECJ did find that the trade monopolies were violations of the EU rules on market integration but it accepted their maintenance if they were necessary to enable the utilities to perform tasks of general economic interest assigned to them by the member states. In telecommunications, it had not accepted such a defence. The Commission had argued that the networks should only be exempted from the Treaty rules if this was necessary for them to continue to fulfil their public duties under acceptable economic conditions and in a state of financial equilibrium. The Commission's view was that member states governments had to prove that by subjecting the network to "cream skimming" by importers that this would have substantially threatened the financial position of the company. The Court rejected these two propositions. First, it stressed that Article 90 did not prevent the member state itself from determining the nature of the public service duties it entrusted to firms, in accordance with its own internal policy goals, as well as from specifying the various legal and other means by which these duties should be performed, i.e. including by monopoly. The Court held that the burden of proof was on the Commission to show that relaxation of the monopoly would not harm the ability of the network operator to meet its public service obligations. Judgements C-157/94 (Commission v Netherlands), C-158/94 (Commission v Italy), C-159/94 (Commission v France), C-160/94 (Commission v Spain), all dated 23 October 1997.

### **5.7.5. Empirical results and hypotheses**

Hypothesis 1: The 1991 advisory committee remains in place with respect to any Commission measures. However, the result is indeterminate, while there is still almost ubiquitous state ownership, the process whereby this translates into legislative preferences cannot be shown.

Hypothesis 2: Confirmed. The Commission and Parliament have negligible influence and there are no implementation powers transferred to the supranational level.

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue.

Hypothesis 5: Indeterminate. There is no recorded discussion of the issue and the directive is silent as to the responsible member state authorities. The discussion is over the extent to which the responsible member state authority can remain the regulated entity, which most member states prefer.

Hypothesis 6: Indeterminate. The Commission case is still with the Court of First Instance at this point.

### **5.7.6. Abandoned 1995 amendment of development of Community Railways Directive**

#### *5.7.6.1. Introduction*

In the light of the reception given to the Licensing Directive and first Infrastructure and Charging Directive, the Commission sought again to open the market but sought to give the impression that it had reduced the scope of its ambitions in the hope that this might be more successful.

#### *5.7.6.2. Commission preferences*

The draft amendment to the Community Railways Directive proposed that international freight, international passenger and international-combined transport be opened and that, in addition, providers of those services be able to engage in cabotage (Commission:1995). Permitting cabotage might potentially have the effect of opening up quite a large segment of domestic markets.

#### 5.7.6.3. *Parliament's preferences*

Parliament supported the Commission but also took the occasion to advocate that infrastructure charges should be harmonised throughout the Community (Parliament:1996). The Commission considered the latter politically impossible and did not adopt it as an amendment (Commission:1997).

#### 5.7.6.4. *Council preferences*

The Council was not required to express an opinion as the proposal was withdrawn.

#### 5.7.6.5. *Legislative process*

Same as in 1995.

#### 5.7.6.6. *Outcome*

The Commission opted to withdraw the directive and pursue its objectives in a new set of proposed legislation with an eye to the increased powers that the Parliament would have as a consequence of the entry into force of the Treaty of Amsterdam. This may also have been a consequence of the failure of the competition law action. There was no point in the Commission pursuing legislation unless something altered to increase leverage.

#### 5.7.6.7. *Empirical results and the hypotheses*

Hypothesis 1: Indeterminate. No Council view expressed.

Hypothesis 2: Confirmed. The Commission and Parliament have negligible influence and implementation powers are not transferred to the supranational level. The Commission's own preference was for a Euroregulator but this was not raised formally. Parliament suggested that the detailed rules for infrastructure charging be written in the body of the directive – an unrealistic objective.

Hypothesis 4: Indeterminate. No Council views expressed.

Hypothesis 5: Indeterminate. No Council views expressed.

Hypothesis 6: Indeterminate. The Court had not yet made its findings.

### **5.7.7. First railway package, 2001**

#### *5.7.7.1. Introduction*

A Commission official wrote of the 2001 directives: “In view of these initiatives [earlier Directives] relatively minor impact on the market, more comprehensive instruments [...] were adopted” (Scherp:2002:4). However, the emphasis is on more comprehensive, rather than comprehensive per se. The first railway package consists of three directives: one amending the 1991 Directive on the development of the Community’s railways; and two directives amending the 1995 Directives, one on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure and safety certification; and, one on licensing of railway undertakings. The essence of these initial proposals was to create NRAs within member states, which were independent of the railway companies – and, which in most countries had until then continued as a matter of member state discretion to be both operator and regulator.

The Commission restricted its market opening efforts to trans-European rail freight networks (TRFN) only. Rail freight constitutes a relatively small part of the operations of incumbent railways, for SNCF and Deutsche Bahn, it comprises about 15 per cent of revenue (SNCF:2009; Deutsche Bahn:2009). The TRFN at most could comprise about 20 per cent of freight traffic (Commission:1990:2) . And, in any event, the latter would be routes volunteered by member states. The incentive for member states to declare routes as TRFN is that they can only obtain EU-funding under the TENS scheme for those routes which they designate as part of trans-European freight networks. The Commission had attempted to set up freight corridors on a cooperative basis with industry (Commission: 1997:10), but these had failed to deliver.

#### *5.7.7.2. Commission preference – first iteration, prior to the amended proposals*

The Commission’s first proposals were that where the infrastructure provider was not a completely separate entity from the service provider then a separate body, an Infrastructure Manager (IM), would need to be set up in each member state to determine access conditions and pricing. The IM would need to publish a network statement containing its criteria for charging and for making train path allocations. In addition, a regulatory body separate from the IM and any service provider would have to be created.

Appeals regarding decisions concerning the access made available (or not) by the infrastructure manager (IM) would go to this regulatory body. Member states would continue to have the option to split network and service activities into two separate companies. There was also some very limited setting out of what accounting separation actually required in terms of accounting practice (Commission:1998).

#### *5.7.7.3. Parliament preferences – first iteration*

Dramatically, the Parliament called for full structural separation of the rail operators within two years. In addition, the body that set access conditions could be the independent regulator but if so there had to be the possibility of judicially reviewing its decisions. A recital also called for technical harmonisation of access rules but no institutional structure was proposed in the legally binding body of the directive to actually achieve this (Parliament:1999).

#### *5.7.7.4. Outcome*

There is no outcome of the first iteration. The Commission was impressed at the strength of the Parliament's views, withdrew its original proposals of April 1999 and put forward a modified set in November 1999. The major bone of contention within Council and between Council and Parliament was the extent to which vertical separation of the incumbent railway was required (Holvad:2006:28). According to Chabalier, at this first reading, France, Belgium, Luxemburg, Austria, Greece, Ireland and Portugal were vocally against the package (Chabalier:2006:11). The former Commission officials with whom I spoke also thought that Italy had been against the first iteration of the Commission package whereas the UK, Denmark, Germany, Netherlands and Sweden were in favour (Interviews:December 2007; February 2010).

#### *5.7.7.5. Commission's amended preferences*

The Commission adopted the Parliament's amendment from the first iteration requiring full structural separation of the network and services arms of rail companies within two years.

On the institutional side, the Commission proposed that where there was an access dispute that the Commission should be able to conduct binding arbitration subject to an advisory committee (unless the issue was one of generic application in which case the Commission decision would be subject to a regulatory committee). This provision would effectively have made the Commission the principal with respect to NRA decisions. A member state could also raise an issue of implementation with the Commission, which it could decide on an expedited administrative basis subject to an advisory committee (Commission:1999).

#### 5.7.7.6. *Parliament's amended preferences*

The Parliament maintained its original position and added further more radical proposals.

The national body that set charges and allocated slots should be independent of the IM.

Opening must be extended within five years to all national and international freight services and not just the TRFN. International passenger services would also need to be opened up by 2010 (Parliament:1999). The Commission did not adopt the Parliament amendment concerning a wider scope of market opening as it believed this was beyond the point where it would be possible to get political agreement.

On the institutional aspects, the Parliament supported the Commission. Interestingly, at second reading the Parliament rejected the Council's proposition for an Agency, the Rail Observation System (see page 224 below). It feared that it was not intended to facilitate the Commission's monitoring of the market and to verify whether member states have implemented effective independent regulation but rather to whitewash member states and water down the Commission's ability to progress liberalisation. Brian Simpson MEP said in an interview for the thesis:

“We are co-legislators, we will not give up our co-legislation rights because Council wants to block something – knew where the block was coming from, countries like France that wanted to protect their national operator. Member states wanted to pretend to

open up through an Agency and then block through comitology.” Interview (February 2010)<sup>156</sup>

#### 5.7.7.7. *Council’s amended preferences*

The Council would agree to access to the TRFN by 2008 (Council:2000) in line with the need to do something to save the freight arms.

The Council argued that if a member state set up an independent regulator then the requirement to structurally separate the infrastructure and service arms of the railway undertaking should fall away. The Regulator must be independent but this was specifically defined by the Council as including the Ministry of Transport. An assessment of independence would be carried out by a new body, the European Rail Observation System (which would be comprised of representatives of member states and industry). Based on the assessment by this body, the Commission could then make a decision as to whether the regulator was independent and this decision would then be subject to regulatory comitology (Council:2000).

The Council agreed that at the request of a member state or on its own initiative, the Commission could review access questions subject to what was described as an advisory committee. However, the design of this advisory committee was different from the normal institutional design of such a committee. The advisory committee was actually structured with the powers of a safeguard committee, the most stringent form of committee available. This meant that a draft measure of the Commission could be referred by a single member state to Council where it could be overturned by qualified majority voting (Council:2000).

Provisions in the directive which could potentially shape the detailed scope of the directives (for example, lists of which services to which access may apply) were defined minimally and moved to annexes) and could only be amended via regulatory comitology (Council:2000).

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<sup>156</sup> Brian Simpson declined anonymity and said he wanted to be quoted. He also thought that eventually there would be a role for an EU Agency for access but this could only be put in place once there was a sufficient number of pro-competitive independent national regulators.

Member states retained the option of choosing between distinct divisions or actual separation of a vertically-integrated company (Council:2000). The flexibility given meant that member states could potentially use it pursue objectives which had nothing to do with facilitating competition. For example, French civil servants told Douillet and Lehmkuhl that the French creation of Réseau Ferre de France (RFF) as a separate infrastructure division was not intended to allow other companies to provide services (Douillet and Lehmkuhl:2001:120). The purpose is to shift rail debt away from SNCF allowing it to invest in new equipment without shifting the sum directly to the French state. This would have increased the French deficit by the equivalent of 1.5 per cent of GDP, leading to a breach of the Maastricht criteria (Douillet and Lehmkuhl:2001:118). In practice, RFF was then created as a shell organisation, which sub-contracted all of its actual activities back to SNCF.

Consistent with the French position, the Council agreed that there must be a separate entity for setting access charges and determining slots but insist that it must be able to allocate the management and collection of charges and access to capacity back to the railway undertaking (Council:2000).

#### *5.7.7.8. Legislative process*

The decision-making rules are co-decision with qualified majority voting (“QMV”) in the Council. The Parliament takes an aggressive pro-competition and pro-effective regulation stance. The Commission withdraws its original position and issues a second version in line with that of the Parliament. Member states are split with Denmark, Sweden and the UK favouring the Commission and Parliament position on structural separation. The Netherlands and Germany are in favour of a national based regulatory system but not structural separation.

Pro-competition member states did not want harmonised regulatory decisions because any institutions designed to actually deliver binding collective decisions would necessarily reflect a majority view and would potentially undermine the efforts of the pro-competition member states to regulate effectively in their home markets (Interview with NRA official: January 2008).

Protectionist member states may also have declined to take the unnecessary risk that could arise if any future possible privatisation dynamic lead to them eventually occupying a minority position. The risk was unnecessary, since the status quo ante allowed them to already pursue the policies they considered to be optimal.

Most member states could live with a discretionary NRA-run system, with the exception of Belgium, Luxemburg and France who voted formally against the package. Distributional issues might have been sufficient to prevent any EU legislation at all. However, member states were also faced with what appeared to be the ineluctable decline of national rail companies in the face of competition from road haulage in freight and from aircraft in longer-distance passenger markets. Consequently, a majority did feel a need to try and give their national companies the possibility to expand internationally. The more Machiavellian amongst them may also have welcomed the possibility of an institutional design that would permit external expansion into liberalising states while allowing national control over the extent of their own market opening.

#### *5.7.7.9. Outcome*

In conciliation, the Parliament and Council agree that the IM must be separate from the railway service provider (European Parliament:2001). However, the degree of separation is left vague, member states can merely create distinct divisions rather than actually require separation and the IM can sub-contract its services back to the integrated rail operator. As the Parliament will not agree to the creation of the European Rail Observation System and its mechanism for avoiding vertical separation, the Council refuses to make vertical separation a requirement in principle (European Parliament and Council:2001).

Member states are required to create an access regulator that is independent of the IM and of any railway operator. However, the definition of independence specifically incorporates a reference to this including the transport ministries of member states (European Parliament and Council:2001).

The Council does agree to access to the TRFN by 2008 and to extend access for international freight to the whole of the network by 2015. Parliament felt that this was a

substantial victory and dropped the requirement for the international passenger market to be opened (Parliament:2001).

Member states or the Commission could raise the issue of implementation by a member state. The Commission can decide on an expedited administrative basis subject to an advisory committee. However, this is not a normal advisory committee at all as a single member state can refer the proposed Commission decision to the Council and the latter can overturn the decision by qualified majority vote. As a Commission official recently noted in a speech, the consequence of this construction is that the Commission has never attempted to use the mechanism (Jost:2010:9). In fact, no stakeholder with whom I spoke was aware that the power even existed (Interviews:2007-2010). Amendment to the annexes (including the potential detailed scope of regulation, for example what may be included in accounting separation or ancillary services) can only be amended via regulatory comitology, which requires a qualified majority vote in favour of the Commission's proposals.

DG Tren does not publish a list of infringement cases relating to access issues. This is because none have ever been completed (Interview:2008). This contrasts with DG Infococ and DG Tren's own practice with respect to passenger rights generally.

#### *5.7.7.10. Empirical outcomes and the hypotheses*

Hypothesis 1: This observation might appear prima facie paradoxical; the Council, in the context of 78 per cent of countries with state ownership, proposed an Agency; and, it was rejected by the Parliament, which was generally taking a very pro-competitive stance. However, the explanation is that the Council were not transferring regulatory authority, as required by the hypothesis, to the Agency. The only power, which they proposed to transfer was a power to declare that NRAs were independent and thereby sought to avoid structural separation.

The Council also defined independence in the directive as being met by NRAs which were ministries. The only issue that the Agency would have been empowered to assess was independence of NRAs. Its own decision-making board would have been formed by

representatives of transport ministries except in the few countries where there are stand-alone NRAs.<sup>157</sup>

With respect to empowerment of the Commission, the Council preferred to set comitology at safeguard level – with the consequence that the Commission has never used it. Amending detail of the Directive, and thereby potentially making it more constraining, was set at qualified majority level which would have required the support of many states with a conflicted position. In practice, discretion over implementation was given to NRAs. However, the result is indeterminate as it has not been possible to trace the link at EU-level from state ownership to formation of national preference.

Hypothesis 2: Confirmed. The Commission and Parliament try to vest hierarchic control over the NRAs in the Commission.

The alternative hypotheses:

Hypothesis 4: Falsified. The Council does not appear to have any constitutional qualms about empowering an Agency designed to prevent effective regulation.

Hypothesis 5: Falsified. The Council has a preference for NRAs rather than the Commission or any Agency empowered to conduct effective regulation.

H6: Falsified. In the previous rounds, the Commission had a preference for a Euroregulator. It did not believe that this would receive political support. In this round, it sought to achieve hierarchical control for itself over the NRAs. It did not believe that competition law was a potential solution as the attempt to use this had demonstrably failed in 1998.

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<sup>157</sup> IBM found in 2007 that only six member states had NRAs which were separated out from ministries and dealing with access to networks (IBM:2007:33).

### **5.7.8. 2007: second package**

#### *5.7.8.1. Introduction*

Commission investigation of the freight market revealed that rail's share had slipped a further 20 per cent to eight per cent of the total freight market in 2003 (Commission:2007:4). The market-opening measures taken so far had in fact had no apparent beneficial effect. The Commission noted:

“The Commission is well aware that the opening of the market has been more theoretical than real, and that transport ministers would be especially reluctant to open up national passenger services to competition. They have therefore concentrated on measures designed to open up the international rail freight market, where current arrangements are so bad that the average speed for cross-border rail freight services is just 18km/h.” (Commission: 2001:28).

The Commission was, tellingly, also able to show that in member states where liberalisation and effective regulation had occurred such as the Netherlands, Sweden and the UK that there had been dramatic absolute and relative gains in rail freight traffic. For example, figures from the UK showed increases of freight traffic volumes of 60 per cent between 1995 and 2005 and an increase of rail freight market share with road from 8.5 per cent to over 12 per cent (Rail Freight Group:2006:45).

#### *5.7.8.2. Commission proposals*

The Commission called for full opening of national freight markets by 2006 and for international freight providers to be able to provide cabotage (Commission:2002).

#### *5.7.8.3. Parliament's preferences*

The Parliament supported the Commission and in addition argued that the same opening should apply for passenger services (Parliament:2004). In an article, the MEP Jarzembowski pointed that benefits consumers had gained from air liberalisation and called for the same to happen in rail:

“Almost all companies in aviation have become more cost-oriented, more customer-oriented and more efficient, and the fares for the customers have been going down, thus also increasing the usage of this mode of transport.” (Jarzembowski:2006:302)

#### 5.7.8.4. *Council preferences*

The Council agreed to accelerate freight opening but refused to liberalise passenger services, promising only that it would examine future proposals on passenger liberalisation (Council:2003).

#### 5.7.8.5. *Legislative process*

The decision-making rules were co-decision with QMV in Council. In the light of further deterioration in freight performance, member states were in favour of bringing forward market opening for freight for the whole network – as long as it was under NRA control.

#### 5.7.8.6. *Outcomes*

Opening of the freight market was brought forward.

#### 5.7.8.7. *Empirical results and the hypotheses*

Hypothesis 1: Indeterminate. The proportion of votes in Council held by member states with state-owned vertically integrated companies remains at 78 per cent. Member states agree to open the entire network for freight but subject only to NRA implementation.

Hypothesis 2: Confirmed. The Commission and Parliament have limited influence. Member states feel sufficient pressure to make the full network potentially available but only subject to their regulatory control. They decline to open up the passenger network.

Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue in this round.

Hypothesis 5: Falsified. Member states were content to rely on NRAs.

Hypothesis 6: Falsified. Already established in previous rounds that competition law is not a viable alternative to regulatory implementation.

### **5.7.9. 2007 – third package**

#### *5.7.9.1. Background*

The Commission duly brought forward passenger liberalisation proposals. They pointed out that the rules agreed in 1991 with respect to international groupings had not lead to any new services. The exemption the directive had in practice provided from competition law for such groupings would be withdrawn since the rules encouraged a cartel:

“The current organisation of the railway market has not really lead to the emergence of new operators as the latter must conclude an agreement with a railway undertaking in another member state to create an international grouping for the provision of international rail services. This requirement constitutes a serious barrier to market entry, even for the provision of niche services, or services that were discontinued by incumbents.” (Commission: 2004:12)

#### *5.7.9.2. Commission proposals*

The Commission’s proposals provided for market opening for international passenger services by 2010. In addition, there should be cabotage (Commission:2003). The Commission considered this was vital as research by Steer Davies Gleave indicated that on many routes international services would not be economically viable if cabotage were not permitted (Steer Davies Gleave:2004). International routes in many countries are granted en masse to a single operator under a framework agreement. The Commission included text to say that this should be subject to a general regulation on public service contracts in transport, which was under review by the institutions.

#### *5.7.9.3. Parliament’s preferences*

Parliament’s preferences were for international passenger services to be liberalised by 2008 and for all passenger services to be liberalised by 2012 (Parliament:2002). However, they accepted that if this jeopardised the economic viability of a subsidised route then such a route should not be opened to competition. The body that would make this assessment would be the NRA. The Parliament advocated that any framework agreements allocating all national international passenger services to a single company should be limited to 5 years only.

#### 5.7.9.4. *Council Preferences*

If one examined only the specific legislation, it would be possible to form the impression that the Council had agreed to open up international passenger services (Council:2003). It accepted the 2012 date for opening access rights for international passenger services. It accepted cabotage – although not as an indirect way of opening up domestic markets:

“Council wants to avoid that a right of access for international rail passenger services, which include cabotage, leads to the opening of the market for domestic rail passenger services. Therefore, the Common Position allows granting the right of access only to those international services, which have as a ‘principal purpose’ the carriage of passengers between stations located in different member states.” Council (2006:5)

It agreed the Parliament’s mechanism for ensuring that subsidised routes were not rendered unviable by additional competition and included specific wording stating that the regulator for these purposes could be a ministry of transport. However, all this was subject to what the Council were simultaneously agreeing on public service contracts in transport in general. There they agreed that member states could grant 15- or 22-year renewable monopolies (Council:2007).

#### 5.7.9.5. *Legislative process*

The decision-making rules were co-decision with qualified majority.

#### 5.7.9.6. *Outcomes*

The Commission withdrew the apparent Court-sanctioned right that international groupings were not automatically permitted. It is likely that a number of northern member states would not have backed its continuance (particularly as the Commission had written in an exclusion of the normal rules for Eurostar which was the one area where the UK had an anti-competition perspective). Many member states did not want European rules applying to their passenger networks. Consequently, they agreed a system which allowed those who wanted to apply it to do so, but equally allowed others to opt out.

The Council position was the final position. The position on framework agreements was decided in the context of the generic regulation on public service contracts in transport. This effectively allows member states not to have competition in international passenger services if they opt not to do so. It permits member states to grant 15-year framework agreements at their discretion and they do not, as the Commission had hoped, have to go to competitive tender (although the Council did agree that companies granted a monopoly could not apply for monopolies in other countries: a somewhat theoretical proposition). The member states effectively ring-fenced national passenger services and made opening of international passenger services optional.

#### *5.7.9.7. Empirical results and hypotheses*

Hypothesis 1: As a result of enlargement, the proportion of votes in Council held by member states with state owned vertically integrated operators rises marginally to 83 per cent. Member states appear to agree to open international passenger freight but with a right to restrict it on routes where the economic effects for the existing operator is problematic. This to be policed exclusively by the NRAs. However, they agree an even more extensive opt out in separate general legislation whereby any transport contract in a member state can be granted to a single operator without competitive tendering. The observation is indeterminate as we cannot observe national preference formation.

Hypothesis 2: Indeterminate. The Commission and Parliament have no influence and there is no empowerment at supranational level. An argument is advanced during the legislative discussions that the policy might put incumbent international passenger services in jeopardy while also being unprofitable for new entrants and that entry in certain routes might lead to all services being curtailed. In order to safeguard the principle of market opening in general, the Parliament proposes that where this is a genuine risk, such lines could be exempted but a body would be needed to verify this rather than leaving the decision to the railway undertaking which would benefit. They propose the NRAs without Commission overview. I have no evidence as to their motivation. However, I would, in light of their preferences in other legislative rounds, suspect that this is because the Parliament believed that this was the best they would get from the member states.

Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue in this round.

Hypothesis 5: Falsified. Member states content to rely on NRAs.

Hypothesis 6: Falsified. Already established in previous rounds that competition law is not a viable alternative to regulatory implementation.

### **5.7.10. Freight regulation**

#### *5.7.10.1. Background*

The continuing difficulty in reviving the European rail freight market and, in particular, the lack of coordination between different rail systems that created substantial delays at borders lead to a further push by the Commission to find an institutional mechanism for delivering operational cross-border paths for freight.

#### *5.7.10.2. Commission proposals*

The Commission proposed that the regulation contain a binding requirement that member states must create a freight corridor across their territory within three years and more than one within further set periods depending on certain set volumes of traffic. A freight corridor would be a route on the existing rail network on which freight would be given priority over national passenger traffic and there would be a cross-border institution that coordinated national IMs managing the corridor. Member states were obliged to propose routes and the Commission could endorse or modify proposals subject to a regulatory committee (Commission:2008).

The body running the corridor would be an independent legal entity appointed by the national IMs, which managed the national networks that the corridor crossed. This governing body was not permitted to take decisions that contradicted the views of an advisory body of strategic terminals (i.e. ports) at either end of a corridor. This governance body had to draw up an implementation and investment and maintenance plan. It was required to consult all freight users (but the proposed rules meant that ports

had a veto). The governing body had to create a one-stop-shop where rail freight companies could book cross-border capacity directly.

The Commission did not propose any increase in its hierarchical powers, although disgruntled access seekers could complain to the Commission who could raise it with the advisory committee for rail. The Commission would also chair a committee for cooperation between the two IMs for delivering each corridor. The NRAs would continue to regulate any anti-competitive behaviour by the IMs and were required to cooperate in a general and non-legally binding manner (Commission:2009).

#### *5.7.10.3. Parliament's preferences*

The Parliament's main concerns were to increase their ability to monitor directly and indirectly. Directly by removing comitology as a basis for the selection of further routes and instead giving the Commission complete discretion to make decisions subject to criteria set out in the regulation and subject to revocation with notice of the Commission's power.

This would mean that the Council could not use regulatory comitology to negotiate the detail of routes. The Council would either have to create more detail in the draft regulation to tie down Commission discretion which would also require Parliament's agreement or it would have to use the ex post power to withdraw the Commission's discretion altogether if it were dissatisfied – which would in effect mean that new legislation would then be needed, also involving the Parliament.

Indirectly, the Parliament proposed that wider groups needed to be involved in governance, consultation and access, thereby maximising the number of groups that would be engaged in surveillance of what the governing body would be deciding. The Parliament included a requirement for NRAs dealing with access issues to be brought up to the same level – too ambiguous an amendment to be legally operationalised (Parliament:2009a; 2009b; 2009c).

#### 5.7.10.4. *Council preferences*

The Council's preferences were for the first set of routes to be agreed politically and fixed, and for further routes to be proposed only where two (or more) member states volunteered a route. Commission approval (or modification) of the latter would be subject to regulatory comitology.

Governance of the corridor would be conducted by a management board of IMs, it would not be a legally independent entity. The management board would report to an executive board of ministerial appointees who would make decisions on a unanimity basis. The consultation mechanism would be whatever the management board decided would be appropriate. The implementation/investment/maintenance plan must be approved by the executive board. The *one-stop-shop* could refer requests for capacity to the relevant national bodies. The Council also removed the requirement for freight to be prioritised on the corridors (Council:2009).

The effect of the Council's amendments would be to make the corridor mechanism an optional one. If the participating member states on a particular corridor chose to make the institutions operational, they could do so, alternatively they could exist merely on paper and the mechanism would have no implications for national management of the network at all. This would mean that the operation of corridors under the regulation would potentially be the same as the voluntary corridors set up back in 1997. A regulatory official who had participated in activity relating to the corridors stated:

“On specific corridors, for example, Rotterdam-Genoa, regulatory bodies meet four times a year to discuss common problems along the corridor. It's quite successful in terms of having a discussion. However, no coordinated regulation occurs as a result. [It] comes back to the issue that you can only regulate your own national network as a regulator. And [the] willingness and ability to act varies enormously. These groups don't free up traffic, the most [they do] is that they may create some common understanding around the issues rather than a final solution. A group could not deal with a complaint from an operator that access to a similar piece of infrastructure is ten times more expensive than in a neighbour. Meetings do not come to conclusions. No guidelines are produced regarding the corridors.” (Interview: January 2008)

#### *5.7.10.5. Legislative process*

Decision-making rules are co-decision with QMV in Council. As at December 2010, the most recent stage passed is the production of Parliament's second reading amendments.

#### *5.7.10.6. Outcomes*

This remains to be seen. However, Council wishes to unilaterally control, and with complete discretion, which routes are agreed. The Council wants governance bodies for the freight routes which decide by unanimity and where member states can decide whether these governance bodies are genuine decision-makers or merely post-boxes which pass issues to the managers of the respective national networks. The member states want to make the governance body report to a ministerial body that decides by unanimity. There are to be no rules that fetter the discretion of these bodies.

The Commission seeks the ability to amend the rules for each route by qualified majority. It seeks to have a separate legal entity to run each freight path which is appointed by the IMs of each member state to run the freight routes and which must have a one-stop shop decision-making capacity. It also wanted pro-competitive external third party customer groups to have a veto over the decision-making of the governance body. The Commission also seeks a role in dealing with complaints between members of the governance body and with respect to users of the freight paths. On these specified routes, freight should be given priority over other forms of traffic. Parliament seeks the same scope of activity and for there to be substantive governance bodies that makes decisions. However, it proposed that no decisions should be made in comitology but rather they must be agreed in the legislation so that Parliament can be involved.

#### *5.7.10.7. Empirical results and the hypotheses*

Hypothesis 1: The result is likely to be consistent with the hypothesis. With respect to freight routes, the Council does not want to create cross-border governance entities. It is likely that this derives from a suspicion that when these prove not to function and complaints are generated that this will provide evidence that there is need for a parallel cross-border regulatory function.

Hypothesis 2: Likely to be confirmed. The Commission and Parliament, at this stage, are proposing different routes towards supranational regulation. The Parliament is advocating that the Commission fills in any incomplete bargains and has complete discretion over implementation with no comitology controls. Any control would then have to comprise of legislative of override, which would strengthen the Parliament as principal. The Commission is trying to create a situation where a supranational economic actor is created. One that will likely fail but in circumstances where failure does not just occur but where there are decisions to fail. It seeks this so as to be able to monitor those failures. This is an attempt at working around the Council's refusal of supranational regulatory control over national actors. However, to date, member states have been happier to allow freight to fail than to create supranational governance. The Council's initial proposals suggest that this is still the majority preference. There is no other conjunctural impact that seems likely. This suggests that the Commission and Parliament's influence will be low.

Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no proposal of an Agency in this round.

Hypothesis 5: Falsified. Member states are content to rely on NRAs.

Hypothesis 6: Already established in previous rounds that competition law is not a viable alternative to regulatory implementation.

### **5.7.11. Potential recast – 2008 onwards**

#### *5.7.11.1. Background*

The Commission wants to go back, revise and consolidate all of the economic access directives. Initially, this was presented as no more than a tidying-up exercise (Interview with a Commission official, May 2008). Subsequently, the Commission issued infringement actions against 24 member states. The vast majority were for failure to have properly independent regulators. According to interviews, member states have responded to the infringement actions by reorganising activities within ministries but not by setting up actually independent regulators (Interviews:February 2010).

Apparently, the Commission is proceeding to take the member states to the ECJ (Interview: February 2010). If the actions fail, which they may well do since the economic access directives specifically state that the ministry can be the regulator, the Commission will presumably then bring forward a directive requiring independence along the lines which have been agreed in telecommunications. Despite the lack of actual proposals, this proposal is included in the thesis because there is some useful supporting evidence of stakeholders opinions on the relative merits of Agencies and NRAs.

*5.7.11.2. House of Lords European Union Committee (Sub-Committee on the Internal Market)*

In June 2008, the House of Lords published an inquiry into the recast including interviews with a wide range of stakeholders. After hearing the evidence, the House of Lords recommended, inter alia, greater detail in the regulatory requirements including mandatory definitions of the costs which can be included in infrastructure charges, full structural separation of incumbents, and NRAs which are required to be independent of government. They also concluded after hearing the evidence: “We recommend that the Commission do not propose establishing an EU-level regulator” (House of Lords:2008:1).

*5.7.11.3. Stakeholders views given in evidence to the House of Lords Committee*

The evidence provided on institutional design suggested that new entrants were wary of any EU Agency for access, as they feared that without supporting layers of independent NRAs being in place that a European Agency would be premature – as it would be dominated by the existing bodies, i.e. national ministries (House of Lords:2008:71). The incumbent witnesses preferred everything to stay as it was, arguing that there was insufficient experience of the package agreed in 2001 to justify any changes (Ibid: 96) and that the room given for varied national implementation reflected a political agreement (Ibid: 97 ).

#### *5.7.11.4. Reflection on hypotheses in the light of stakeholders reactions to the possibility of an Agency*

It is interesting that rail new entrants are not in favour of an Agency. This contrasts with telecommunications,<sup>158</sup> where new entrants have recently been in favour of Agencies and incumbents opposed. However, it should be noted that in the mid-1990s that new entrants in the telecommunications sector were also divided with respect to the merits of a telecommunications Euroregulator.<sup>159</sup> The clearly expressed fear of rail freight new entrants is that an Agency would be dominated by ministries. The structural difference between 1997 and 2010 in telecommunications is that there is now a blocking minority of member states without state ownership, whereas there was not in 1997. There are not enough states without a state-owned, vertically-integrated entity to form a blocking minority in rail in 2010. These views are consistent with the rational choice approach to institutional design adopted in the thesis.

## **5.8. Legislative developments in interoperability and safety**

### **5.8.1. Introduction**

European legislation gradually began to set harmonised requirements for technical and operational aspects required of the technical systems that comprise a network. These were necessary in order that rolling stock in use in one member state could use the networks in other member states. The emphasis of Commission advocacy in promoting interoperability was partly the benefits for railway undertakings, but also the benefits for manufacturing industry (Commission:1990:53). Interoperability and safety legislation has been considered by the legislative bodies six times. The distinguishing feature compared to economic access is that the Commission has been empowered to make binding detailed regulatory decisions. Comitology on these decisions has been set at a lower level of control, regulatory comitology rather than safeguard comitology. As regards interoperability, when it seemed clear that a regime based on rules set by national economic actors and a relatively unskilled Commission and implemented by NRAs in a loose network was not actually delivering mutually compatible national implementation

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<sup>158</sup> See page 170.

<sup>159</sup> See page 150.

in practice, member states were prepared to agree to the formation of an Agency. As regards safety, when it became equally clear that uncoordinated ministerial bodies were not delivering mutual recognition for safety clearances, the Commission supported by an Agency, was also empowered to take supervisory control over implementation.

## **5.8.2. The High Speed Directive**

### *5.8.2.1. Introduction*

The Commission's initial 1990 document on a Community rail policy highlighted the fragmented and insular nature of equipment supply and the increased costs this meant for rail service providers (and by implication the governments which subsidised them). The Commission noted that there was virtually no cross-border equipment trade and noted that in other sectors, where there was cross-border trade, that costs had been reduced by a quarter (Commission:1990:32). The Commission also described rail infrastructure as a strategic industry with exports of over one billion euro with the potential to achieve very large export markets in the future if EU companies could achieve European economies of scale (Ibid:53).

The first directive dealing with interoperability issues was promoted by the French presidency during its 1995 mandate (Douillet and Lehmkuhl:2001:121). The aim of the High Speed Directive was to achieve the interoperability of the European high-speed rail network at each stage of design, construction and operationalisation. The core mechanism was the Technical Specifications for Interoperability (TSIs), and its observance would be binding on railway undertakings.

### *5.8.2.2. Commission proposal*

The Commission proposal was that it should be the driver behind TSIs. It would request TSIs in a particular area to a body bringing together industry interests, the European Association for Railway Interoperability (AEIF). The body would come up with proposals. The Commission would make a binding decision subject only to advisory comitology. However, TSIs would apply only to Trans-European Networks (TENS); a tiny percentage of EC lines although with the potential to grow. The total EU network was approximately 150000 km. TENS envisaged a high speed network of roughly 30,000

kms in 2010 but at the time of the legislation it was substantially lower – less than 8,000 kms in 1998 (Commission:1999:8). However, the relevant networks were those that were volunteered by member states. Community funding would be made available as an incentive. (Commission: 1995). However, the maximum Community funding available was only ten per cent of the overall costs. Each member state could select the body competent for inspecting compliance with TSIs (Commission:1994).

#### 5.8.2.3. *Parliament preferences*

The Parliament only had the right to be consulted. It advocated that interoperability should also cover customer-facing issues such as ticketing and interconnecting reservation systems. The Parliament went further than the Commission's original proposals and stated that the bodies that inspected compliance with the TSIs must be independent of any railway undertaking. It also said that derogations from TSI applications should be decided by the Commission and only subject to an advisory committee (Parliament:1995).

#### 5.8.2.4. *Council preferences*

The Council's preference was that the comitology body be set at regulatory comitology level and this body would also have the ability to set the brief to the AEIF. It is likely that the concern of member states was that the Commission, in conjunction with manufacturers, might come up with expensive schemes for interoperability, which member state governments might ultimately have to fund. Member states were also concerned to ensure possible derogations from a requirement to apply TSIs, in particular where application would threaten the economic viability of an existing project. They also wanted to be able to make the railway undertakings responsible for ensuring that TSIs were observed. (Council: 1995).

#### 5.8.2.5. *Legislative process*

The decision-making rules were qualified majority voting in the Council and consultation of the Parliament.

#### 5.8.2.6. *Outcome*

The institutional outcome was that regulatory comitology would apply to the selection of TSIs. However, once selected, any request for derogation in a particular member state would be subject to advisory comitology (actually advisory, not nominally advisory with safeguard rules as on access issues). In other words, an institutional mechanism was created here that meant that member states had to comply with standards once they were agreed.

The regulatory committee as well as the Commission would have the ability to set briefs for the AEIF – giving the member states the ability collectively to override briefs which they considered likely to give rise to expensive outcomes. TSIs would apply to high-speed TENS only, so the costs would generally not impact on any existing networks. Member states would be able select the compliance body (which would need to be independent of the pecuniary interests relating to infrastructure; the form of words, while somewhat ambiguous, were primarily directed at equipment manufacturers not railway undertakings).

#### 5.8.2.7. *Empirical observations and the hypotheses*

Hypothesis 1: Indeterminate but consistent with the hypothesis. Agreeing TSIs involves a much lower level of distributional conflict than access. The Council sets up a mechanism that is quite different from that which applies to access issues as the Commission does make the detailed rules, on advice from the manufacturers and railway undertakings, and subject to regulatory comitology. However, the general distributional concern that manufacturers might use the process to choose the most expensive option and the Commission may not have the incentives/skills to control this, leads the member states to design an override mechanism to alter briefs. Implementation, or rather inspection of implementation, is, however, reserved for national bodies with no administrative review powers over the inspecting bodies by the Commission. The result is indeterminate as it is not possible to directly trace the absence of a factor.

Hypothesis 2: Confirmed. Commission and Parliament advocate that the Commission should have the ability to decide the detailed content of TSIs.

Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue in this round.

Hypothesis 5: Indeterminate. There is no discussion around an Agency at this point. However, the Council accepts that there is a functional need to have single European TSIs and that this can only be achieved by having binding central decisions, but it prefers them to be implemented by unsupervised national bodies.

H6: Falsified. Competition law is not an appropriate tool for standard setting.

### **5.8.3. Safety requirements: 2001 package of directives**

#### *5.8.3.1. Introduction*

Railway safety had usually been handled internally inside the vertically integrated incumbent, often on an informal basis (El Koursi et al:2007:7). In line with its attempts to open up the international freight market, the Commission now pushed for safety to be regulated on a transparent and independent basis since there would potentially be multiple entities sharing infrastructure. This was partly needed to ensure that the new regime preserved and hopefully improved further on the high safety standards of the old regime. As NERA put it in a report for the Commission in 2000: “There should be some (relatively) immediate benefits from clarifying the requirements placed on operators and suppliers. There can be no safety argument against this – rather the opposite” (NERA:2000:ix).

The NERA report found that one of the obstacles to cross-border activity was safety regulations (NERA:2000:8), and recommended that an EU Agency be set up to oversee national safety authorities (NERA:2000:131). NERA also found that in so far as there were barriers to trade derived from safety concerns, new entrants did not believe that they were conscious attempts to implement indirect discrimination but rather that they resulted from variation in the different national regimes (Ibid:8). Nonetheless, the new, and hopefully not conflicted, regime would also ensure that the vertically-integrated incumbent did not remain the controller of safety and, thus, have the potential to exclude competitors on safety grounds.

A separate directive was also proposed to extend TSIs agreed at the EU-level to cover conventional rail. However, TSIs would not be sufficient to deliver safety on their own. While TSIs did cover safety aspects of sub-systems or components on a harmonised basis, it was not a mechanism for reviewing overall safety on any given network. The latter required an assessment of the safety of the combination of those TSI components and the varieties of existing rolling stock, physical infrastructure and operational practices in each member state (Lundstroem:2002:12).

#### 5.8.3.2. *Commission preferences*

The key issue for the Commission was obtaining agreement that the body that carried out the licensing of railway undertakings and issuing of standards and rules could not be a provider of rail transport services. This was a change to the 1995 directive relating primarily to economic access which permitted the member states to allocate licensing tasks to whichever entity they preferred. The licensing system should incorporate a safety certificate that would set out explicitly all the national rules for technical, operational and safety requirements. Railway undertakings would be responsible for meeting those requirements (Commission:2000).

#### 5.8.3.3. *Parliament's preferences*

The Parliament supported the Commission's proposals while adding two additional powers. The Commission should be able to adopt undefined technical harmonisation measures in order to support interoperability. The other power was a right for an undertaking to ask the Commission for a ruling on whether a national safety rule was in compliance with EC Law. The Commission adopted both of these amendments. The Parliament had a stronger negotiating position with respect to this directive as this negotiation took place under co-decision rules (Parliament:1999 and 2001).

#### 5.8.3.4. *Council preferences*

The Council added a requirement that when a licensing authority issued, amended or revoked a licence that it must inform the Commission, who would then inform other member states. This was based on prudential grounds. At first reading the Council wished to retain the status quo ante whereby any entity, which a member state

nominated, could be the licensing body. However, at second reading, it accepted the principle that the responsible body needed to be independent – as long as the functions of granting and verifying safety certificates could be delegated back to railway undertakings (Council:2000).

#### 5.8.3.5. *Legislative process*

The decision-making rules were co-decision and QMV in Council. There was no major disagreement between the member states or between the Council and the other institutions on safety issues. However, Belgium, France and Luxemburg voted against since all the 2001 directives were voted on together as a package. The safety rules are contained within the same directive as access rules.

#### 5.8.3.6. *Outcome*

The principal change was that the licensing and safety certificate issuing body would be required to be independent of a railway undertaking. However, member states retained the ability to delegate the functional activity, if not the legal responsibility, to the railway undertakings. Safety requirements would have to be explicitly set out and met as part of a safety certificate process.

The Council opposed and then accepted in conciliation a right for operators to approach the Commission and ask for an opinion on the legality under EC law of national safety certificate requirements. This was something that the Commission could do regardless of whether it was enshrined in a directive or not so it was not a major concession.

The ability for the Commission to take “technical harmonisation measures” was deleted and, instead, the Council agreed that the Commission should undertake a study of interoperability.

Institutionally, the generic comitology provisions relating to access in the infrastructure charging and safety certification directive also applied to safety certification – which meant that a higher degree of control applied to safety than it did to interoperability; however, it seems likely that this was simply a case of path dependency; a consequence of the rules on safety certification being included in legislation which was primarily

focused on economic access. This is suggested by the fact that in the next legislative round that a joint safety and interoperability directive puts them both under the same regulatory committee rules.

5.8.3.7. *Empirical observations and the hypotheses*

Hypothesis 1: Falsified. There are no major distributional issues here. The Council selects NRAs. However, there may be an issue of path dependency here. The safety regime is constructed through amendments to the infrastructure-charging directive, and that regime is effectively duplicated and applied to safety. The lack of coordination to which this gives rise leads the Council to support an Agency in the next legislative round.

Hypothesis 2: Confirmed. The Commission and Parliament advocate the Commission having the power to undertake expedited administrative review of NRA decisions. However the safety rules are part of a directive which also covers access issues, and the influence of the Commission and the Parliament is subordinated to the extent of their influence on the access parts of the Directive.

Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue in this round.

Hypothesis 5: Indeterminate. There is no discussion around an Agency at this point.

Hypothesis 6: Falsified. Competition law is not an appropriate tool for standard setting.

## **5.8.4. Interoperability of the trans-European conventional rail system**

### *5.8.4.1. Introduction*

The opening up of rail to international freight under the access rules<sup>160</sup> also meant that the rules for interoperability had to be agreed for the freight sector. The Commission had agreed the setting up of trans-European rail freight freeways on a voluntary basis with the railway undertakings (Commission:1997). However, these had failed to amount to anything in practice. Lyons says this was because only the existing national incumbents were permitted access and because of very high access charges (Lyons:2000: 81). The Commission was also able to show that its attempts to encourage voluntary cooperation had also failed as far as interoperability was concerned: locomotives still had to switch at borders with lengthy delays because there were 16 incompatible IT systems in the EU (Commission: 1999b:7).

### *5.8.4.2. Commission proposal*

The Commission's objective was to extend the TSI regime to those parts of the conventional rail system used for international freight and which form part of the TENS networks. As with high-speed rail, these represent a fraction of the EU train network – covering approximately 20 per cent of international freight volumes (Commission:1999:2).

Institutionally, the difference with the High Speed directive was that the Commission proposed that only it should be able to set briefs for the AIEF. It opted not to argue again for advisory review only (Commission:1999b).

### *5.8.4.3. Parliament preference*

The Parliament's only addition was that users and social partners should be consulted on draft TSIs (Parliament:2001).

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<sup>160</sup> See page 226.

#### 5.8.4.4. *Council preference*

The Council agreed that comitology should be regulatory. However it split the review process into two stages. Comitology of the original brief and then comitology of the Commission decision. Underlining member state concern to avoid EU specifications that a country might consider too expensive, a single member state should be able to require the AIEF to examine alternative specifications. The Council agreed that users and social partners should be consulted (Council: 2000).

#### 5.8.4.5. *Legislative process*

The decision-making rules are co-decision with QMV in Council.

#### 5.8.4.6. *Outcome*

The EU extended rules agreeing TSIs from the high speed to the conventional network for international freight (where a network is declared a TENS network by the member state).

Comitology remained regulatory (with two stages and the ability of the Committee at the request of a single member state to require the AIEF to look at alternative briefs other than that given by the Commission). Users and social partners would have a right of consultation on draft TSIs.

#### 5.8.4.7. *Empirical results and the hypotheses*

Hypothesis 1: Indeterminate. The Council agrees an extension of Commission implementation powers from high-speed TSIs to conventional TSIs. While there is a modification of the rules to give individual member states the right to make sure that the advisory industry body is reviewing all the alternatives and not just those they may prefer, no individual member state can block the adoption of a TSI. However, it is not possible to trace the effect of the absence of distributive conflict. This is dealt with in the conclusion of the thesis by looking at co-variation.

Hypothesis 2: Confirmed. Commission and Parliament advocate that the Commission should have the ability to decide the detailed content of TSIs. Member States follow this agenda.

Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no recorded discussion of the issue in this round.

Hypothesis 5: Indeterminate. There is no discussion around an Agency at this point. However, the Council accepts that there is a functional need to have single European TSIs and that this can only be achieved by having binding central decisions.

Hypothesis 6: Competition law is not an appropriate tool for standard setting.

### **5.8.5. Second Railway Package: Rail Safety and Interoperability Directives**

#### *5.8.5.1. Introduction*

In 2001, the Commission published *European Transport Policy:2010: A Time to Decide*, which pointed out that the ambition to create a viable freight market was still being frustrated and would not be achieved without radical steps, including with respect to safety and interoperability. The document dryly noted that the average speed of international rail haulage due to the various delays was only 18 km/hour which was slower than an ice breaker opening up a shipping route through the Baltic Sea (Commission:2001:28) It also quoted Louis Gallois, the former chairman of SNCF, who stated before a meeting of the French National Assembly in June 2000: “I think the Charleroi-Paris route needs five driving crew members: two in Belgium and three in France [to deal with different national technical systems]” (Ibid:28). (A distance of less than 300km, which can be driven on the road by one truck driver (Intereconomics:2006:308)).

In particular, there was concern that the TSIs proposed by the AEIF were replete with open points on fundamental issues of technical compatibility which meant that TSI s were not in fact harmonising interoperability.

The Commission was able to show that rail freight figures had halved since the mid-1990s and the opening up of the road haulage market. Specifically, rail freight had an eight per cent share in 2003 (Commission:2007:4) compared to 15 per cent in 1995 (Commission:1997:3). It was still the case on nearly all routes that locomotives had to be

swapped at borders because of differences between command and signalling IT (Commission:2003:5).

#### 5.8.5.2. *Commission proposal*

The Commission's objective was to fundamentally reform the EC rules for safety and interoperability by extensive institutional reform. The Commission proposed the creation of a European Rail Agency to draft European rules that the Commission would adopt. The objective was, as far as possible, to gradually replace national rules. The Agency would also replace the AEIF as the body responsible for drawing up TSIs which it was hoped it would do faster and to better effect: operating with majority voting instead of the AEIF's consensus practice. The Commission's intention was that it would have a preponderant voice in the management and direction of the Agency compared to the member states.

The Board of the Agency would comprise of six representatives of the Commission and six of the member states and decisions would be by two-thirds majority (there would also be three non-voting experts. The Executive Director of the Agency would be proposed by the Commission and his or her dismissal could only be sanctioned with the consent of the Commission. Agency work packages would require first Commission approval and then Board approval (Commission: 2002a).

Safety issues would be harmonised by agreeing common targets, measures to achieve them and indicators for measuring them at European level. The Commission would adopt these, advised by the Agency and subject to a regulatory committee. Safety certificates designed to deliver these would comprise of a part A, common to all railway undertakings, and a part B, specific to any individual network. The Agency would be empowered to draw up a strategy to move to a single part A, gradually eliminating the coverage of part B. Once a company satisfied one NRA as to its compliance with Part A, it would not have to do so again in any other member states. The Commission would be empowered, subject to a regulatory committee, to veto new or amended national safety rules on an expedited administrative basis if they were contrary to EC law. The Agency would have the right to carry out inspections of the national bodies implementing TSIs (Commission:2002b; Commission:2003a; Commission:2003b).

In parallel with changes to access rules, the new safety and interoperability regime would apply to the whole conventional freight network (Commission:2003).

#### *5.8.5.3. The Parliament's preferences*

The Parliament agreed with the Commission's objectives and general approach. However, it also sought to increase its role. It argued that the common safety targets and measures should be legislative issues not passed to the Commission and Council in comitology. It also argued for representation of specific functional interests on the board and for an increase in their number (although the Commission should have the ability to select from the range of representatives put forward by these interests) (Parliament:2002; Parliament:2003; Parliament:2004a; Parliament:2004b; Parliament:2004c; Parliament:2004d).

#### *5.8.5.4. Council preferences*

The Council was also keen to preserve the dying rail freight sector. It also agreed with the general approach. It did not seek to argue that there should be a reliance on formal or informal networks of NRAs. However, it sought to preserve its collective position by agreeing rules around the Administrative Board so that member states would dominate the decision-making process. In addition, it would remain the case that the independent national safety authorities could be part of ministries (Council:2003 and 2007).

#### *5.8.5.5. Legislative proposal*

The decision-making basis is co-decision with QMV in Council. There is no disagreement within the Council. The Parliament and the Commission disagree with the Council over the structure of the Agency, pushing for it not to be under the collective control of the member states. The Parliament also argued that harmonised common safety targets and methods should be set in legislation, so that it can participate in setting them. This is rejected by the other institutions on the basis that it was too technical, time consuming and there was a need to be able react swiftly to technological issues. No conjunctural issues strengthen the negotiating position of the Commission and the Parliament.

#### 5.8.5.6. *Outcome*

A Europeanised system was set up with the Commission able to take decisions. The Commission was to be advised by a European Agency. The European Agency was collectively controlled by Member State appointees. There was no requirement for these to be drawn from NRAs (called National Safety Authorities or “NSAs”) and they can be representatives of national ministries. Comitology of Commission decisions is set at regulatory committee level. Member States can go beyond EC Law in setting safety targets. However, the Commission can veto national safety rules on an expedited administrative basis, without going to the ECJ, if these are not compatible with EC legislation

#### 5.8.5.7. *Empirical results and hypotheses*

Hypothesis 1: Indeterminate but consistent with the thesis. TSIs and safety issues involve a much lower level of distributional conflict than access. The two are brought together in a similar regime separate from access. In respect of both issues an Agency is empowered to advise the Commission, which will take decisions. Regulatory comitology applies to Commission decisions (rather than the safeguard threshold applied in access issues). The Commission not only has the ability to make detailed rules for implementation, it is also given the power to undertake administrative review of NSA rules. The Agency can conduct inspections of the national bodies implementing TSIs. The Council was supportive of these changes. Disputes are centred on the structure of the Agency only, where the Commission and the Parliament seek to give Commission appointees veto power over Agency decisions and the Parliament, supported by the Commission, seeks to obtain the participation of interest groups. The result is indeterminate as it is not possible to directly trace the absence of a factor.

Hypothesis 2: Confirmed. Commission and Parliament advocate that the Commission should have the ability to decide the detailed content of TSIs.

Alternative hypotheses:

Hypothesis 4: Falsified. The Council raises no constitutional objection to an Agency.

Hypothesis 5: Falsified. The Council takes the view that a formal Agency structure is necessary to deliver outcomes – there are informal networks in existence, but it does not seek to rely on them.

Hypothesis 6: Falsified. Competition law is not an appropriate tool for standard setting.

## **5.8.6. Revised Safety on Railways Directive**

### *5.8.6.1. Introduction*

Commission reports on interoperability and safety indicated that there continued to be long delays in achieving mutual recognition particularly with respect to the application of existing rules to locomotives (Commission: 2006). The Commission pushed for amendments to the safety directive specifically to facilitate mutual recognition of locomotives.

### *5.8.6.2. Commission proposals*

The Commission consulted informally on whether the Agency could be given the power to licence locomotives on a pan-European basis (Commission:2006). However, opposition to this step from member states meant that the Commission did not even include this in its draft proposals. Instead the Commission proposed that application of a set of international standards for locomotives set out in the annex to the directive could not be rechecked by national authorities once their application to a locomotive (or series of locomotives) had been checked by one national authority. The list of accepted standards could be amended by regulatory comitology.

### *5.8.6.3. The Parliament's preferences*

The Parliament exercised its new power to insist on regulatory comitology with scrutiny. This is exercisable if any amendments proposed to a committee are so extensive as to be tantamount to new legislation. The Parliament also proposed that railway undertakings be able to request a technical opinion from the Commission should they receive a negative opinion from a national authority.

#### 5.8.6.4. *The Council's preferences*

The Council agreed on regulatory comitology with scrutiny. The Council did not agree that the Commission should be responsible for giving technical opinions (indeed this was merely a way of the Parliament trying to increase the role of the Agency at the expense of the NSAs, since the Commission would have turned to the Agency to provide such advice).

#### 5.8.6.5. *Legislative process*

Co-decision and QMV in Council. There is no disagreement in Council. There is no conjunctural issue that increases the negotiating position of the Commission and Parliament. There is probably greater *impatience* on the part of the Commission and the Parliament to deliver something for cross-border transactors even if they cannot obtain their first preference.

#### 5.8.6.6. *Outcome*

The Commission did not back the Parliament since not increasing the role of the Agency had been the price paid for obtaining agreement that locomotive safety issues should not be checked by more than one national body.

#### 5.8.6.7. *Empirical results and hypotheses*

Hypothesis 1: Indeterminate but consistent with the thesis. Regulatory authority still remains with the Agency/Commission. In this round, the Commission informally and the Parliament formally were seeking to replace NSAs by the Agency as the body which would conduct the technical implementation work. The member states were concerned to protect their NSAs. As Kelemen found with respect to the Medicines Agency, distributional concerns shaped its design (Kelemen:2002:103). Here they do the same; member states support the development of binding European rules but they want them to be deployed, subject to review by the Agency and the Commission as agreed in the previous legislative round, by an NSA.

Hypothesis 2: Confirmed. Detailed rules to be proposed by the Commission (advised by the Agency). However, the Commission and Parliament's influence, despite an attempt, does not extend to having the Agency replace NSAs in conducting implementation.

Alternative hypotheses:

Hypothesis 4: Falsified. There is no objection to the role of the Agency agreed in the previous round. However, there is an objection based on subsidiarity to the Agency conducting implementation as opposed to undertaking draft decision making in relation to setting rules and policing them.

Hypothesis 5: Falsified. The Council does not wish to supplant the role already agreed for the Agency. The exercise it wishes to restrict to the NSAs is one of implementing the decisions made in the Agency.

Hypothesis 6: Falsified. Competition law is not relevant for standard setting.

### **5.8.7. 2006 Interoperability Directive**

#### *5.8.7.1. Introduction*

The Commission proposed a recast of all the safety and interoperability directives so they would be collected for ease of reference in one directive.

#### *5.8.7.2. Commission proposals*

The Commission did propose one change: altering the power of the comitology committee to change the terms of reference for TSIs so that only the Commission would be able to do this henceforth.

#### *5.8.7.3. Parliament's preference*

It supported the Commission.

#### *5.8.7.4. Council's preference*

The Council no longer considered this controversial. This may be because the body designing TSIs was now no longer composed of industrial interests. It now comprised of

NRAAs (which could be independent bodies or indeed parts of ministries themselves), albeit that they cooperated with working groups which contained industrial interests. Nonetheless, the agenda was now set by bodies that would be more inclined to be cognisant of the potential national budgetary implications of TSIs.

*5.8.7.5. Legislative process*

Co-decision with qualified majority voting. Council is unified. No conjunctural issues increase Commission or Parliament negotiating power. The issue is a tidying up process, no institution could be described as impatient.

*5.8.7.6. Outcome*

All institutions agree.

*5.8.7.7. Empirical results and the hypotheses*

Hypothesis 1: Indeterminate. Commission and Agency agenda-setting powers strengthened.

Hypothesis 2: Confirmed. Commission and Parliament advocate strengthening of Commission agenda setting powers. Their influence derives from their own agenda-setting position.

Alternative hypotheses:

Hypothesis 4: Falsified. No constitutional objections are raised to strengthening the positions of the Agency and the Commission.

Hypothesis 5: Falsified. Council agrees to increased agenda-setting powers for the Agency.

Hypothesis 6: Competition law is not an appropriate tool for standard setting.

## **5.9. Regulatory implementation**

### **5.9.1. Variation in the quality of implementation**

#### *5.9.1.1. Economic access*

The evidence that exists points to a great degree of variation in application by NRAs. Three pieces of evidence are presented below. The first is Table 5.3 showing the statistical results of comparing regulatory scores attributed to national rail regulatory regimes by IBM (IBM:2007) and combined freight and passenger market shares recorded by IBM (Ibid) with the existence of vertically integrated state owned entities (Tarrant and Cadman :2009). The second table, Table 5.4, was presented by the UK's Department of Transport to the House of Lords EU Committee's enquiry into the EU rail freight regulation based on data provided by the European Commission indicating the alleged weaknesses by country of national implementation (House of Lords:2009:chapter 2, figure 3). The third example is taken from DG Tren's slides from 2006 and shows outcomes by country in the single specific area of national charging for access to infrastructure, and provides an example of the concrete outcomes for access seekers (Scherp:2006:10).

The quantitative scoring of the application of the EU rail framework in member states has been undertaken by IBM (IBM:2007). They find that scores vary significantly between member states. Their overall conclusion is:

“Rail regulation continues to vary quite considerably from country to country. There are still countries, for example, which have implemented the Directives on paper only and/or have only provided their regulatory authorities with weak competences. Very few countries in fact have regulatory authorities that are actually capable of providing non-discriminatory network access.”

Ibid (4)

IBM provides a range of measures. Table 5.4 uses the ACCESS score, which measures how the law is put into practice, rather than the LEX score which records formal transposition only. These scores and also market shares can be correlated with the nature of ownership in the member states. Where member states have a vertically integrated state operator, scores out of a potential 1000 for regulatory access are on average

substantially lower. The finding is statistically significant, although the small number of observations mean this is not reliable. Similarly, market shares are on average much higher where there is vertical integration – although this figure is not significant.<sup>161</sup>

**Table 5.3 Correlation of state ownership with scores for regulatory effectiveness and market share**

<b>Rail</b>		Access score	Mean market shares
Vertically integrated and state owned	Mean	641.1	93.5
	<i>Observations</i>	<i>14.0</i>	<i>13.0</i>
	<i>Standard deviation</i>	<i>118.8</i>	<i>11.7</i>
Non-vertically integrated	Mean	733.3	74.1
	<i>Observations</i>	<i>7.0</i>	<i>7.0</i>
	<i>Standard deviation</i>	<i>74.8</i>	<i>37.5</i>
Significance	z-test	1.7%	18.3%

Source: Status of companies: Conway and Nicoletti:2006; own research; Access score and market shares : IBM (2009)

The House of Lords inquiry into the Commission’s Recast exercise, included evidence provided by the Department of Transport which shows massive variation in the quality of implementation. This data is collected on the basis of alleged non-implementation of the directives. The basis is, therefore, different from the IBM ACCESS index, which assesses the quality of the implementation. The UK Government stated:

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<sup>161</sup> When the data is pooled with the other sectors examined in the thesis, the number of observations rises

“We believe that in a number of member states rail regulators lack the resources and independence to be effective enforcers of rail legislation, and therefore are not in a position to facilitate market entry and competition.”

Department of Transport (2009:2)

**Table 5.4 Summary of alleged infractions provided by the Department for Transport**

	AT	BE	BU	CZ	DE	DK	EE	GR	ES	SF	FR	HU	IE	IT	LT	LU	LV	PL	PT	RO	SE	SL	SK	UK
Insufficient guarantee infrastructure manager independence from railway holding/affiliates	X	X			X			X						X				X						
Essential functions still performed by incumbent railway undertaking				X			X				X	X				X	X						X	
Insufficient access of foreign freight railway undertakings to national infrastructure									X															
Incumbent railway undertaking insufficient management independence				X			X	X											X				X	
Infrastructure manager doesn't determine infrastructure charges				X				X		X			X							X				
Infrastructure charges not related to costs								X			X													
Insufficient legal provisions to ensure infrastructure manager revenue and costs										X									X					
Insufficient incentive for infrastructure manager to reduce infrastructure costs/access charges			X	X	X			X		X	X	X	X		X			X					X	X
Charges set above marginal cost (or similar)										X								X					X	X
Regulatory body insufficient powers to control charges										X														
Absence of performance scheme to encourage railway undertakings/ infrastructure manager to minimise disruption	X	X	X	X		X		X	X	X	X	X	X	X	X	X			X		X	X		

and significance improves (see pages 340 and 341 in the concluding chapter).

Regulatory body insufficient powers to monitor rail service market competition	X		X	X		X	X	X	X	X	X		X	X	X	X				X		
Regulatory body insufficient accessibility		X				X			X					X	X	X		X	X	X		
Regulatory body insufficient independence from incumbent railway undertaking/infrastructure manager		X	X			X		X	X	X	X			X	X	X			X	X		
Regulatory body insufficient powers to enforce decisions and requests for information				X			X	X	X	X			X		X	X						X
Regulatory body decisions not subject to judicial review																					X	
Regulatory body no obligation to take action within 2 months																						X
Insufficient procedure to determine international train paths			X					X	X				X		X							
Infrastructure charges not related to costs					X						X											
No provision for regulator participation in international cooperation of regulatory bodies					X	X		X						X							X	
Insufficient provision for infrastructure manager cooperation in traffic control					X																	
Infrastructure manager tasks not consistent with financing																				X		
Regulatory body insufficient supervision of applicant/infrastructure manager negotiation on infrastructure charges																				X		
No separate profit and loss accounts and balance sheets for infrastructure manager and transport services																					X	

Note however that the UK government chart tracks non-implementation rather than poor implementation. If we look at one example, access charges, the UK government chart records just two failures to implement. In reality, there is enormous scope for variation in access charges without breaching the implementation rules. This does not necessarily mean that any particular charge will be discriminatory or used to provide cross-subsidies within vertically integrated entities – although there is strong suspicion that this occurs in many countries. However, where entities are vertically integrated it is impossible to ascertain without effective accounting separation.

In 2007, a working group of the European Council of Transport Ministers found that accounting separation had barely been implemented in the European Union:

“At most, 7[EU railways] meet some part of the reporting requirements of the EU with respect to the availability of information, separation of accounts, transparency of cross-subsidies and transparency of public support (and in some cases where the transparency is available, the results show that cross subsidies are actually being employed, which contravenes EU requirements [...]). Each of these analyses leaves unanswered questions,

especially about whether information is adequate even where it nominally exists.” ECMT (2007:19).

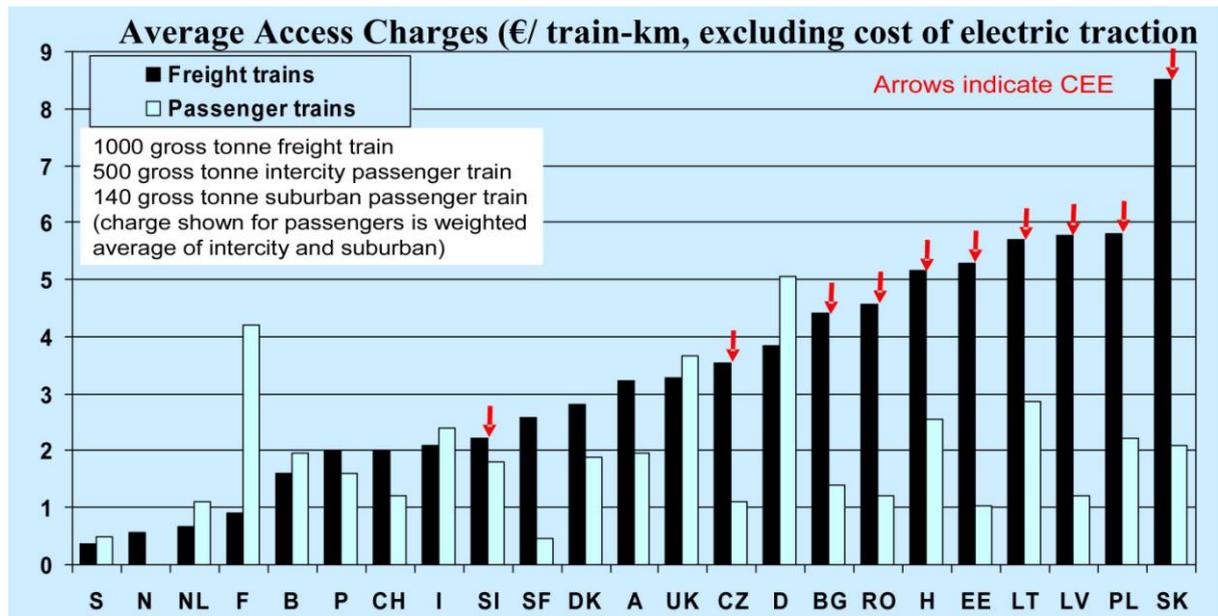
In evidence to the House of Lords in 2009, the Secretary General of the European Rail Infrastructure Managers, a trade association, said:

“In the structure of an integrated company, although you may have separate holdings, as in Deutsche Bahn or various others, there is a lot of money that it is very easy to pass through the books and cross-subsidisation, which may not be apparent just looking at it [...]. It can also be very detrimental, where the funds are used, for instance, from a freight business to subsidise a passenger business, because the freight charges are then much higher than they need be, and in fact they act as a barrier to transferring road traffic to rail, so it is not a truly open market” House of Lords (Questions numbers 43-59).

In any event, the extent to which highly varied charging compromises cross-border traffic is not disclosed by averaging. The mixture of fixed and variable elements means that some national regimes favour short frequent trains and others favour longer less frequent services. The railway economist Nash considers:

“There is little doubt that the current situation makes life difficult for operators of international freight, in terms of transparency of charges, in terms of confused incentives (for instance short frequent trains could be cheapest under one country’s regime and heavy infrequent trains under its neighbour’s) and above all the level of charges may be prohibitive in terms of international traffic involving transit of that country.” Nash (2005:277)

**Table 5.5. Average access charges euro/train-km, excluding cost of electric traction**



(Scherp:2006:10).

Table 5.5 shows the variation in access charges across the EU.

### 5.9.1.2. Variation in interoperability and safety

#### 5.9.1.2.1. Variation in safety

There is no quantitative cross-national assessment. There was a study by NERA in 2000 for the Commission that found that there was a great deal of diversity and that this was perceived to be a problem for new entrants. As far as the Agency concerned, the most recent report, using data from 2007, can only report that the Agency was getting off the ground (ERA:2009).

#### 5.9.1.2.2. Variation in interoperability

There is useful data for interoperability. A comprehensive investigation into the operation of the interoperability regime took place in 2009 and was conducted by the European Rail Agency. This indicates that the Agency fairly swiftly revised the TSIs for high speed developed by the AEIF and which had been adopted in 2003. It also developed seven new TSIs for conventional rail, with a remaining two expected by the

end of 2010 (ERA:2009:22). To this extent, the picture looks extremely positive and a stark contrast with the lack of harmonisation in economic access issues where there are no common rules.

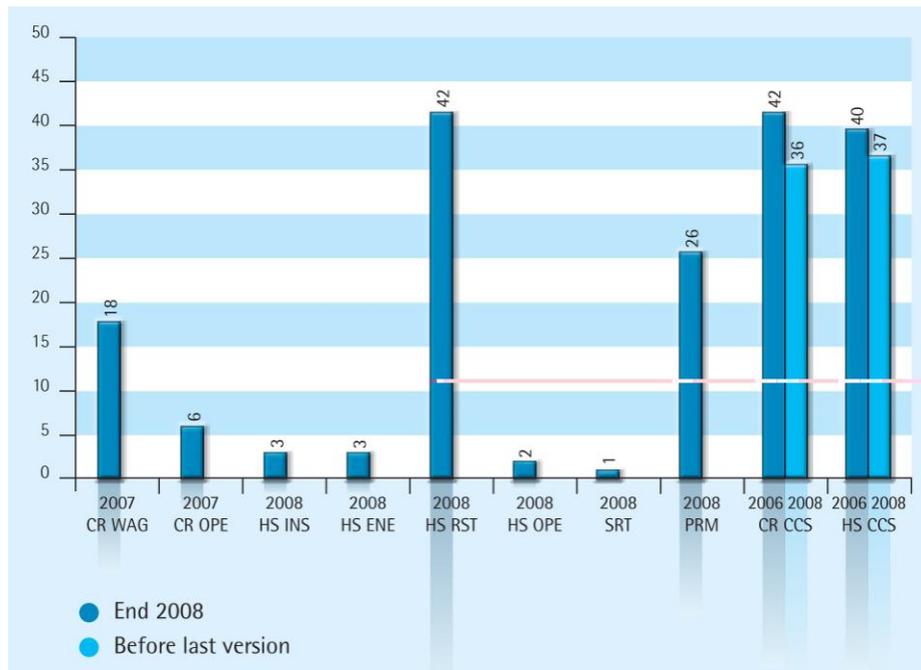
These findings echo those of a study conducted by KEMA in 2007 for the Commission: “Interoperability is progressing. The legal system is in place. Implementations in the member states are nearly completed. The institutions in the member states and on the European level have largely been established. A large part of the TSIs is available. The first interoperable parts of the network have been put into operation. Interoperable traffic on these lines is starting to take place. Interoperability now can grow further from *pragmatic* to *full*.” KEMA (2007:6)

However, the picture is more complicated because TSIs can be agreed with *open points*. These effectively permit agreements to disagree on the minimum requirements for interoperability and safety. Where there is an open point, member states are permitted to adopt specific national rules. ERA’s findings tend to indicate that these remain significant, especially with respect to the command and control IT systems (CCS).<sup>162</sup> Table 5.6 shows the number of open points against TSIs (ERA:2009:27). ERA has succeeded in reducing the number of open points on CCS marginally.

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<sup>162</sup> The other TSIs are wagons (WAG), operations (OPE), infrastructure (INS), energy (ENE) rolling stock (RST), people with restricted mobility (PRM), safety in tunnels (SRT).

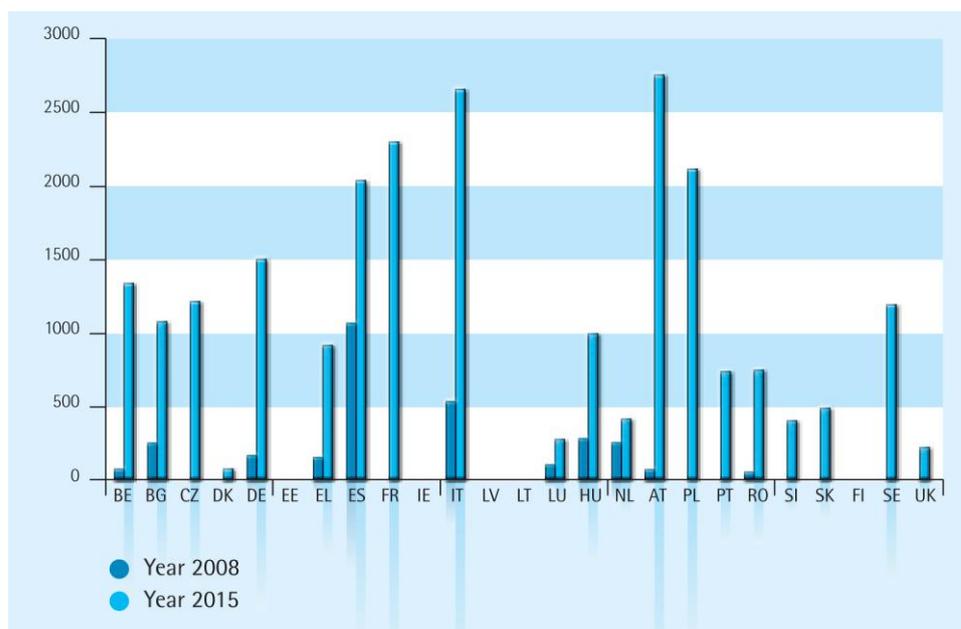
**Table 5.6. Number of open points by TSI as of 1/01/2009 (ERA:2009:27)**



(ERA:2009:27).

It is less surprising that ERA have struggled to close open points on conventional rail systems (CR) as the national systems are largely fully deployed. However, it might appear more problematic that ERA has failed to do so on high-speed systems (“HS”) since in practice interoperability can only occur with the evolution of the networks due to the long replacement cycles. The degree to which high-speed networks have been deployed to date in the EU is actually rather limited, so this should be the area where interoperability can most easily be delivered. Table 5.7 shows deployment in 2008 and likely deployment by 2015.

**Table 5.7. ERTMS kilometres per member state by 2008/15**



(ERA:2009:38)

As an external, non-engineer observer, it is not possible to personally assess the significance of the gaps in the TSIs. Interviews suggest that they are highly significant. An Agency official stated that the current high-speed TSI was largely inherited from the AEIF and because the latter agreed everything on a consensus basis, their agreements tried to accommodate the technical products of every participating manufacturer, ensuring open points and a lack of actual interoperability (ERA official, interview:December 2007) . The next Agency-driven TSI will apparently require that all of the European Rail Traffic Management System (ERTMS) software is backward compatible so that all of the different national CCS systems will be able to communicate with each other. Simultaneously, the Commission has used its powers to advance deployment. Arguably, it has in fact partly gone beyond its powers. However, it has succeeded in doing so because, fundamentally, the majority of member states wish it to succeed in delivering on interoperability.

The Commission has taken two steps. It has obtained agreement from the Council to increase TENS funding to 50 per cent for ERTMS projects and this finance has been

focussed on the six main freight corridors (COM:2009:9). The Commission would seem to have gone beyond its apparent powers in adopting a binding deployment plan for ERTMS. It argues teleologically that the power to adopt TSIs includes the power to adopt a deployment plan since “interoperability can only be achieved if the corridors are fully equipped” (Commission:2009:recital 7). Germany was apparently opposed to this in comitology and argued it was illegal (Interview: December 2007).<sup>163</sup> However, Germany did not obtain support from other member states, particularly those whose investments would be pointless if they could not interconnect with compatible German networks.

The Commission apparently pointed out that if the interoperability directive did not give it such a power with respect to TSIs then it would have to seek a new directive and in which case a qualified majority in Council and the Parliament would be likely to seek a more extensive binding deployment plan (Interview: December 2007). The decision was agreed in comitology and no legal challenge has been forthcoming. The Commission has effectively moved beyond the powers given to it, advised by the Agency, to adopting rules and policing them, but also the ability to decide the timetable for adoption of implementation by NRAs.

#### *5.9.1.3. Empirical results and the hypothesis*

Hypothesis 3: Confirmed. Implementation by NRAs of access rules is varied and it appears to vary depending on whether the regulated entity is state owned or not. Conversely, adoption of TSIs and now the timetable for their deployment is being exercised with binding effect by the Agency and the Commission. There is too little data on safety certification to make an assessment.

### **5.9.2. Cooperation between regulators in rail**

#### *5.9.2.1. Introduction*

Interviewees from three member states were interviewed in order to ascertain whether (i) there are any indications that the activities of regulators have been affected by state

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<sup>163</sup> Germany was an early adopter of a CCS national variant which would need to be replaced (expensively). It is also, due to its geographical position, the country that would need to equip the most

ownership; and, (ii) whether the conditions identified as being necessary for informal governance by national regulators through networks have occurred.

Respondents are divided into two groups: those dealing with economic access issues and those dealing with safety issues. In countries A and B the state owns a vertically integrated incumbent. In country C, the state owns a network provider only. The questions and answers are set out in Annex Eight.

5.9.2.2. *Responses from interviewees regarding interactions between ministries and regulators on access issues*

Interviewees from three member states were asked five questions about the relationship between ministers and state-owned entities; about how important the Ministry considered the ownership stake in the entity; about the degree to which ministers were actively involved in access regulation; whether state-owned companies lobbied ministers on access regulation; whether ministers discussed access issues with regulators; and, whether ministers either formally or informally gave regulators instructions.

The results from country A are clear: the NRA has no independence and the regulated entity acts as the de facto regulator. In country B, the ministry official hinted that the situation was nuanced, but the answers of an NRA official and a new entrant indicate that the NRA is at least relatively independent (different answers were provided by the respondents from the telecommunications NRA in the same country). However, it may be that the scope of regulatory activity has been set tightly such that the regulatory space within which the NRA can act without interference is limited. An official at the Ministry of Transport for country B said that the Minister had refused to accept a proposal by the *independent* regulator to introduce a price cap on infrastructure charges and regulatory cost accounting. These are standard regulatory mechanisms for controlling monopoly pricing. This is an indication that state ownership and investment was interfering with the independence of the regulator. The official said:

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corridors.

“We do not need a price cap, prices are set by the market and are non-discriminatory so should not impact on competition. We have invested a huge amount in infrastructure and the investment of the state must be respected.”

There is no reason why a price cap on infrastructure and a close control over the flows of funds within the regulated company would not respect investment unless repayment is achieved through the general performance of the vertically integrated company (i.e. via the share price) as opposed to a return tied to the specific performance of the monopoly infrastructure asset (for example, via a loan or a bond). Absent the accounting separation, it is impossible to know whether the claim as to the prices being non-discriminatory or not is true.

*5.9.2.3. Responses from interviewees regarding interactions between ministries and regulators on safety and interoperability issues*

The interviews indicated that in all three member states the ministries formally control decisions on safety and interoperability issues – either directly or via the comitology process. In all three member states, including in two states where the NSA was a stand-alone NRA, Ministries occupied both the board positions on the Agency and the seats in comitology. This was considered inevitable by officials from all bodies because decisions on interoperability and safety had potentially very large budgetary implications for member states. If rail companies were obliged to upgrade networks and equipment, they would turn to the state for subsidies.

*5.9.2.4. Responses from members of NRAs from three countries participating in the informal access network*

The informal network of access regulators in rail has no officially designated name. It meets a couple of times a year, convened by the Commission and does not usually produce any formal opinions. Its level of informality is such is that it has no formal rules. Responses to the questions in Annex Eight from participants revealed that none of the conditions for deliberative supranationalism appear to exist.

5.9.2.5. *Responses from members of NSAs from three countries participating in the informal safety network and in ERA*

The informal safety network is far more active than the access network with more regular formal meetings and working groups that are constantly active. However, similarly, it is an informal cooperative grouping without formal rules. Its activities appear to have become more substantial compared to those of the informal access network and as a consequence of the existence of the Agency. The NSAs are not necessarily on every working group of the Agency and typically the board members of the Agency are from ministries. This decision-making apparatus and the impact of its decisions on the NSAs means that the latter have a strong incentive to coordinate with other NSAs in order to try and shape Agency decisions (Interviews:2010).

5.9.2.6. *Results of interviews*

The results of the interviews for economic access indicate that in countries with state-owned entities that there is ministerial influence on the regulator, although the degree appears to vary between countries A and B. In country C, issues of discrimination are not going to arise as the network operator is not vertically integrated. On interoperability and safety issues, ministries are highly engaged in all three countries. In this sector, the existence of the European Agency and comitology would appear to reinforce the hierarchical power of ministries collectively. The arguments for informal network governance by regulators do not appear to hold on either set of issues. The networks in safety appear to be far more active than those on access. This would appear to be a consequence of the existence of a formal decision-making power at European-level.

## **5.10. Findings with respect to the hypotheses**

### **5.10.1. Hypothesis 1**

*“The greater the distributional conflict in a policy area, the less likely member states are to delegate regulatory authority to autonomous European level regulatory bodies, and the more likely they are to delegate to bodies (such as NRAs) more subject to control by national governments.”*

With respect to access to the network the member states have only been willing to empower NRAs, which in this sector they have explicitly defined as including ministries. The null hypothesis would be that high distributional conflict leads member states to prefer to give market opening authority to European-level institutions, receives no support. The degree of state ownership in the rail sector has been found to be higher than in any of the other cases examined in this thesis.

The member states have had seven occasions to hone their preferences for institutional design. As far as economic access is concerned, they have set the threshold for the Commission to undertake administrative reviews of NRA decisions at too high a level (a sui generis advisory committee where a single member state can trigger a Council vote) for the Commission to be able to operationalise the power. They have repeatedly defined NRAs in the EC directives as including the Ministry of Transport. They have excluded the vast bulk of rail activity from coverage by EC access rules at all and made opening international passenger entirely optional for member states.

While the Commission has considered internally the possibility of creating a Euroregulator for access, the Council has only been willing to consider a European-level Agency for access with a single power designed to prevent regulation rather than facilitate it. Nonetheless, the results here are indeterminate from a process tracing perspective as I cannot trace at EU-level the process by which state ownership at the national level causes the Council to act in one way or another.

With respect to interoperability and safety issues, member states have been willing to delegate effective regulatory authority to European-level bodies over time. However, these are issues on which distributional issues are less significant compared to access. This is not to say that there are no distributional issues. However, member states have structured comitology and the Agency to deal with these. The concern there, from a ministerial perspective, is that manufacturers, the Commission or NSAs might propose measures which ministries considered unnecessarily expensive. The decision-making structures have been designed to allow ministries collectively to make sure this does not happen, while nonetheless not permitting individual member states from blocking European interoperability or allowing incompatible safety licensing schemes to block cross-border trade.

Asked to explain why there are different decision-making structures between economic access on the one hand and interoperability and safety on the other, an official of the Rail Agency said: “The discrepancy is largely explicable by the fact that you don’t really see an impact on the market by regulating for safety, where economic regulation has a direct effect on a politicised market” (Interview: January 2008).

While I cannot trace the process at EU-level by which the existence or absence of distributional issues causes a result, it is possible to show that institutional outcomes vary with existence or absence of distributional outcomes. In every legislative observation in the rail sector, the member states select NRAs (of a particularly non-independent variety); in each of the rail safety and interoperability cases, except for on one occasion where path dependency appears to be at work, they select effective regulatory institutions at European-level. Nonetheless, the design they espouse there is shaped by distributional concerns, specifically the risk of increased subsidies for rail.

### **5.10.2. Hypothesis 2**

*The greater the influence of the Commission and Parliament in the politics of bureaucratic design in a particular sector, the more likely that a supranational regulator (either the Commission alone or in conjunction with an EU Agency) will be tasked with delivering regulation.*

With respect to economic access, the influence of the Commission and Parliament has been limited. The Commission had no structural power. It had no existing legislative empowerment. Competition law turned out to be an empty vessel in this sector; the unanimity of Council preferences for the possibility of monopoly appears to have deterred the Court from any legal activism. The degree of state ownership has also meant a consistent large majority of member states wish to retain control of market developments within the bodies over which they have unilateral control. This has not made it possible for the Commission and Parliament to do much to build coalitions other than to agree NRA discretion and vague powers. The Commission and Parliament had a limited degree of negotiating power derived from a conjectural issue. The decline of national freight and the Commission’s advocacy that it could only revive on a cross-border basis meant that there was a constituency for doing something. However, the

small size of the market and the extent to which it was dominated by incumbents who had much bigger passenger markets with which to be concerned, meant that the pressure for doing something effective was very low.

Where the Council did propose an *anti-regulation* European body, the Rail Observatory, the Commission and Parliament did not support this design option since it was actually intended to reinforce national control.

With respect to safety and interoperability issues, where member states did want common solutions, the Commission and Parliament were able to successfully advocate the creation of an Agency. However, for the same reasons as discussed above, their formal influence was limited and the design of control over the Agency was that proposed by the Council.

The null hypothesis would require that in a situation of potential influence that the Commission and the European Parliament do not push for supranational institutions to be empowered to deliver regulation. However, on most occasions the Commission and Parliament pushed for empowerment at European-level.

### **5.10.3. Hypothesis 3**

*“EU Agencies will typically lead to more effective implementation than institutional designs that rely on the activities of networks of regulators.”*

The evidence of this chapter is that while there is an informal network of regulators for economic access, harmonisation in economic access regulation has not taken place. Conversely, the EU Agency does propose rules on interoperability and safety. The actual impact of this activity on the ground is not swift due to the long replacement cycles in rail infrastructure, but it is occurring with respect to interoperability. (The published material on safety certification is too limited to be other than indeterminate). The null hypothesis would find either that there was no difference or that the opposite occurred.

### **5.10.4. Hypothesis 4**

*“The Council will decline to empower Agencies to undertake implementation for constitutional reasons.”*

This is clearly not the case since the Council was prepared to advocate an Agency for a specific access issue (albeit the intention behind this was to achieve the opposite of the normal purposes of an Agency) and did support an Agency for interoperability and safety. In neither case were any constitutional impediments raised.

#### **5.10.5. Hypothesis 5**

*“The Council does not have strong preferences with respect to the selection of either NRAs or Agencies because NRAs in networks are the functional equivalent of Agencies.”*

The Council has had a strong preference for NRAs untrammelled by effective Commission review powers. On interoperability and safety it developed a preference for Agencies because the existing system reliant on un-policed NRAs and the Commission working with industry did not deliver.

#### **5.10.6. Hypothesis 6**

*“The Commission does not have a strong preference for Agencies over NRAs because it can regulate utility sectors using competition law.”*

European competition law clearly failed in 1998 in the sector.

## **6. Chapter 6: Pharmaceuticals' authorisations**

### **6.1. Introduction**

Pharmaceuticals' authorisations was the first sector for which a *pre-decision making* Agency was designed. It was set up in 1993, prior to the adoption of independent NRAs in EU legislation. It was therefore a design that was then amongst the palate available in other sectors, should the principals have wanted such a template. This chapter explains the development of the Agency and how it was designed to ensure effective supranational implementation. Paragraph 6.2 and 6.3 explains why there was a need for regulation and harmonisation in the sector. Paragraph 6.4 looks at the extent to which there was any distributional conflict. Paragraph 6.5 examines the institutional proposals and legislative outcomes in detail and tests the hypotheses against these outcomes<sup>164</sup>. Twenty five legislative documents were reviewed. Paragraph 6.6 reviews regulatory outcomes and the extent to which the Agency has delivered effective implementation. Paragraph 6.7 examines the current nature of cooperation between NRAs within the Agency.

Competition law was not a relevant tool here because, aside from state aid rules, competition law is primarily directed at the activities of economic actors (Baquero-Cruz:2002:128). The safety rules being set here were being set by public authorities and applied to all economic actors regardless of their ownership status or nationality.

This chapter contains only limited references to industry views. This is because unlike DG Information Society, DG Market does not provide publicly accessible files of industry views on proposed legislation with respect to pharmaceuticals.

### **6.2. The need for regulation and harmonisation**

Prior to 1965, national authorisation regimes varied considerably and, in most member states, medicines companies were only required to notify authorities that a product had been placed on the market, without any examination of quality, safety or efficacy

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<sup>164</sup> Summary tables of principals' preferences and outcomes can be found at Annex Ten.

(Duprat:1965:297). However, after the thalidomide crisis in 1965,<sup>165</sup> all member states introduced national licensing with safety clearance procedures (Hancher:1990:108).

In principle, pharmaceutical products were always subject to mutual recognition; once authorised in one member state, it should have been possible to trade them across national boundaries within the European Community with no further verification by other national authorities. However, given the potential threat to health to which unsafe products could give rise, pharmaceuticals clearly fell within the category of goods where the exception to the normal principles of free movement of goods applied because of the need for “protection of health and life of humans” (Article 36 EC Treaty). Under EC Law, national measures are permissible as long as safety measures have not been harmonised (Weatherill and Beaumont:1995:478). Member states were not prepared to rely on the authorisation processes conducted in other member states and insisted on national clearances. The concern with automatic mutual recognition was that companies might seek the least rigorous national clearance process in order to supply throughout the EC. BEUC, the European consumer body, for example, making this point to a survey by the Committee for Proprietary Medicinal Products (CPMP)<sup>166</sup> in 1988 (CPMP:1988:162).

The consequence of multiple un-harmonised national authorisation regimes was that it made it difficult for companies to take advantage of the single market because the procedures and requirements varied between safety regimes. They could undertake years of trials for a product in one member state and find that the trials were not valid in other member states. Two US commentators described the situation prior to the creation of the Agency as follows:

“The EU represents one of the world’s largest prescription drug markets. Yet, access to its entirety has long been hindered by the different systems for product review and market authorisation among the member states.” (Healey and Kaitin:1999:919)

The Commission’s objective from 1965 was to achieve harmonisation of the authorisation process so that safe medicines would be available to all Community

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<sup>165</sup> Supplied throughout the EC by a German pharmaceuticals company.

<sup>166</sup> See page 286 for a description of the CPMP.

citizens and that EU pharmaceutical companies could achieve scale in order to compete with global, and in particular US rivals (Commission:1993).

### **6.3. Competition Law not relevant in practice**

For the reasons set out on page 194 of the chapter on rail, competition law was not a mechanism that could have been used to deal with safety issues.

### **6.4. Distributional conflict**

Distributional issues were potentially far less severe than in the utility sectors as long as the scope of EU activity was restricted to authorisations. State ownership in pharmaceuticals has never been very extensive. There are no specific figures available. However, Beltratti et al. found that less than five per cent of a more widely defined sector, which included health care equipment, pharmaceuticals and biotechnology was state owned in Europe in 1995 (Beltratti et al:2007:29). A survey of 22 member states in 2008 did not find any evidence of state ownership (see Annex 2). The only member state in which a large part of the sector appears to have been state owned was France for the period 1983-93. Nonetheless, there were some distributional issues and while they were not severe enough to prevent the eventual delegation of power over implementation, they did impact on the design of the implementing institution at EU level.

Table 6.1 sets out levels of state ownership. There is a stark contrast with the utility sectors.<sup>167</sup>

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<sup>167</sup> See page 135 for telecommunications, page 199-200 for rail.

**Table 6.1 Vote in Council of member states with state ownership of pharmaceuticals**

	Number of state-owned entities	Weights in council by Countries with state ownership	Proportion of total votes in Council
1965	Unknown	Unknown	Unknown
1975-1987	Unknown <sup>168</sup>	Unknown	Unknown
1993	<5 % of industry <sup>169</sup>	Very low	Very low
2004	0	0	0

Source for ownership in 2004: Conway and Nicoletti:2006

The main distributional issue, according to Kelemen, was a motivation on the part of member states to protect the existence of their existing national regulatory bodies (Kelemen:2002:103). This was corroborated in an interview for the thesis with a regulatory official, who said:

“Member states are not protectionist of companies but protectionist of jobs in the regulator. Although, this is usually phrased as the Minister for Health being responsible for public health and buck stopping with him or her and therefore they want to retain a national competence.” Interview (2009)

However, another official argued that this concern went beyond the distributional: governments may have believed that they would ultimately be held to account for any future safety failure by national electorates, regardless of whether they had delegated authority to a Community institution. This provided the motivation for wanting to

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<sup>168</sup> France was probably the only large member state with a partly state-owned pharmaceutical sector for the period 1983-93.

<sup>169</sup> This figure comes from Beltratti et al. (2007:29).

maintain the existence of operational national bodies and for them to be the protagonists in any European decision-making process (Interview:2009).

A further issue was that a European body could potentially impose costs outweighing its benefits on national pharmaceutical companies, depending on its organisation and powers. Producers did not want the powers of a new fully centralised European body to retrospectively impact on the drugs that they had already had cleared through existing national regulatory systems and there was strong opposition before 1993 from the European Federation of Pharmaceutical Industries and Associations (EFPIA), the association representing innovator pharmaceutical manufacturers to any institution that might resemble the American Federal Drugs Agency, from whom a federal licence had to be obtained for all products (Hauray: 2006: 89; interviews 2009).

Their fear was the creation of a system that existed alongside and in addition to the national systems so that there were two regulatory hurdles that had to be cleared. This would both raise costs and through lengthening possible clearance times, potentially cut the effective life span of patents for innovative medicines, diminishing the period of maximum profitability (Orzack et al:1992: 864). Their other concern with institutional design was that unless configured appropriately, the clearance system might be capable of stalemate between national authorities and not provide for authorisations at all (Hauray:2006:98)

On the other hand, industry, national governments and the Commission were also very concerned at the slowness with which drugs could achieve pan-European sales as a consequence of having to obtain a licence in each member states. This could take up to six years (Sauer:2009:11) compared with approximately a year for continent-wide clearance in the US (Healey and Kaitlin:1999: 969). The effect of these slow clearance processes was that European drug companies were unable to achieve the scale of sales before patents expired which would allow them to finance renewed research. The Commission reported that the number of new drugs and levels of investment being undertaken by European companies was falling compared to companies that were external to the Community (Commission:1993:5).

As well as shaping what European rules could cover, distributional issues also shaped what any supranational body or set of detailed EU legislative rules could not cover. For medicines to access a national market, authorisations are necessary but not sufficient. The vast bulk of the European national markets comprise of sales to national health and social security systems. As Gardner puts it: “Without public reimbursement a manufacturer has little practical hopes of market penetration or profit no matter how open the internal market is in theory” (Gardner:1996:50). However, member states made it very clear to the Commission in the 1960s that it would not gain any competence over drug purchasing rules since these fell within the administration of national budgetary and health care policies. The Commission was careful to keep this aspect of regulatory policy on a separate track from authorisations,<sup>170</sup> even though it was well aware of its significance (Commission:1980:10). Member states were prepared to agree a transparency directive that required them to set out how their drug purchasing schemes functioned, they were not prepared to cede price-setting and reimbursement rules which had implications for national health budgets. The Commission and private litigants then used the treaty rules on free movement of goods where these rules were deliberately constructed to keep out imports.<sup>171</sup> However, where national rules were designed to keep down costs without any intention to discriminate against imports, the Court considered this was a legitimate exercise of national discretion.<sup>172</sup>

## **6.5. Legislative developments**

### **6.5.1. Introduction**

In the pharmaceutical sector, there have been three main waves of law-making regarding product authorisations and these have increasingly centralised the authorisation procedure for medicines<sup>173</sup>. The legislative attempts to deliver a harmonised process for companies seeking authorisation have been described as the following succeeding types:

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<sup>170</sup> Article 1 of Regulation 2309/93 which sets up the Agency, for example, states in its second paragraph: “The provisions of this Regulation shall not affect the powers of the member states’ authorities as regards the price setting of medicinal products or their inclusion in the scope of the national health system of the member states’ authorities or their inclusion in the scope of the social security schemes on the basis of health, economic and social conditions.”

<sup>171</sup> See for example, *EC Commission v Italy*, Case 56/87 [1988] ECR I-6097.

<sup>172</sup> See, for example, *Duphar BV versus Netherlands State*, case 238/82 [1984] ECR at 541 and 542.

<sup>173</sup> Summary tables with principals’ positions and outcomes can be found in Annex Seven.

legal harmonisation, procedural coordination, and procedural integration based on empowerment of an Agency and the Commission (Feick:2008:43-45).

Repeat evidence of first the failure of legal harmonisation and then procedural coordination, led member states to agree a centralised system of authorisation and then to extend the number of drugs that fell within its scope. Implementation is now either directly or indirectly centralised for virtually all new products.

The legislative preferences of each of the EU legislators and the outcomes are also summarised in table form and set out in Annex Ten.

## **6.5.2. 1965 legislation**

### *6.5.2.1. Background*

The Commission reacted very swiftly to the thalidomide crisis, fearful that it would lead to a segmentation of the common market along national lines due to the adoption of divergent safety regimes. The Commission's first proposed directive set out to harmonise authorisation regimes so that member states would potentially have confidence in each other's regimes and would consequently permit mutual recognition without duplicatory efforts at testing (Council:1965).

### *6.5.2.2. Commission proposal*

In order to be sold on a national market, medicines would have to be authorised. The application for authorisation required the submission of the results of various tests including pharmacological and clinical tests. Authorisation would be refused where the medicinal product was harmful under normal conditions of use; lacking in therapeutic efficacy or this was insufficiently substantiated; or, where its quantitative or qualitative composition was not as declared. One of the information requirements, which applicants for an authorisation had to meet, was the provision of evidence of any authorisations already granted in other member states for the product but there was no requirement imposed in the directive on a national body receiving such evidence to give it any particular weight (Bulletin of the EEC:1962:40).

There is no evidence that indicates whether or not the Commission informally considered proposing the empowerment of a supranational institution. There is nothing in the published documents which suggests that it was a consideration (Bulletin of the EEC:1962:40). Later material suggests that they believed member states would be determined to maintain their own safety regimes and that any Community institution would necessarily therefore be duplicative.<sup>174</sup>

The Commission did not seek (and has never sought in subsequent rounds) to require independence of national regulators from ministries in this sector since there is no obvious conflict of interest as there is in sectors with state ownership. In some member states, the competent bodies are separate administrative authorities, in others they are departments in the ministry of health. Interviews with both innovator and generic company representatives revealed that no side of industry considered regulatory independence an issue with respect to authorisations (Interviews 2009). Unlike the utility sectors, there is no issue concerning access to infrastructure networks of any type. The main distributional conflict between private actors is between those companies that develop new drugs and seek patent periods which are as long as they can persuade authorities to permit (innovators) and those companies which seek to reproduce existing products as cheaply as possible and lobby for patent periods to be as short as possible (generics).

This view that independence was not an issue was also shared by regulators. The lack of interest in the issue meant that none of the officials interviewed had any precise view on the numbers that might be independent, the view was that most are probably part of government departments (Interviews:2008 and 2009).<sup>175</sup> In other sectors considered for this thesis, regulators will on a confidential basis talk about political pressures. As far as medicines authorisations are concerned, regulators were not aware of any protectionist pressures. The following comment was typical:

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<sup>174</sup> See page 286 below.

<sup>175</sup> A benchmarking survey of the organisation and practices of the European Medicines Agencies for the Heads of Medicines Agencies does not consider institutional relations, see: [http://www.hma.eu/fileadmin/dateien/HMA\\_joint/HMA\\_Topics/BEMA/BEMA\\_report\\_1st\\_cycle.pdf](http://www.hma.eu/fileadmin/dateien/HMA_joint/HMA_Topics/BEMA/BEMA_report_1st_cycle.pdf) as at 12.7.2010. A request to the Heads of Medicines Agencies as to the institutional status of their agencies was made to the organisation in July 2010, no response was received.

“I have not been made aware of any member state breaking the rules or using authorisations to protect national companies and I am a regulator that has moved around and I have never even heard that as chat in corridors.” (Interview:2009)

Where interviewees thought that objective standards might not apply, although they had no direct experience of this, was in the context of national health and reimbursement plans and indeed there is evidence from ECJ cases that this has happened (Interviews 2009).<sup>176</sup>

#### 6.5.2.3. *Parliament's preferences*

The Parliament's role consisted of providing an opinion only. It suggested some minor technical amendments (Parliament:1965).

#### 6.5.2.4. *Council preferences*

The Council endorsed the Commission's attempts to achieve legal harmonisation and to empower NRAs (Council:1965). Although the literature argues that, in 1993, it was employment in the NRAs themselves that was the distributional issue shaping design, it is harder to make that argument for 1965 since most member states did not have NRAs at that point. This is speculation, but it seems much more likely that politicians felt a need to be seen to responding to the then thalidomide crisis and did not feel that a European body would be considered an acceptable response by national electorates.

#### 6.5.2.5. *Legislative process*

The decision-making basis was unanimity. The Parliament's view was an opinion only. The Commission proposed what would achieve unanimity in the Council.

#### 6.5.2.6. *Legislative outcome*

The Commission proposals were supported by the other institutions. There was no attempt by the Commission to propose Europeanised implementing powers.

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<sup>176</sup> See footnotes 171 and 172 above.

#### 6.5.2.7. *Empirical results and hypotheses*<sup>177</sup>

Hypothesis 1: Falsified. Member states had a preference for NRAs despite the lack of distributional conflict. Kelemen argues that distributional consequences shaped the design of the Agency in 1993 by requiring design to preserve the jobs of the existing staff (Kelemen:2002:103). Possibly this can be extrapolated back to the time of formation, but it is more likely that the finding here does not confirm the hypothesis; rather, concerns other than distributional ones can also cause member states to prefer NRAs over supranational institutions.

Hypothesis 2: The Commission's influence was formally low as unanimity was required in the Council. The Parliament had no formal agenda-setting powers. In the context of a regulatory crisis which was likely to lead to completely different national safety regimes, the Commission was probably best advised to use its right of initiative and the informal agenda-setting powers to at least try and embed the new NRAs into a common legal regime.

The observation tends not to support the hypothesis as there is no evidence that the Commission and the Parliament considered a supranational solution. But it is probably best recorded as indeterminate since as in rail, the Commission's true preference in the original round may not have been revealed in order not to deter the Council from supporting an EC competence.

The Alternative hypotheses:

Hypothesis 4: Indeterminate. There is no evidence of any debate.

Hypothesis 5: Indeterminate. The NRAs were only coming into existence and Agencies do not exist.

Hypothesis 6: Falsified. Competition law not relevant.

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<sup>177</sup> For the empirical results in relation to hypothesis 3 see page 302.

### **6.5.3. Legislative rounds, 1975-1987**

#### *6.5.3.1. Background*

The 1965 attempt to create the circumstances in which automatic mutual recognition would take place did not work. Member states set up their own individual testing regimes and declined to recognise the authorisations granted by other member states. The second round of legislation (amending directives to the 1965 directive were adopted in 1975, 1983 and 1987) tried to accommodate this by harmonising the testing regimes deployed by each national authority, i.e. by adopting greater legislative specification.

#### *6.5.3.2. Commission proposal*

The Commission's view was that automatic mutual recognition would be facilitated by improving the information made available to national regulators about each other's activities. In order to achieve this, it proposed amending the 1965 directive to harmonise the nature of the tests that were conducted at national level so that member states would be more likely to recognise tests that had been conducted in other member states (Council:1975a). The Commission also proposed an institutional solution: the creation of a committee of the national regulators, who would coordinate with respect to the design of tests and with respect to refusals to recognise previously granted authorisations (Council:1975b).

It does not appear that the Commission proposed any direct powers of implementation be created at European level in 1975.<sup>178</sup> It appears to have rejected this option on the basis of political infeasibility. It did not do so in the draft proposals further amending Directive 65/65 in 1983 (Commission:1980) and 1987 (Commission:1984). This would be consistent with views it set out in its 1980 report on progress in the sector to date. The Commission stated:

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<sup>178</sup> There is no Official Journal reference to Commission proposals in the agreed legislation set out in the OJL of 1975. Prelex does not contain any documents on medicinal products prior to 1976. A review of all the OJCs for 1973, 1974 and 1975 for this chapter did not find any draft proposals for the 1975 legislation. The draft institutional proposals for the 1976 legislation for veterinary products (OJC 1976/152/1 of 5.7.1976) mirror the 1975 Council Directive for Human Medicinal Products and do not contain such a proposal. None of the authors, Abrahams and Lewis, Hauray, Hancher and Permanand, who previously examined this field, suggest that there was any attempt to argue for hierarchical supranational powers over implementation prior to the discussion over the Agency.

“The setting up of a European body for the issue and revocation of marketing authorisations does not appear to be advisable [...]. Recognition of authorisations seems to be the simplest and most effective solution: a medicines manufacturer and maker in one member states must, in principle, be allowed on the market of any other member state.” (Commission :1980: para 10)

The Commission labelled calls from consumer groups for a European registry as “extreme” (Ibid:para 5). At this point, it could only conceive the alternative to mutual recognition as a full spectrum supranational authorisation body:

“The setting up of such a body with highly qualified scientific experts, a large administrative staff and perhaps research laboratories needed by these experts would be prohibitive from the point of view of costs, all the more so since this European body would have to operate concurrently with the national bodies for an indefinite period.” (Ibid: para 5)

The Commission instead pursued the creation of a formal network of NRAs. The institution proposed by the Commission was named the Committee for Proprietary Medicinal Products (CPMP). This body comprised of representatives of the Commission and the responsible national authorities. Its purpose was to review applications when a manufacturer wanted to place the product on multiple markets.<sup>179</sup> However, the CPMP could not take binding decisions. It could only give an opinion. The Commission proposed to strengthen these provisions for the 1983 Directive. Member states would be required to observe mutual recognition unless they provided a reasoned view to the CPMP as to why they were not prepared to authorise a product (Commission:1980). The 1984 proposals in addition required that biotech products be analysed at national level only after a non-binding opinion had been agreed in the CPMP (Commission:1984).

#### 6.5.3.3. *Parliament's position*

The Parliament does not appear to have been asked for its opinion on the 1975 directive; the directives refer back to consultation having taken place in 1965. The Parliament

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<sup>179</sup> The threshold adjusted from five member states in 1975 to two member states in 1987 in a further attempt to try and make the procedure relevant (Council:1987).

backed the Commission's proposals with respect to the 1983 (European Parliament: 1981) and 1987 directives (European Parliament: 1986). There was no suggestion in either Opinions of the Parliament for a need for supranational implementation powers.

#### *6.5.3.4. Council position*

The Council agreed the Commission's proposals.

#### *6.5.3.5. Legislative process*

Voting in this round was unanimity with consultation of the Parliament.

#### *6.5.3.6. Outcome*

The Commission's proposals were adopted. However, while there was greater specification, general legislation could only really provide for a non-exhaustive set of issues that should be tested for (for example, carcinogenic effects) and for some of the methodologies to be applied but without being able to set the actual tests that would be conducted in every instance or the cost-benefit analysis that should be conducted (Council:1975a). The CPMP came into existence but could only issue non-binding opinions. No supranational powers of implementation were proposed.

#### *6.5.3.7. Empirical results and hypotheses*

Hypothesis 1: Falsified. Member states continued to have a preference for NRAs. As discussed with respect to the previous round, this is likely to have been due to reasons of precautionary political prudence rather than for distributional reasons.

Hypothesis 2: Indeterminate. The decision-making rules remain the same as in the previous round. The Commission and Parliament have little influence. In the absence of any alternative, the Commission and Parliament favour increasing cooperation between national bodies at the European level and propose institutions that will deliver this. There is evidence that the Commission considered a supranational solution but ruled it out as politically unviable. It is unclear whether it would have been their first preference absent considerations as to the likelihood of Council support.

The alternative hypotheses:

Hypothesis 4: Indeterminate. No discussion took place.

Hypothesis 5: Indeterminate. There is no template for an Agency that could act in this area.

Hypothesis 6: Falsified. Competition law is not relevant.

#### **6.5.4. 1993 legislative round**

##### *6.5.4.1. Background*

The difficulty with harmonising safety measures is that while it is feasible to harmonise the general principles which tests are designed to verify, each drug or type of drug is a one-off event requiring specific tests in order to validate its efficacy, quality and safety and where trade-offs between efficacy and safety may be required.<sup>180</sup> Furthermore, the assessment of risks and benefits can vary depending on the medical culture of the country in which the assessment is being made. For example, Hauray gives the example of French officials being more focussed on concerns that a product might react negatively with antibiotics given domestic overconsumption than assessors from member states where this is less of an issue (Hauray:2006:231).

Abraham and Lewis give another example from a German regulator: “This is not pure science usually. Take oral contraceptives , for example. What is worse, to prevent a certain amount of thrombotic events, but get so many more women pregnant that didn’t want to be that there are more abortions?” (Abrahams and Lewis:2000:122).

In addition, the value of tests is uncertain. As a leading pharmaceutical lawyer put it an interview for the thesis:

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<sup>180</sup> See, for example, an explanation by the UK Medicines Agency (MHRA) as to how it applied the test with respect to harm: “In practice, in considering whether a product met the existing test, the risk of harm had to be considered in relation to the therapeutic benefits of the product, so in practice the risk-benefit approach was already being applied” (MHRA:2001:8).

“The outcome of an evaluation [...] is not a black-and-white decision: the decision is the outcome of a risk-benefit analysis in which neither the risks nor the benefits can really be calculated. Moreover, no one knows what will happen in the outside world, when the product is being used on patients who differ completely from trial subjects, with respect to age, co-morbidity, co-medication, etcetera. And the medicinal product could well be used in a different way than the official product information foresees (off-label).” (Interview:2009)

The activities of the Committee were a complete failure at achieving mutual recognition. The CPMP itself noted in a report on the functioning of the system that the standards for clinical tests set out in the directives “could guarantee neither the uniformity of the experimental work done in the different member states or the harmonisation of decisions taken by national authorities” (Hancher:1990:153). (There was some limited improvement after 1987 with respect to biotech products because national authorities were required to make initial national assessments of innovative drugs at the same time as the CPMP, which at least potentially allowed some coordination of national testing requirements).

Authors analysing the work of the CPMP in this period concur with the CPMP’s own views. Abraham and Lewis found that “in statistical term, the history of mutual recognition prior to 1995 was one of failure. The multi-state procedure saw member states raising objections to essentially every application submitted” (Abrahams and Lewis:2000:107). Hancher stated of the CPMP: “As a means to coordinate national techniques of risk/benefit evaluation, the CPMP procedure had failed”(Hancher:1990:153).

By the end of the 1980s, the Commission and member states were obliged to recognise that despite a round of legislation in 1965 and then a flurry of amendments to the 1965 legislation in 1975, 1983 and 1987 that mutual recognition in this field simply did not work. In its 1988 report, the Commission noted that there had been only 41 applications for review in the CPMP in the previous nine years compared to the 1,000s authorised each year across the member states. Companies had largely abandoned using it because it

did not assist in obtaining clearances (Commission:1988:5).<sup>181</sup> At this point, the Commission began to consider institutional innovation as a means to resolving the failure to achieve mutual recognition.

#### 6.5.4.2. *Commission Proposal*

When mutual recognition as it currently existed was appreciated as a dead end, it was the Head of Unit for pharmaceuticals in DG Market, Fernand Sauer, who developed the idea of an Agency that would incorporate the national authorities rather than replace them. However, the construction would nonetheless significantly empower the Commission, since it would be the body that made the formal decision. In the Commission's original proposal, this Community decision would not be subject to comitology. This would effectively have made the Commission the sole principal of the national regulators. It would however have been constrained by the need to provide detailed reasons for departing from the opinion of the CPMP.

The Commission proposed that a limited set of advanced biotech products be subject to a centralised and exclusive Community authorisation process. A product which fell into this category could only be marketed anywhere in the Community if it received a Community authorisation. The company would submit an application to the new Agency. The CPMP, supported by the Agency, would draft an opinion. The Commission would decide based on the opinion. It would have to provide detailed published reasoning for deciding differently from the Committee's opinion. There was no proposal for comitology with respect to the Commission's decision. If a member state raised doubts with respect to a draft Commission decision based on new scientific or technical criteria which had not in the Commission's view been considered by CPMP then the Commission could remit it to the CPMP.

The Members of the CPMP were to be appointed by the member state for three-year renewable terms. Member states were to "refrain from giving any instructions to Members of the Committee which is incompatible with the tasks referred to in part 2"

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<sup>181</sup> In 1982 the Commission had noted that those companies using it generally did so to potentially obtain access to small markets for products for which they had already had authorised individually in the larger member states (Commission:1982).

(Commission:1990: Article 50(1)). This was an attempt to ensure that only scientific criteria were taken into account. However, the second part of draft Article 50 makes clear the dual role of members of the committee and representatives of their national bodies:

“In addition to their tasks of providing objective scientific advice to the Community and to member states on the questions referred to them, the members of each Committee shall ensure that there is appropriate coordination between the work of the Agency and the work of scientific bodies established in the member states.”

Members of the Committee could also bring national experts with them to committee meetings.

The supranational interest was intended to be supported within the Agency by the Executive Director of the Agency. He or she would have the right to attend all meetings and would provide an annual report to the Management Board. He would appoint rapporteurs and co-rapporteurs to examine applications. The Executive Director would, in turn, be appointed by the Management Board from a list proposed by the Commission. The Management Board would have two representatives from each member state and two from the Commission. The Agency would be part-funded by fees and part funded from the Community budget (Commission:1990a).

For non-biotech (i.e. traditional) products that required multiple authorisations and where mutual recognition was not automatically granted, the Commission proposed to create an arbitration process, conducted by the CPMP. When a company had received an authorisation in one member state but another or other member states had adopted divergent decision(s), then the company, a member state or the Commission could refer the matter to the CPMP. The opinion of the CPMP would be passed to the Commission and a Commission decision would follow as in the centralised procedure. Again, no comitology was proposed (Commission: 1990b). The timescales were necessarily inferior to the centralised procedure because they required divergent national decisions to occur before arbitration was available. However, unlike the CP, a company could withdraw its application with respect to any member state at any point (Commission: 1990b).

Opinions of the Agency and decisions of the Commission would be published to member states and applicants for authorisations (Commission:1990a and b).

#### 6.5.4.3. *Parliament's preference*

The Parliament supported the Commission's plans for an Agency. At first reading, it sought a number of changes with respect to institutional design. Most of these were intended to make the Parliament a principal and to *denationalise* the work of the Agency (Parliament:1991). However, the Parliament only enjoyed a consultative role. Consequently, it did not have much of a negotiating position.

The Parliament advocated that the members of the CPMP should be chosen from a list of experts compiled by the member states (the list would include alongside the names of the candidates their academic and technical backgrounds and their main scientific publications in international journals). The member states would choose from that list, but only after it had been approved by the Parliament. The draft text was also amended to state that members of committees were only to give advice derived from an objective scientific position and the clause relating to representation of national authorities was deleted (Parliament:1991).

The Executive Directive of the Agency would need to be approved by the Parliament (Parliament:1991).

The CPMP would not itself give an opinion but rather it would be given by the Agency, i.e. after approval by the Management Board. The management should include representatives of consumer groups, the Commission and the Parliament as well as member states (Parliament:1991).

A wider set of drugs would be obliged to pass through the centralised process. Future amendments of the list would have to be jointly approved by the Parliament (Parliament:1991).

The Agency should be financed by Community budget into which fees received for authorisations would be contributed (Parliament:1991). The Parliament's concern being that its potential leverage over the Agency would be reduced if it were largely self-financing.

Two of its amendments were directed at enhancing the ability for other parties as well as the Parliament to monitor the process.

Member states that disagreed a draft Commission decision would have to provide a detailed scientific position and not just a reasoned position (Parliament:1991).

Any interested party should be able to obtain copies of the opinions and decisions (Parliament:1991).

The Parliament moderated its opinion slightly at second reading and withdrew its positions on the budget, representation on the Management Board for consumer groups and the need for its approval for the Executive Director. It advanced a point made by the Commission that it had not backed at first reading, that the Executive Director should appoint the rapporteurs and co-rapporteurs rather than the CPMP (Parliament:1993).

#### *6.5.4.4. Council's preference*

In the discussions concerning the creation of an Agency, the principal concern of member states was to preserve the role of the national regulatory authorities (Kelemen:2002:101). In this round and subsequent legislative rounds, there was extensive debate surrounding the extent to which the members of the management board and of the authorising committees would be autonomous of the national authorities or would represent them (although the greatest piece of controversy was over Treaty base (see below)). In these debates, the member states largely rebuffed attempts by the Commission and the Parliament to dilute the role of national authorities on either the management board or in the Committee for Proprietary Medicines Human (as the CPMP would now be known).

French and German authorities were initially hostile to the proposal for an Agency altogether. They advocated continuing to work towards general mutual recognition rather than creating a European body. However, the positions of the two NRAs were undermined (even with respect to their own ministers) by the Commission pointing out that they themselves had refused mutual recognition to virtually every single product that had gone into the networked multi-state procedure (Hauray:2006:117).

Most member states were not alarmed by the Commission proposals because in the 1993 scheme the fully centralised regime (the CP) only applied to biotech products and at that

point there were few products and companies in this field in the EU.<sup>182</sup> The greatest piece of controversy around the 1993 legislation was whether the Treaty basis would be Article 235 (which required unanimity) or Article 95 (which required qualified majority voting). Germany in particular objected to using Article 95 to create a new institution since Article 95 was intended for the harmonisation of national laws and it received support from Denmark, Portugal and the UK.<sup>183</sup> The objection may partly have been one of principle and partly, industry interviewees suggested (Interviews:2008 and 2009), because it strengthened Germany's negotiating position, which helped restrict the number of innovative products that went into the centralised procedure. Germany like a number of other member states with large national authorisation agencies preferred the Mutual Recognition Procedure (MRP) because, unlike the CP, companies choose the rapporteur under the MRP. This generates funds for the agency that provides the rapporteur.<sup>184</sup> Under the CP, allocations are voted on by the committee and this would likely generate a wider distribution of rapporteurships than the six that more or less monopolise the procedure under MRP as a result of selection by companies.

In reaction to the detailed positions of the Parliament, the Council made it clear that the members of the CPMH had a dual mandate: they had to reconcile scientific views and national representation. Articles 52(2) and 52(3) were redrafted to emphasise the role of CPMH members as representatives of national authorities. The final texts read:

“52(2) In addition to their task of providing objective scientific opinions to the Community and member states on the questions which are referred to them, the members of each Committee shall ensure that there is appropriate coordination between the tasks of the Agency and the work of competent national authorities, including the consultative bodies concerned with the marketing authorisation.

“52(3) The members of the Committees and the experts responsible for evaluating medicinal products shall rely on the scientific assessment and resources available to the

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<sup>182</sup> The Commission's 1991 paper found activity in this field in 1991 restricted to 30 small and medium enterprises in the EU only. (Commission:1991).

<sup>183</sup> The Commission accepted the argument on the basis that Germany agreed to not use unanimity to block the legislation (Interview:2009).

national marketing authorisation bodies. Each member state shall monitor the scientific level of the evaluation carried out and supervise the activities of members of the Committees and the experts it nominates, but shall refrain from giving them any instruction which is incompatible with the tasks incumbent upon them.” (European Parliament and Council:1993)

The Council’s view was:

“As the opinions of the scientific committees form the basis for common decisions that lead to products being placed on the markets of the member states, and for which the member states are responsible, it is important that the members of the scientific committees should be appointed directly by the member states. However, as the Council shares the aim of ensuring that the Committees are sufficiently multidisciplinary, it has agreed to provide for co-opted members to complement the expertise of existing member .” (Council:1993:16)

It refused Commission and Council suggestions for a Management Board where member state representatives could be outvoted by representatives appointed by other institutions (Council:1993:17).

Decisions of the Commission would be subject to comitology. Extending the list of medicines covered by the centralised procedure and decisions implementing the opinions of the Agency (i.e. the CPMP) would be reviewed by regulatory committees. These would normally be by written procedure unless a member state requested a meeting (Council:1993).

The Council proposed that the Committee would name its rapporteurs and co-rapporteurs, not the Executive Director. The Council alone would select the Executive Director from a list proposed by the Commission. The Management Board would comprise two members from each member state and two appointees each from the Commission and the Parliament. The Agency budget would be partly funded directly by authorisation fees and partly from the Community budget. Only member states would be

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<sup>184</sup> Six member states have always provided the vast majority of rapporteurships in the indirect procedures (Interviews:2008 and 2009). According to the CMD(h) website, in 2008, 70 per cent of the rapporteurships

able to request arbitrations in the indirect procedures, not companies nor the Commission (Council:1993)

#### *6.5.4.5. Legislative process*

The decision-making process commenced under a co-decision Treaty base but shifted to a unanimity Treaty basis. The Parliament only had a consultative role. The issues were in three dimensions in this legislative round. A potential blocking minority objected to the use of Article 95 for the creation of a regulatory institution, but were prepared to vote for a regulatory institution in any event under a Treaty article on a unanimity basis. This was either a matter of general principle or a tactical move. The objection was met by the Commission amending its proposal. The other two main issues were: the range of products that would be subject to the new regime and the precise construction of the new Agency. On the latter two issues, the Commission had to meet almost all the requirements of the Council since the latter were not subject to any divisions. The incentive for the Commission to agree was that it was a major step forward. If it could be shown to work as an institutional solution, pressure would come from industry for it to be expanded in the future. It would also serve as a precedent for other sectors.

#### *6.5.4.6. Outcome*

The Commission opted and successfully pushed for centralisation: direct and indirect. It met the concern of national capitals to protect national regulatory authorities by centralising around an Agency. The Commission would make the final decision on implementation under both procedures, but it could only act after advice from an Agency which would comprise of the NRAs, from amongst whose ranks and facilities would be drawn the resources to undertake product reviews (Kelemen:2002:104). The Commission's decision would be constrained legally by the need to give detailed reasoning for departing from the CPMP's opinion. The Commission would be constrained politically by the need to avoid veto in regulatory ministerial comitology. The Ministerial Committee would in turn also be constrained legally in the sense that a

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in MRP and 84 per cent in DCP went to Denmark, Germany, UK, Netherlands, Sweden and France.

draft Commission decision modified to meet their requirements would also be subject to legal challenge (Gehring and Krapohl:2007).

#### 6.5.4.7. *Empirical results and the hypotheses*

Hypothesis 1: Indeterminate although consistent with the hypothesis. Process tracing cannot as a method show that the absence of a variable causes an outcome. However, it can provide us with data to permit observation of what occurs with covariation. It is possible to say that once the Commission had developed a form of supranational implementation that did not exclude the NRAs, any distributional concerns were eliminated. It also dealt with any concerns that politicians might have over the appearance of relinquishing national political responsibility. From a safety perspective, it may also have looked attractive to politicians, there would now be review from a rapporteur NRA, a separate review from a co-rapporteur country, collective peer review of the reports, testing of the conclusion by the Commission and a chance for the Ministry to review the decision again, if required, in comitology – the chances of a dangerous product being cleared, presumably diminished by the repeated rounds of review. In addition, the functional single market benefits to be gained from delegating regulatory implementation to an Agency/Commission lead the Council to agree to the empowerment of European-level regulatory bodies.

Hypothesis 2: Confirmed. The Commission's informal agenda-setting powers were significant here, since they successfully proposed a structure which met member state concerns to retain NRAs while simultaneously constructing a European-level decision-making process. The Parliament's influence was informal as it only had a consultative role. Hypothesis confirmed.

The alternative hypotheses:

Hypothesis 4: Hypothesis falsified. No constitutional arguments were made to say that an Agency was a constitutionally invalid mechanism.

Hypothesis 5: Hypothesis falsified. The Council had a preference in favour of an Agency as opposed to NRAs acting alone because the latter had demonstrably been utterly unable to act as the functional equivalent of the proposed Agency.

Hypothesis 6: Competition law not relevant.

### **6.5.5. 2004 legislative round**

#### *6.5.5.1. Background*

Evidence that member states fundamentally wanted the system to work and had a commonality of interests can be traced in how they responded to the successes and failures of the third round. The CP worked well. However, the new MRP worked poorly in its first iteration. National authorities continued to raise objections to products authorised in other member states. The consequence was not arbitration. This was because the 1993 directive permitted companies to withdraw products from member states that objected. Companies had an incentive to do so. The directive required product launch to be halted until all the member states in which launch was sought agreed mutual recognition. If, for example, 11 member states accepted the analysis of the reference member state, market access could be suspended in all member states due to the doubts of the twelfth. Furthermore, from a company's perspective there was a risk that the objections of a member state might lead to either withdrawal or safety conditions being added to national authorisations which had already been granted.

#### *6.5.5.2. Commission proposals*

The Commission's position in this round was to bring to an end the ability for companies to withdraw selectively from the MRP. It was also to split the MRP into two parts: the MRP and the decentralised procedure (the DP), which would move a number of products into a less-contested procedure. Under the existing MRP, regulators who had already authorised a product then had to defend their procedures and tests. Under the new DP, the system would work like the CP, which meant that NRAs coordinated before any initial decision was taken. This coordination would take place in a network of regulators, the Coordination Group for Mutual Recognition and the Decentralised Procedure-Human (CMD(h)) before a referral took place to CPMH.

The CMD(h) had come into existence informally when the MRP was set up in 1994. The CMD(h) would operate by unanimity voting (as it had done in its informal phase)

whereas CPMH would continue to operate by simple majority when consensus was not obtained in CMD(h).

The Commission also sought to extend the list of products covered by the CP. It suggested that due to enlargement that representation on committees be reduced to one person per member state and that, in addition the CPMH, be able to co-opt five independent experts to ensure that all specialisms were covered. With respect to the management board, it proposed that there be four representatives of the Council in total, four Commission representatives, four representatives of the Parliament and four representing patients and industry (the latter four would also be appointed by the Commission) (Commission:2001).

#### 6.5.5.3. *Parliament's preferences*

The Parliament returned to some of the detailed issues it had pursued in the early 1990s. This time it potentially had more prospects for success as the legislation was now subject to co-decision.

At first reading, it again argued that core tasks should be met by the Community Budget.

The executive director should be appointed only after appearing before the Parliament.

The member states should propose five possible members of the Committee each and the executive director should have the choice of selecting one representative from each of the member states from these national pools. Membership of the Management Board should include a wide range of stakeholders comprising two representatives of industry, one representing patients, one representing doctors' organisations, one representing social security schemes; the latter stakeholders to be approved jointly by the Council and the Parliament. The scope of the CP should also be widened (Parliament:2001).

At second reading, responding to criticism from the Council that having industry representatives on the board created a potential conflict of interest, it argued for the Commission, the Parliament, patients' organisations and doctors' organisations to be represented. Otherwise, it maintained its suggested amendments (Parliament:2003).

#### 6.5.5.4. *Council preferences*

The Council position with respect to the CP was to extend it, but not as widely as suggested by the Parliament and with a review in 2008 for the inclusion of further products (Council:2003).

Most significantly, member states agreed that companies could no longer withdraw selectively from the MRP and that they could launch products in all non-objecting member states prior to final approval. This was partly to meet industry request and partly because it raised health concerns. If products were being withdrawn from some member states because of likely “serious potential risk to health” and being marketed to others without the concern, withdrawal meant that the scientific issue was not being pursued to its conclusion (Interview:2009). The MRP was also split into two streams: one for products that were already authorised in one member state (which continued to be called the MRP) and the DP. The DP would apply to products that had not yet been authorised in any member state. The innovation, here, was that reference member states and objectors would work together on the initial authorisation. This made it much easier for companies to meet the requirements of both sets of countries before investing in forms of tests or product formats which were capable only of meeting one country’s requirements. It also meant that rapporteur authorities would work to meet the concerns of member states rather than insist on the correctness of approaches they had taken to a product which the rapporteur authority had already authorised (Council:2003).

A similar argument over Treaty basis occurred in 2004 as in 1993. However, on this occasion Germany received no support and withdrew its objection. It was suggested by one interviewee that the lack of support for Germany was because industry lobbied other member states heavily in favour of extending the CP and it was understood that Germany’s position was motivated by a desire to preserve the MRP (Interview:2009). The Council agreed to do so, although not as widely as the Parliament had advocated. However, it agreed for a review in 2008 of some of the categories not automatically included (which has subsequently taken place and more product areas have been moved into the CP) (Council:2003).

With respect to institutional changes, the Council’s first common position removed the right for MEPs to participate in the Management Board altogether and instead doubled

the Commission representation. In conciliation, the Council agreed to revert to the status quo ante and add some of the other stakeholders as otherwise the whole proposal would have failed in co-decision (Interview:2009). The Council agreed with the Commission proposals to reduce the number of member state representatives in the CPMP to one per member state and the ability of CPMP to co-opt five additional independent experts. The Council rejected the Parliament's proposals concerning the executive director's ability to select members of the CPMP (Council:2003).

#### *6.5.5.5. Legislative model*

The procedure was co-decision with qualified majority voting in Council. The issues were in the same three dimensions as debated in 1993. However, the Treaty base issue fell away before inter-institutional negotiation. With respect to the degree to which the CP would be extended and the structure of the Agency, there were no differences between the member states. There were no structural or contingent issues that favoured the negotiating positions of the Council and the Parliament. The Commission and Parliament achieved very marginal institutional gains.

#### *6.5.5.6. Outcome*

The ability to withdraw selectively from MRP was withdrawn and the DP created. Attempts to denationalise the CPMP and to radically alter the composition of the Management Board were rejected. Coverage of the centralised procedure was extended to a wider set of products (with more moving to the centralised procedure after a review in 2008). Interviewees considered that virtually all new products could take advantage of the centralised procedure whilst the MRP was now mainly used for generics (Interviews:2008 and 2009). Fundamentally, the Commission has been very content with the authorisation system since 1993 (Interview:2008). The Parliament was able to use its power in co-decision to increase its institutional purchase but only to a limited extent.

#### *6.5.5.7. Empirical result and the hypotheses*

Hypothesis 1: Indeterminate but consistent with the hypothesis. The functional benefits to be gained from delegating regulatory implementation to an Agency/Commission and the very low levels of distributional conflict (revolving around the number of

notifications some NRAs might get through MRP as opposed to CP) would seem to make it logical for the Council to agree to the extend the range of drugs to which European-level regulatory bodies are empowered to authorise.

Hypothesis 2: Confirmed. The Commission and Parliament have a limited degree of influence as the Council's position is unanimous but they do successfully advocate reform of the MRP and creation of the DP.

The alternative hypotheses:

Hypothesis 4: Hypothesis falsified. No constitutional arguments were made to say that an Agency was a constitutionally invalid mechanism.

Hypothesis 5: Hypothesis falsified. The Council preference for an Agency remained unchanged and the range of products with respect to which it was empowered were increased.

Hypothesis 6: Falsified. Competition law not relevant.

## **6.6. Regulatory implementation**

### **Authorisations granted under the different regimes**

**Qualitative commentary and quantitative outcomes regarding authorisations under each regime are assessed below.**

#### **6.6.1. Qualitative assessment**

In the phase where authorisations were reliant on NRA cooperation in committees, member states did not grant mutual recognition at all. The committees adopted lowest-common-denominator opinions. Hauray reports that the opinions of the Committee (agreed by unanimity) in this period were mutually inconsistent collages of the positions of each NRA (Hauray:2006:239). The delegates were under instruction from their national bodies and there was neither any actual negotiation (Ibid:241) nor any actual scientific debate (Ibid:251). Mere membership of the committee had not produced the

*cosmopolitans* that some analysts predict<sup>185</sup>. The CPMP conducted a study in 1988 and found after a consideration of 51 applications for authorisations considered by the committee that results “do not show any real progress towards mutual recognition. Each concerned member state seemed to conduct its own assessment and raised its own objections.” (CPMP:1988:2)

Conversely, rule-making at European level has been successful in pharmaceuticals. The figures for authorisations granted show that the directly centralised procedure is increasingly significant, although numerically the indirectly Europeanised procedures (the MRP and DP) still substantially outweigh the former (Feick:2008:50). However, many of the drugs authorised under the indirect procedures are generics: interviewees stated that virtually all new innovative drugs were now going through the CP. Surveys of industry conducted in 2001 on behalf of the Commission found that the centralised procedure was the procedure viewed most favourably by industrial users (Cameron McKenna and Anderson Consulting:2001). DG Competition’s recent pharmaceutical sector inquiry also examined the working of the authorisation procedure: the major complaint from companies with respect to authorisations was that the most popular reference countries were overbooked (Commission:2008:379).

### 6.6.2. Quantitative assessment

The effectiveness of the different procedures can be analysed through the figures for authorisation, see Table 6.2.

**Table 6.2 Percentage of authorisation requests granted via European procedures**

Procedure	Multi-state cooperative procedure <sup>186</sup>	Centralised procedure in the	Mutual recognition procedure	Mutual recognition procedure	Decentralised procedure <sup>190</sup>
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<sup>185</sup> See page 74 of the literature review.

<sup>186</sup> Commission (1993).

		Agency <sup>187</sup>	in the Agency <sup>188</sup>	after rule change regarding withdrawals <sup>189</sup>	
Period	Pre-1995	Post-1995	1995-2000	2005-2008	2006-2008
% of authorisations cleared	0	78	50	95	95

In Table 6.3, the figures for the frequency of objections by each member state to requests for multi-state authorisation show how systematically dysfunctional the system was.

**Table 6.3 Percentage of individual applications for authorization to which Member State authorities made objection in the network of authorities**

Objecting state	B	Dk	D	Gr	E	F	IRL	I	Lux	NL	UK
No. Of applications receiving objections	88	83	85	48	67	74	55	93	0	92	86
%											

Source: Commission (1993)

The post-1993, pre-2004, MRP process, while rather dysfunctional, was none the less an improvement since about 50 per cent of products tended to be cleared. Although, in that

<sup>190</sup> Op cit footnote 187.

<sup>187</sup> Figures from annual reports of the Medicines Agency 2001-2008 (which list earlier years).

<sup>188</sup> Mutual Recognition Facilitation Group (2001).

context, we should note that companies rarely took the risk of applying for clearance through the process to all member states, but rather to a subset in which they estimated they would get clearance, so the figures would be worse than they appear in Table 6.2. They do not reflect the extent to which products were not being made available throughout the EU. The figures with respect to the CP and the revised MRP post 2004 show a vast improvement<sup>191</sup>. Authorisation under the CP runs at about 70 per cent of applications. Clearances under the reformed MRP and DP run at about 95 per cent. The higher figures for the latter compared to the former are due to the latter being principally generics, i.e. similar to innovative products that have already been cleared.

### **6.6.3. Conclusion**

Commentary and figures are both stark; deliberative supranationalism based on a network of NRAs failed, the Agency transformed the process.

### **6.6.4. Market shares**

In other sectors, the thesis also looks at market share. This is of no assistance in this sector. There is no aggregate information available to make an assessment about market shares revealing the extent to which national markets are open. In any event, this would be extremely difficult to construct as each individual pharmaceutical product would have a different profile.

To the extent that there is information available, it tends to indicate that competitive outcomes are extremely varied. This underlines the point made on page 280 above that authorisations are a necessary, but not a sufficient condition for an effective single market.

The Commission's recent sector enquiry found that generics were struggling to erode market shares of originator companies once exclusive patent periods had expired. However, this does not appear to reflect a particular bias towards nationally based companies (France, Germany and the UK which have strong innovator manufacturing presence are countries in which generics acquire market share more rapidly than in many

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<sup>189</sup> Op cit footnote 187.

<sup>191</sup> Op. cit footnote 187.

member states). There is also no obvious geographic split between outcomes in different parts of the EU (Commission:2008:88).

The problem may arise partly as a result of the way that national health and social security reimbursement schemes operate. In some countries, medical institutions are mandated to purchase by chemical ingredients (which are the same in innovative and generic products), in others they are mandated to buy by brand name. DG Competition's view is that the variation in outcomes was also partly a function of litigation practices designed to slow adoption of generic products (Commission:2008). This is partly a function of national legal procedures or approaches which facilitate litigation by innovator companies against their generics rivals. However, this is a consequence of the general design of national litigation processes and is autonomous of any consideration of outcomes in pharmaceuticals.

An analysis of the extent to which generics take market share from originator products once exclusivity expires also may not tell us about the overall degree of competition. This would depend on whether a product is also subject to competition in different national markets from other innovator products (referred to as *Me Toos*). An example of a product market where there is competition between innovators would be statins where doctors could choose between recommending between roughly 15 different products with marginally different characteristics (Interview:2009). With respect to competition between innovators and generics, DG Competition found that there was a high degree of variation in national market conditions. Within two years of expiry of exclusivity, DG Competition found, at the extremes, that generic penetration was 75 per cent in Denmark, compared with 22 per cent in Greece (Commission:2009:88).

## **6.7. Cooperation between regulators**

### **6.7.1. The changing nature of cooperation in the pharmaceuticals sector**

Cooperation in the committees of European regulators moved from a purely deliberative and completely dysfunctional system prior to 1993 to a situation where cooperation was induced by the requirement to produce a draft authorisation which after hierarchical approval would be pan-European, binding and open to legal challenge.

Change in the decision-making rules produced an abrupt switch in behaviour. Post 1995, the date of implementation of the 1993 regulation, the directly and indirectly centralised procedures immediately produced binding collective decisions.<sup>192</sup> The principal factor that changes in 1993 is the decision-making rules (although no doubt the quality of the new Agency staff and the existence of a physical hub in the Agency also facilitated interworking (Sauer: 2009:17). In this context, it should be noted that the membership of the committees remained largely constant (Abrahams and Lewis:2000:121), so the change cannot be ascribed to change in the type of personnel. The key change is that from 1995, the Committees had to make a single decision on a majority basis. In this climate *deliberative supranationalism* could thrive, since when a decision must be made, a scientific rationale discourse does provide a common language for decision-making. Everson et al. argue:

“Committees which already played a significant role in the old multi-state drug application procedure-have not only become more important, but more independent since the creation of the EMEA. This is because it is in their interest to establish an international reputation for good scientific work, and for this purpose the degree to which they reflect the views of the national governments is irrelevant.”(Everson et al.:1999:59)

This on its own cannot be a sufficient explanation of causality. If it were so, it would be necessary to explain the absence of such an interest prior to the 1993 changes and why the new development was exogenous to change in the decision-making rules.

The suggestion sometimes made that we should make a distinction between NRA committee members at European level and their NRAs seems highly dubious (Eberlein and Grande:2005:101). Legally, committee members are required by the directives to *ensure* coordination with their national authorities. In order to fulfil their scientific mandate they also need to do so since the national bodies supply the resources allowing them to analyse applications. In addition, it is the national authorities that appoint them to the committees and should they fail to represent their national authorities appropriately then their relatively short (three-year) mandates would not be renewed. It is sometimes

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<sup>192</sup> In the first year of operation only one product was withdrawn and none were voted down in the CP; thirty-four were authorised. (*Medicines Agency Annual Report 2001*).

suggested that the committee members may have carved out separate positions from their national bodies based on their own individual scientific expertise. A senior German regulator cited by Abrahams and Lewis disagreed with the theory of *locals* and *cosmopolitans* (Gouldner:1958):

“The CPMP itself is not the body to do any science. There is a big difference between the theory that this is a commission of people with big scientific backgrounds and the reality that this is a collection of European administrators...CPMP members are all administrators in national authorities and what they are discussing, everything the CPMP is doing, will have effects [in national regimes],” (Abrahams and Lewis2000: 122)<sup>193</sup>

In other words, the reason committee decision-making now works in medicines is not because it has somehow caused representatives of national authorising bodies at national level to defect from their national bodies and become cosmopolitans (Eberlein and Grande:2005:101). It works because the regime now requires the national agencies themselves to participate in European decision-making and the representatives on European committees are links in that process.

The requirement to agree a draft in the Agency committee could still potentially have given rise to a live and let live process between authorities, creating opinions that were a hodgepodge of potentially contradictory national positions. However, the system was buttressed by the fact that it was the Commission that formally made the decision based on the committee’s draft. If, hypothetically, the committee had made lowest-common-denominator decisions (as prior to 1995), it would have risked veto by the Commission or the submission to comitology of the Commission’s own decision. The Commission has to provide detailed reasoning as to why its decision varies from that of the CPMH (Article 10: Council and EP:1993) but this would potentially be quite feasible in opposition to an Agency decision that was no real decision. A draft Commission decision could, of course, have been overturned in comitology by representatives of the national ministries. However, in such a scenario, it would be clear that a collective political decision was being made not to facilitate the single market as opposed to the accidental

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<sup>193</sup> One of the CPMP representatives for one of the leading rapporteur states interviewed for the thesis was a lawyer with no scientific training.

outcome of a series of individual decisions indifferent to the collective effect of impeding the single market. In addition, such a decision by the Commission (but effectively by the Council of Ministers) would be subject to judicial review and the Court would have measured it against the objective criteria contained in the directive and the Commission's reasoning would already have established why these criteria had not been met (Krapohl: 2004: 537). The system created here is one where there is a permanent shadow of hierarchic authority (Heritier and Lehmkuhl:2008:2).

The actual dynamic of the system is that the incentives operate in such a way that no vetoes by the Commission or in comitology have ever occurred (Sauer:2000:254; Broschied and Feick:2005:12).<sup>194</sup> Interviewees confirmed that the situation had not altered. They did add that a number of authorisations had been informally referred back to the Agency by the Commission since 1993 and the Agency had been asked to re-evaluate aspects. (Interviews:2008).<sup>195</sup>

Although some authors suggest that the Commission simply rubber stamps draft decisions, this is not a view shared in the Commission. In an interview for the thesis, a Commission official said:

“If the evidence or reasoning is not adequate then we would refer the decision back. This is not a rubber-stamping exercise. We cannot afford to be complacent. There would, for example, be political risks to the Commission if we took a decision authorising a product that turned out to be dangerous.” (Interview:2008). No statistics are retained by either the Agency or the Commission on either informal referrals back by the Commission or formal referrals back by the Committee.

Many of the conditions for professionalisation which network governance theorists consider necessary for purely informal networks to informally Europeanise participants do exist in the case of this Agency (whereas as argued in previous chapters these conditions do not exist in the context of actual existing informal networks or indeed in

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<sup>194</sup> A Commission report of 2001 reports that the standing Committee had, as of 21 May 2001, adopted 257 decisions unanimously and 5 by qualified majority. No draft decision had been rejected. Commission (2001:7)

the context of the committees that operated in pharmaceuticals prior to the creation of the Agency). However, what the evidence here suggests is that this exists at the level of NRAs rather than individuals. A *reputation* game does now exist in medicines authorisation because of the existence of direct and indirect centralised rule-making. Representatives of national authorities who are acting as rapporteurs and co-rapporteurs must persuade their foreign colleagues of their methods and assessments (the fact that there are two independent reports, one by rapporteur and one by a co-rapporteur emphasises this).

All national regulatory authorities are at least partially funded by authorisation fees and some are wholly funded from this source. In the CP, the funds are split 50:50 between the Medicines Agency and the NRAs providing the rapporteur and co-rapporteur. (A fee for CP clearance currently costs euro 242,600.) If representatives lose their good standing, they will not be awarded rapporteurships in the CP by the CPMP (Interview:2009). In the MRP, companies can select the rapporteur agency; if it is badly perceived by other regulators, it will be weaker at obtaining authorisations and companies will in consequence turn to another regulator. The activities of all participants in the CP, MRP and DP are of course potentially transparent since all decisions must be reasoned, published and collectively decided.<sup>196</sup>

Even where national regulators attempt to reconcile their approaches in the CMD(h) network prior to a referral to the CPMH, they know that if they cannot do so successfully that the review will move into the CPMH. According to interviewees, the incentive, in general, is to factor in likely outcomes later in the procedure into their approach in the

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<sup>195</sup> One NRA interviewee said this would be a number in single figures. Another NRA interviewee said that the Commission would informally refer back a couple every year before sending them to the standing committee.

<sup>196</sup> At the level of individuals one might note that there is much greater scope for individual reward as a result of cooperative behaviour at European level than in the utility sectors. There are markets in this sector for international regulators. EMEA provides well-remunerated and interesting jobs and now has a staff of 614 (EMEA:2008:75). This compares favourably, for example, with the Dutch regulator which employs just under 200 (MEB:2008:65) despite being the most active in providing rapporteurs compared to any other regulator. (The UK's MHRA employs approximately 900 (MHRA:2008:36). However, one might be sceptical that this would have anything other than a marginal impact on an individual's behaviour. Even a purely utility maximising individual would have to consider the weighting to be given between the value of existing employment and an alternative hypothetical employment which is one amongst potentially a number of others and where loyalty to one alternative hypothetical future employer could prejudice the availability of other alternatives.

network. However, this does not always mean that they will always reconcile differences and approve a product. Interviewees suggested that sometimes a national regulator will hold out for arbitration in CPMH as a means of blame shifting. The logic is that if an NRA has a safety concern that is not going to be accepted by the other NRAs, it can require the Agency and the Commission to approve the product and should there then be a future problem with the product, it can shift the blame to the other actors (Interviews:2008 and 2009).

### **6.7.2. Regulators views on cooperation and independence**

Semi-structured interviews were sought with regulatory officials from the same three countries as in the other case studies. However, it was only possible to obtain an interview with a representative of Country C. An additional interview with a representative of Country D (also a supplier of a large number of rapporteurs) was conducted instead<sup>197</sup>. In this sector, interviews have not been conducted with individual companies regarding ministerial involvement in decisions. This was because the evidence accumulated that regulatory independence was not an issue as far as authorisations are concerned. This approach was adopted after representatives of both innovator firm and of generic firm EU-level trade associations said that this was not an issue that they considered at all relevant to this sector (Interviews:2009). There is no requirement and no pressure at EU level for independence of NRAs and a chain of reporting and decision-making that extends to national ministers is not considered controversial. It has not been an issue in legislation because there is no ownership conflict of interest. The responses from regulators indicate that they are both part of a national chain of decision-making which includes elected officials and part of an integrated European decision-making where the conditions for deliberative supranationalism exist (see Annex 10).

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<sup>197</sup> I am very grateful to Professor David Coen for writing formally to the Heads of the Medicines Agencies in countries A and B. No reply was received to these requests either. The representatives of countries C and D could think of no policy reason for which interviews and responses were not provided by countries A and B.

## **6.8. Findings with respect to the hypotheses**

### **6.8.1. Hypothesis 1**

Hypothesis 1 states:

*“The greater the distributional conflict in a policy area, the less likely the Council is to delegate regulatory authority to an EU Agency, and the more likely they are to delegate to bodies (such as NRAs) more subject to control by national governments.”*

In the first two observations, the Council had a preference for NRAs. It is not clear to what extent distributional issues played a role. It seems more likely that the prime cause for this preference was a concern that NRAs were necessary politically to reassure electorates on safety issues. Nonetheless, the literature (corroborated by an interview) suggests that distributional issues were a factor in 1993 when the *pre-decision making* Agency was invented for this sector. Once this distributional issue was resolved by making the NRAs the decision-makers within the Agency, member states did alter their preference in favour of an Agency. Therefore, the first two observations suggest the hypothesis as specified is not a sufficient explanation. The second two observations, which occur when this involvement of NRAs was guaranteed within the Agency, would seem to support the existing hypothesis.

### **6.8.2. Hypothesis 2**

Hypothesis 2 states:

*“The greater the influence of the Commission and the Parliament in the politics of bureaucratic design in a particular sector, the more likely that an EU Agency (either the Commission itself or an EU Agency) will be tasked with delivering regulation rather than NRAs; and vice-versa.”*

The first observation is indeterminate. The second observation supports the hypothesis as the Commission considers a EU-level body but opts against pursuing it as politically unviable and instead proposes the creation of a formal network of NRAs. The third observation shows the importance of the Commission’s informal agenda-setting powers. The policy creativity of the Commission’s Head of the Pharmaceuticals Unit, Fernand Sauer, was key in designing an Agency that the member states could accept (Hauray:110-

123). The role of the Parliament was supportive but not determinative; the Agency model was agreed before the Parliament had a legislative role. The latter was more significant in incremental but relatively marginal efforts to make decision-making less representative of national authorities (i.e. making a supranational regulator, more supranational). The fourth observation effectively records a continuation of the third round with modifications supported by the Commission and Parliament that increase the scope of activity of the Agency.

### **6.8.3. Hypothesis 3**

Hypothesis 3 states:

*“EU Agencies will typically lead to greater regulatory harmonisation than institutional designs that rely only on the activities of informal networks of regulators.”*

Medicines authorisations provide a case where it is possible to compare the implementation success of committees of NRAs with that of an Agency. The outcomes are starkly distinguishable: a catastrophic record for the first and success recognised by all stakeholders for the latter. The outcomes in the first two observations compared with the outcomes in the second two observations clearly fit the hypothesis.

The alternative hypotheses

### **6.8.4. Hypothesis 4**

*“The Council will decline to empower Agencies to undertake implementation for constitutional reasons.”*

The first two observations are indeterminate. The second two falsify the hypothesis. The Council support the creation of an Agency and when there is a constitutional argument over Treaty base this is not extended into an argument over the propriety of the objective.

### **6.8.5. Hypothesis 5**

*“The Council does not have a strong preference of either NRAs or Agencies because networks of NRAs are the functional equivalents of Agencies.”*

In the first two observations, the Council appears to have a strong preference for NRAs. In the latter two observations, as long as NRAs were preserved as part of the collective decision-making process, the Council had a strong preference for an Agency precisely because a network of NRAs was not the functional equivalent of an Agency. This can be seen from the stark empirical results regarding authorisations examined with respect to hypothesis 3.

#### **6.8.6. Hypothesis 6**

*“The Commission does not have a strong preference for Agencies over NRAs because it can regulate using competition law.”*

Competition law is not a relevant tool and is not considered so by any protagonist.

## 7. Chapter 7: Conclusion

### 7.1. Introduction

The puzzle set in the introduction of the thesis was how to explain why different choices between NRAs and Agencies are made by EU legislators when selecting institutions to regulate similar single market issues.

The early chapters of the thesis explained why NRAs were likely to have some fundamentally different properties to Agencies in terms of the extent to which individual Member States rather than a wider set of principals could direct them. The literature chapter nonetheless noted that much of the existing literature gave similar technocratic functional explanations for selection in EC frameworks of both NRAs and Agencies.

By disaggregating the preferences of the three EU legislators through examination of their draft contributions to legislation and the effects on selection of the relevant rules of legislative adoption, the thesis has been able to show that regulatory design is often contested.

Consistent with a view of technical functional explanation for the features of the selected institutions, much of the literature also assumed that the agreed legislation reflected the preferences of all the principals in so far as design would impact on regulatory implementation.

The literature section of the thesis critiqued the view that Member States had become neutral market arbiters. It pointed out that research for the thesis had found a much higher degree of state ownership across Europe than scholars of regulation, perhaps working on the basis that the UK experience was typical, tended to assume.

The theory section argued that the puzzle set in the introduction could be resolved on the basis of a set of rational propositions. We would find so-called *independent* NRAs selected rather than Agencies where the Council did not want harmonised implementation of single market rules and where it dominated in the legislative process. Member States would adopt such an approach when a sufficient number considered that the distributional consequences of the successful prosecution of a single market could be harmful for them. The Commission and the Parliament who, as most analysts have found,

do have an interest in both the success of the single market and the transfer of powers to supranational level, would push for an Agency and/or the Commission rather than NRAs to control regulatory implementation. The empowerment of supranational institutions would partly depend on the degree of their influence. The theory section further suggested that we should be able to test these propositions not just by examining the legislative process and its outcomes but also by examining implementation outcomes.

In order to investigate these theories, three hypotheses (and a further three alternative hypotheses drawn from existing alternative explanations for outcomes) were tested in each legislative round in each of the three single market sectors examined in the case studies. The combined results and cross-sectoral comparisons are presented in this concluding chapter.

What the results in each of the case study chapters showed is that the level of distributional conflict can determine the institutions selected to regulate the sector. Where legislation potentially exposes state-owned entities to competition and there is a sufficiently large set of member states with state-owned entities, then the institutions selected as authoritative regulators are NRAs, typically organised into networks, as for example, in the regulation of rail or telecoms access.

Conversely, in areas characterized by lower levels of distributional conflict, member state governments and supranational actors (the Commission and Parliament) strike compromises that lead to the creation of Agencies. Member-state governments seek to obtain the benefits from consistent implementation but resist delegating power directly to the Commission. The Commission and Parliament seek to strengthen EU-level regulatory capacity, and recognise that the member states will not empower the Commission directly. Agencies are then created. These dynamics were observed in the formation of the Medicines and Rail Agencies.

In some sectors, multiple institutions are created. The explanation for this is that legislators on occasion divide regulation in a sector into different types of issues, where distributional conflict is high with respect to one set of issues and low with respect to another. For instance, in the rail sector, regulation of access to national rail networks, which potentially has high distributional consequences has been separated from safety

regulation, which entails less distributional conflict. Access to rail networks in practice remains subject to national control, while safety regulation has been delegated to an Agency (ERA). Likewise, in telecommunications, NRAs regulate the content of access regulation while an Agency (BEREC) deals with procedural issues only.

This chapter sets out the central empirical findings, the strengths and weaknesses of the research and the general empirical and theoretical conclusions.

## **7.2. Central empirical findings**

This section of the thesis sets out the combined empirical findings from the three case studies.

It sets out the results for the three hypotheses of process tracing in the case studies. It then shows the extent to which there is co-variation between the degree of distributional conflict and the type of institution selected. This examination includes all sectors where a choice was made between independent NRAs and Agencies. It then proceeds to show the nature of outcomes resulting from interplay between the interests of the Council and Commission. Finally, it sets out the results of the examination of regulatory implementation. The quantitative data from the case studies is amalgamated and as a consequence of analysing a wider population produces statistically significant results.

### **7.2.1. Process tracing**

The empirical findings set out in the individual case studies and derived from process tracing indicate that the theory advanced in the thesis is a possible explanation for the selection of regulatory institutions in EU legislation in each of the cases.

#### *7.2.1.1. Hypothesis 1*

*The greater the distributional conflict in a policy area, the less likely the Council is to wish to delegate authority for implementation of regulatory rules to autonomous European level regulatory bodies, either an Agency or the Commission, and the more likely it is to prefer to delegate to NRAs; and vice versa when distributional conflict is low.*

#### 7.2.1.1.1. Confirmation and Indeterminacy

There were 20 observations of legislation relevant to hypothesis 1. The results were indeterminate 17 times. While indeterminate, it is possible to show that the Council's preference on almost all of these occasions was as predicted by the hypothesis and that the predicted outcomes occurred in the presence or absence of distributional conflict. However, it is not possible to trace the formation of the preference at Council-level from the existence of distributional conflict as this occurs within national ministries and they have motivations for obscuring the process. An examination of covariation below at page 321 also supports the first hypothesis.

#### 7.2.1.1.2. Falsification

The first two cases where hypothesis 1 was falsified occurred in pharmaceuticals, where the Council clearly considered NRAs preferable prior to the Commission invention of a design that combined NRAs and a supranational regime even although distributional conflict was slight. Kelemen and one of my interviewees<sup>198</sup> explained this as arising from a distributional cause (Kelemen:2002:103). Although it would support my theory, I am sceptical. Although, all other things being equal, national ministries would no doubt like to preserve employment in NRAs, the numbers were at most in the low hundreds and insignificant compared to employment in pharmaceuticals production. It seems more likely that concern over the appearance of ministerial responsibility was the driver. Consequently, this would suggest that a respecified hypothesis should state that distributional conflict will only be determinative when distributional issues are actually salient for politicians. In pharmaceuticals, I think distributional issues were less salient than the perceived need for national political responsibility in the wake of thalidomide and, at that point, the supranational regulatory designs on offer did not include any variants which included NRAs within their governance structure.

The other occasion on which the first hypothesis was falsified occurred in rail safety where safety was included in a primarily access-related Directive and was therefore subject to the same institutional oversight. This appears to be the result of path

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<sup>198</sup> See page 278.

dependency since on the next legislative occasion, safety was combined with interoperability in a separate Directive subject to different institutional rules.

#### 7.2.1.2. Hypothesis 2

*The greater the influence of the Commission and Parliament in the politics of bureaucratic design in a particular sector, the more likely that a supranational regulator (either the Commission alone or in conjunction with an EU Agency) will be tasked with the implementation of regulatory rules; and vice-versa.*

##### 7.2.1.2.1. Confirmation

There were also 20 observations of legislation relevant to hypothesis 2. 17 provided confirmations.

##### 7.2.1.2.2. Indeterminacy

The result from the 1965 legislation in pharmaceuticals was indeterminate. There is no evidence on the legislative record of that date of any consideration by the Commission of pushing for empowerment over implementation for the Commission or another supranational body. It is also true that in rail and telecommunications the evidence that the Commission's earliest preferences for supranational institutions are derived from oral or alternative written sources such as newspapers. No evidence of this sort was unearthed during the research into pharmaceuticals but this may be due to the fact that the witnesses interviewed had become involved in the sector much later and that the surviving documentary evidence is not comprehensive. There is evidence in the next round of pharmaceuticals legislation that the Commission considered a Euroregulator. However, it is unclear whether it rejected that option for reasons of realpolitik or because it did not favour such an approach. An observation arising from legislation with respect to legislation concerning network access to provide passenger services is also indeterminate as the Commission and Parliament made no attempt to push any supranational agenda. However, given their failure to make any headway in supranational control over implementation with respect to access for freight, with its clear need for cross-border access to survive as a viable economic activity, it is likely that they took this into account

and did not promote their true preferences. This particular observation is capable of appearing either to support or falsify the hypothesis.

#### 7.2.1.3. *Hypothesis 3*

Hypothesis 3 is not investigated by process tracing.

#### 7.2.1.4. *The alternative hypotheses*

Hypothesis 4

*The Council will decline to empower Agencies to undertake implementation for constitutional reasons.*

Hypothesis 5

*The Council does not have strong preferences with respect to the selection of either NRAs or Agencies because NRAs in networks are the functional equivalent of Agencies.*

Hypothesis 6

*The Commission does not have a strong preference for Agencies over NRAs because it can regulate utility sectors using competition law.*

##### 7.2.1.4.1. Confirmation

Only hypothesis 4, that member states had constitutional reasons for declining to empower an Agency, received any indication of confirmation at all. This was in telecommunications. However, it should be noted that the evidence that this was an explanation is that member states gave this as the rationale for their preference on two occasions. In a EU context, however, this is unlikely to be sufficient evidence to suggest that there is an unidentified independent variable. Unlike many federal constitutions, the EU constitution does not reserve any powers for any particular level of government. The rule for the allocation of powers, *subsidiarity*, explicitly states that tasks should be allocated where they will most “effectively” be wielded (Shaw:1996:83). If the Council on occasion declines to transfer implementation for *constitutional* reasons, this does not explain why on any particular occasion, as opposed to others, it considers that the

transfer is either appropriate or inappropriate; the decision is always open to political choice. The telecommunications results, themselves, show that what was not constitutionally *appropriate* by the Council in one round, was considered appropriate in later ones. In addition, Agencies had already been considered appropriate in other sectors in an earlier time frame, for example in pharmaceuticals. So while there are two supportive observations, they are unlikely, in fact, to be an explanation for preference.

#### 7.2.1.4.2. Indeterminacy

The findings of indeterminacy for the alternative hypotheses arise from legislative rounds where there was simply no discussion that was relevant to the hypotheses.

#### 7.2.1.5. Summary of the results

The results for the hypotheses advanced are either confirmation or indeterminacy, and these are shown in Table 7.1.

**Table 7.1. The results for the hypotheses**

Hypothesis	Confirmed	Falsified	Indeterminate
1	0	3	17
2	17	0	3
4	2	9	11
5	0	11	9
6	0	17	3

## 7.2.2. Covariation

### 7.2.2.1. Covariation in the case studies

If we look at covariation in the case studies between the presence of distributional conflict and selection of institutions, there appears to be a complete correlation in the

studied sectors between the presence of distributional conflict and the selection of NRAs. These results are listed as the first three rows in Table 7.2.

The results also appear to be very strong if we look at a wider population which includes all of the other areas of sectoral regulation where EU framework legislation requires either *independent* NRAs or an Agency to exercise substantive regulatory discretion (or, in the Agency cases, pre-decision making discretion). In addition to the sectors analysed in the case studies, the full population includes: aviation safety, broadcasting, chemicals, financial services, electricity network access, gas network access, maritime safety and postal services. ( The Food Safety, Agency is also included – although, in my view this is a not pre-decision making regulatory Agency as the Commission is not legally required to seek or take into account the opinion of the Agency when it make a decision). These are listed in the table after the three cases examined in the thesis. The only sector where the finding may not fit with respect to distributional conflict is financial services. Financial services is a sector which has had a large state presence in most EU countries (other than the UK) and during the recent crisis, this state presence has become ubiquitous. However, in September 2010, the Member States agreed to move from NRA to Agency governance. As this is not a sector researched in the thesis, any comment is speculative. However, one explanation could be that the crisis undermined one distributional coalition and replaced it with another: politicians became more concerned at the electoral consequences of cross-border banking collapses on tax payers than the consequences of more harmonised sectoral trading rules on the relative competitiveness of their financial sectors.

**Table 7.2 Covariation between distributional consequences of legislation, state ownership and type of institution**

Table 7.2 maps the extent of state ownership, the voting weight of countries with state ownership and outcomes as of December 2010. A blocking minority requires approximately 90 votes. A set of legislation is described as of potentially systematic distributional consequences if the nature of the rules is assessed as having predictable and large scale distributional effects for national economic actors.

Sector	Field of activity of EU legislation	Number of member states with ownership in sectoral economic actor <sup>199</sup>	Council voting weight of states with ownership stake <sup>200</sup>	Potential systematic distributional consequence	Outcome
Pharmaceutical	Licensing/authorising marketing of pharmaceuticals	0	0	Low	Agency – EMA
Rail	Common safety standards; and  Determines conditions for market entry by regulating monopoly infrastructure	21	261	Low for safety standards ----- High for regulation of rail access	Agency – ERA ----- Informal network organised by Commission on access issues

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<sup>199</sup> Data on state ownership is correct as of 31 December 2008. Research has not been conducted for state ownership for earlier periods except for the case studies. Figures were gathered in a survey conducted for the thesis and for a paper by Tarrant and Cadman (2009). Information on state ownership was requested from all member states in 2008, and responses were provided by 23 member states (the exceptions were Latvia, Lithuania, Malta, and Slovakia). However, as the share of state ownership has declined in all sectors over the past two decades, any sector that had a *blocking minority* in place in 2008 would certainly have had one in place in earlier years. The only exception is the financial services sector, where state ownership expanded during the recent financial crisis, although it was already high. See Annex 2.

<sup>200</sup> Wiberg, M., (2005) New Winners and Old Losers. A priori voting power in the EU-25. Discussion Paper C149, Centre for European Integration Studies, Bonn.

Sector	Field of activity of EU legislation	Number of member states with ownership in sectoral economic actor <sup>199</sup>	Council voting weight of states with ownership stake <sup>200</sup>	Potential systematic distributional consequence	Outcome
Telecommunications	Determines conditions for market entry by regulating monopoly infrastructure	14	152	High for regulatory remedies ----- Low for procedural issues determining to which entities regulation applies	ERG with Commission as observer and IRG without the Commission ----- Agency – Body of European Regulators for Electronic Communications (BEREC)
Aviation	Common safety rules; and  Determines conditions for market entry by regulating monopoly infrastructure (access to landing slots/charges for airport use)	15	152	Low for safety rules ----- High for regulation of access to landing slots/airport charges	Agency – European Aviation Safety Agency (EASA) ----- Informal airport regulators group (meets once a year, organised by the Commission)

Sector	Field of activity of EU legislation	Number of member states with ownership in sectoral economic actor <sup>199</sup>	Council voting weight of states with ownership stake <sup>200</sup>	Potential systematic distributional consequence	Outcome
Broadcasting	EU rules set common standards around content of production (for example, regarding product placement, percentage of EC content)	21	261	High	The Contact Committee – a formal network with Commission participation
Chemicals	Common safety rules	0	0	Low	Agency – European Chemicals Agency (ECHA)

Sector	Field of activity of EU legislation	Number of member states with ownership in sectoral economic actor <sup>199</sup>	Council voting weight of states with ownership stake <sup>200</sup>	Potential systematic distributional consequence	Outcome
Electricity	Determines conditions for market entry by regulating monopoly infrastructure	17	173	Low for cross-border transmission networks ----- High for distribution networks serving end users	Agency for the Cooperation of Energy Regulators (ACER) deals with cross-border transmission ----- Regulatory networks the European Regulators Group for Electricity and Gas and the Council of European Energy Regulators <sup>201</sup>
Financial Services	Micro-prudential rules which effect profitability	16	203	High	Lamfalussy committees of national regulators, no ability to propose binding rules (changes in September 2010)
Food	Common safety rules	0	0	Low	Agency – European Food Safety Authority (EFSA)

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<sup>201</sup> The former network includes the European Commission as an observer, while the latter excludes the Commission entirely.

Sector	Field of activity of EU legislation	Number of member states with ownership in sectoral economic actor <sup>199</sup>	Council voting weight of states with ownership stake <sup>200</sup>	Potential systematic distributional consequence	Outcome
Gas	Determines conditions for market entry by regulating monopoly infrastructure	10	126	Low for cross-border transmission networks ----- High for distribution networks serving end users	Agency for the Cooperation of Energy Regulators (ACER) deals with cross-border transmission ----- Regulatory networks the European Regulators Group for Electricity and Gas and the Council of European Energy Regulators <sup>202</sup>
Maritime	Common safety rules	0	0	Low	Agency – European Maritime Safety Agency (EMSA)
Posts	Determines conditions for market entry by regulating monopoly delivery systems	21	252	High	Informal network organised by Commission on access issues

The findings in the table drawn from that an examination of all of the sectors where EU framework legislation requires either *independent* NRAs or an Agency to exercise

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<sup>202</sup> Ibid.

substantive regulatory discretion (or in the Agency cases, pre-decision making discretion) indicate that there appears to be a complete correlation between the presence of distributional conflict and the selection in EU legislation of *independent* NRAs.

7.2.2.2. *Covariation factoring in the influence of the Commission and the Parliament as well as the Council*

In Chapter 3, a model of the interaction between hypothesis 1 and hypothesis 2 was presented<sup>203</sup>. As these two hypotheses concern the legislative preferences of the legislators, if they are correct, it should also be possible to map the outcomes that arise from all variations of their interaction, as shown in Table 7.3.

**Table 7.3. Placing the cases**

		Influence of Commission and /or Parliament High	Influence of Commission and /or Parliament Low
Potential distributional conflict between member states and between Member States and Commission	High	A: Competition law	B: Airline landing slots and airport charges Broadcasting Financial Services until 2010 Rail Access  Telecommunications access Electricity and gas national grids
	Low	C: Food safety	D: Rail safety Maritime safety Aviation safety Medicines authorisations Chemicals Telecommunications procedure Electricity and gas cross-border capacity Financial services from September

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<sup>203</sup> See page 105 above.

			2010
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*Box A:* As discussed in the theory chapter, there are few cases in this quadrant. The institutional reforms involved in the ‘Modernisation’ of Community Competition law in 2003 (with Regulation 1/2003) illustrate the dynamics of Box A. It has been argued that principal and agent theory has little traction on this case on the basis that the Commission successfully carried out a *coup*; persuading member states that it was decentralising while it was taking command of a network of national competition authorities (Wilkes:2005:437). However, this conclusion was reached without a careful examination of the preceding act of delegation or the legal context within which this later act of delegation occurred. I would argue that the significant structurally and conjuncturally derived negotiating power of the Commission meant that it was unlikely to see its prerogatives substantially reduced. The assumption that, at a minimum, the British, French, German, Italian and Scandinavian economic ministries and competition authorities, their permanent representatives, the external and internal legal advisors, and their business lobbyists such as the UNICE (now BusinessEurope), CBI and Medef, could not understand the content of the proposals seems implausible. I would also argue that what happened in this case was that the Commission did offer up some constraints on its freedom of action in exchange for procedural changes that enhanced its ability to be more effective where it did act.

The Commission was in a strong position. It had been empowered in competition in the early days of the Community. At that time there was no hint as to the Commission’s later ability to flex its competition law muscles even when member states were opposed (Conant:2002:101). It was also the case at that time that the commanding heights of most European economies were owned by the state. State monopolies were apparently largely outside the scope of competition law; the intended target of competition law were private actors (Baquero Cruz:2002:128). In this context, it is not surprising that the previous act of delegation, Regulation 17 of 1962, empowered the Commission to conduct implementation and subjected it to a particularly fangless form of advisory committee (Council:1962). There was no obligation on the Commission to give any particular weight to the Committee’s views (no *utmost account* requirement) and the Committee

was expressly forbidden to publish its opinion (which might otherwise have assisted private parties).

Two later conjunctural developments further increased the Commission's room for discretion and also concerned member states. First, in the Masterfoods case in 2001, the ECJ held that the Commission could retrospectively overrule national competition authorities and courts. Second, the EU regulatory regime in energy had failed abysmally and this was considered to be a consequence of vertical integration (see the later DG Competition Sector Inquiry (Commission:2006)). It seemed possible that the Commission would start to bring structural separation cases for the utilities. The ECJ had already held that it had the power of separation in a merger case,<sup>204</sup> and it would only be an incremental and logical step for this to be extended to standard abuses of dominance. A minority of member states had structurally separated their energy companies and these companies were now lobbying for this to be visited on other rivals (Interview:2007).<sup>205</sup> This minority of member states would likely back Commission and Court legal activism.

Given these circumstances, why did the Commission seek legislation that exposed it to the risk of member states opportunistically seeking greater control over its activities? The risk certainly existed. According to interviews with one current and one former DG Competition official, France apparently sought the creation of a full blown Agency, modelled on the Medicines Agency, such that the Commission could only act where a committee of national authorities had agreed with a Commission decision based on an opinion of a rapporteur country.<sup>206</sup> However, the Commission successfully threatened to withdraw the legislation if this idea was pursued in negotiations.

The Commission sought legislation for a number of reasons. First, it sought legislative changes in a number of areas to increase its effectiveness, for example, level of fines and leniency programmes. Second, it had been delegated some pointless tasks in Regulation 17/62. While, as Riley points out, the use of resource this implied for the Commission

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<sup>204</sup> Euroemballage and Continental Can v Commission C 6/72 [1973] ECR 215: CMLR 199. This merger case was assessed using the abuse of dominance rules as at the time the Commission had no specific merger control powers. Technically, therefore, the ECJ has already found that the Commission has powers of structural separation to deal with abuses.

<sup>205</sup> There was also lobbying of the Commission for this to take place in the telecommunications market (Interview:2008).

can be exaggerated (Riley:2003), it was costly (both in terms of resources and possible impacts on business activity) for companies conducting business in the EU. The latter was undermining the legitimacy of the Commission and European competition law with pan-European businesses, normally the constituency that most favoured the Commission. Third, rival national competition law regimes were being constructed. There was a risk of this generating higher levels of conflict than already existed, if national regimes and the Commission were not applying the same law.

The bargain was that the national competition authorities would apply EC law. The Commission would have the right to override (which it had anyway due to the *Masterfoods* ruling), which is the rule which Wilks suggests is the key innovation (Wilks:2005:437), but the comitology rules would be changed so that a member state could seek the support of its national peers if it did not view this as a legitimate exercise of Commission implementation power. Under Regulation 1/2003, the Commission must take into “utmost account” the views of the NCAs and “in particular” where it is seeking to override (Council:2003). In addition, the Competition Network can decide (without Commission agreement) that its opinion can be published.<sup>207</sup> The ability of the Commission to structurally separate was recognised but subject to the caveat that the Commission had to prove that behavioural remedies (i.e. the kind of remedies contained in framework directives) had not worked. Normally, once the Commission has identified an abuse, it has discretion as to the remedy (subject to general principles of law such as proportionality). Now, if it wishes to deploy structural separation, it must satisfy an additional legal threshold.<sup>208</sup> The requirement for administrative review by the Commission of cooperative agreements between economic actors was removed. Instead, the power to prohibit anti-competitive agreements was shared with NCAs but on an ex post basis and only where a problem was identified. The Commission and NCAs shared more extensive powers on fining and other technical points.

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<sup>206</sup> Interviews 15.11.2008 and 17.11.2008.

<sup>207</sup> Note that Regulation 1/2003 explicitly prohibits the ECN from issuing opinions on cases under review by NCAs. It is a control targeted on the Commission alone.

<sup>208</sup> It may be difficult to prove a failure of behavioural remedies because in markets where these have failed there may both no new entrants capable of generating the data necessary for an authority to prosecute a case and also insufficient data generated as consequence of the inadequate behavioural (regulatory) rules.

In essence the ECN was a compromise between the Commission and national governments. The latter hoped the ECN might dilute Commission power by forcing the Commission to take recommendations of national competition regulators into account. However, given the negotiating strength derived from its existing position, the Commission had no need to accept any substantial dilution of its hierarchic authority over implementation.

*Box B:* The combination of high-distributional conflicts and low-supranational influence has undermined efforts to establish powerful EU-level regulatory authorities. The Commission and Parliament have called for the establishment of new Agencies in a number of sectors characterised by high distributional conflict – such as electricity, gas, financial services, rail, and telecommunications. However, in the crucial area of regulation of access to national networks – the sectoral issue on which distributional conflicts are centered - Agencies have not been empowered. The most that the Commission has been able to achieve is the creation of weak advisory networks, which can issue non-binding opinions. The failure to give the Commission or Agencies substantive implementation powers in these areas might appear surprising, since these are core areas of economic regulation, vital to the effort to create a single market. However, they are also areas where state ownership remains common. In a situation of state ownership, administrations potentially face distributional issues effecting them directly (budgetary effects and reductions in state employees) if the owned entity is regulated effectively by a European body. Therefore, they block the establishment of powerful EU-level regulatory bodies and permit only the establishment of loose networks of NRAs that can be controlled by national governments.

*Box C:* The dynamics of Box C are illustrated by developments in the field of food safety regulation, where member states favoured the establishment of a new European level Agency, but where the Commission and Parliament used their influence to assure that real regulatory power would remain in the Commission's hands. In food safety, the Commission had already been substantively empowered through general product safety and specific food safety directives (so-called *vertical* directives) (Commission:1997:19). Under the latter, member states were required to notify any proposed national rules. The Commission could veto these if it considered they would unjustifiably infringe mutual

recognition (subject to agreement from a regulatory committee of member state representatives).

During the initial panic over the failure to deal properly with BSE, the Commission had been prepared to consider a strong Agency (Kelemen:2002:16). However, ultimately the Commission and the Parliament considered that powers were likely to be exercised more *independently* if they were kept within the Commission than if they were transferred to an Agency whose management board would be dominated by member state representatives (Kelemen:2002:107). Consequently, while an Agency was set up, its mandate and its powers are weak in comparison to *full-fledged* EU Agencies such as the Medicines Agency. The Commission is not obliged to seek the Food Safety Agency's opinion prior to acting and even if it does seek its opinion, it is not required to take *utmost account* of its opinions. In these respects, it resembles a weak regulatory network more closely than a powerful regulatory Agency.

*Box D:* The vast majority of Agencies are found here. Compromises between member state governments and supranational actors (the Commission and Parliament) lead to the creation of European Agencies. Member state governments seek to benefit from greater European-level regulatory harmonisation but resist delegating power directly to the Commission. The Commission and Parliament seek to strengthen EU-level regulatory capacity, and recognize that the member states will not empower the Commission directly. Under these circumstances, compromises are struck which vary in their details but are similar in their essence: Agencies are created that are subject to control by boards dominated by member state representatives but that also work with the Commission and are subject to oversight by the Parliament.

These dynamics can be observed in cases such as the formation of the Medicines Agency. There can also be migration into Box D from Box B. If distributional conflict in a policy area decreases over time, for instance due to privatisation or secular shifts in the structure of an industry – the conditions in that area may shift from those of Box B to Box D. Likewise, lawmakers may succeed in dividing a given policy area, such as rail regulation, into one set of issues where distributional conflict is high (Box B) and one set of issues where distributional issues are low (Box D). Thus, in rail access regulation, in practice remains subject to national control (in Box B), while safety regulation, which

entails less distributional conflict, has been addressed separately with the creation of an Agency (Box D). Similarly, new Agencies are being created in electricity, gas and telecommunications. In the energy sectors, the Commission has managed to distinguish regulation of cross-border networks from the regulation of networks delivering within member states. The former will be regulated by the Agency/Commission, the latter not. Equally, in telecommunications, a new Agency/Commission will deal primarily with procedural issues (which entities are regulated) and not with the content of national access regulation that will continue to be set by NRAs.

### **7.2.3. Regulatory implementation**

#### **Hypothesis 3**

The thesis investigated the extent to which the ownership of state-owned vertically integrated companies gives rise to less effective implementation by NRAs compared to Agencies. It also compares the performance of NRAs to assess whether national regulatory regimes give rise to less effective implementation in the presence of state ownership.

##### *7.2.3.1. Confirmation*

In terms of comparing the performance of NRAs with Agencies, the data is not there to make multiple findings. Consequently, there is one overall observation for each case study. The results of the investigation in the case studies into the respective implementation efforts of NRAs and Agencies in rail and pharmaceuticals indicate that Agencies are more successful than NRAs in carrying out the tasks allotted to them.

The analysis of implementation was qualitative (looking at examples of output or comment on output for key products) and quantitative.

The qualitative assessment tended to confirm the hypothesis as to less effective implementation under NRA regimes than Agency governance in pharmaceuticals and in rail. In telecommunications, there is not yet a functioning Agency, however, there is certainly qualitative evidence as to a great deal of ineffective NRA implementation in telecommunications.

The quantitative material available for NRAs and Agencies in rail and pharmaceuticals tends to suggest superior performance for Agencies, starkly so in pharmaceuticals, apparently so in rail – at least in terms of the rapidity of decision-making, although the time lags there between regulatory decisions and effects on the ground make it difficult to fully assess effectiveness.

The quantitative research of implementation within regimes policed by NRAs examined whether low third-party scores for regulatory outputs across the board correlated with state ownership. The number of observations in each individual sector case was too low to produce statistically significant figures although the mean score for regulatory output in each case was lower where there was state ownership. However, the results become statistically significant and support the hypothesis when the variables from more than one sector are combined<sup>209</sup>..

#### *7.2.3.2. Indeterminacy*

The result for telecommunications is indeterminate as there is not yet a comparative result for telecommunications. There will be a comparison once the new Agency is up and running. It is likely that it will be successful in terms of output in obtaining NRA response to Commission reviews of NRA decisions on market definitions and findings of significant market power. It will be successful because it will be in the NRAs interests to participate and the Commission will make the decisions in any event, as it has already done so on the more than 1,000 occasions on which it has already met this mandate (Commission:2010:3).

As we cannot yet compare the activities of NRAs with an Agency in telecoms, the result is recorded as indeterminate. However, if we compare the patchy success of NRAs in telecommunications with success of Agencies in pharmaceuticals and with respect to rail interoperability then it would also seem likely that NRAs supervised by the Commission and an Agency in telecommunications would be more successful than NRAs alone.

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<sup>209</sup> See page 340-341 below.

**Table 7.4. Summary of outcomes assessed on a qualitative basis**

	Confirmed	Falsified	Indeterminate
Hypothesis 3	2	0	1

*7.2.3.3. Supporting research explaining variation as to NRA implementation*

Research into the views of stakeholders in each case study indicated that where there was state ownership that NRAs were influenced by ministries and that informal networks were unlikely to counterbalance pressures from ministries since in those areas where the only empowered regulatory institutions is the NRA, the theorised conditions for deliberative supranationalism do not appear to exist.

*7.2.3.4. Correlation of access regulatory scores, market shares and state ownership of vertically integrated companies*

The statistical analysis below combines the data from the rail and telecommunications cases. It also adds similar data from the electricity and gas sectors in order to increase the number of observations.<sup>210</sup> Electricity and gas regulation is comparable with telecommunications regulation and is structured in a similar way (Eberlein and Grande:2005:95; Eberlein:2007:76; Thatcher and Coen:817; Levi-Faur:1999). Increasing the number of observations gives rise to statistically significant results showing higher market shares and lower scores for implementation where there are vertically-integrated state owned regulated companies.

*7.2.3.4.1. Regulatory scores*

Regulatory scores are produced by third parties for the rail (IBM 2007) and telecommunications sectors (ECTA 2009). In both cases, the authors of the reports assign a score to each country based on a range of criteria that the authors regard as all those that are relevant to ensuring an effective regulatory regime. The criteria are weighted

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<sup>210</sup> This analysis was produced for a paper by Tarrant and Cadman for EUSA (2009).

towards outcomes but also include some institutional elements. In electricity and gas, there are neither any pan-European new entrant organisations nor any individual large pan-European access seekers, which is a function of the lack of competition in many EU member states. The type of entity that has both an interest and the resources to sponsor extensive detailed implementation reports does not exist. Consequently, scores from a more limited report by Datamonitor, cross-checked with a report by the law firm Charles Russell have been used (Datamonitor:2006; Charles Russell:2005).

The Datamonitor report scores countries for the extent to which they have applied the unbundling arrangements in the electricity and gas directives. These were discretionary until the new directives of December 2009. These provisions allowed member states to select from a palate that ranged from accounting separation only to ownership separation whereby the activities of the vertically integrated company had to be fully functionally separated and the capital of the two parts of the firm held by different entities or owners.<sup>211</sup> There are five different possible scores, between 0 and 5, corresponding to the extent to which these forms of organisation were more likely to achieve their stated purpose of delivering non-discrimination. The score for energy is less nuanced than for the other sectors whereby a much larger range of regulatory outcomes are measured; however, the extent to which the unbundling provisions have been implemented is likely to have a determinative effect on the level of competition. In the 2006 Energy Sector Inquiry, DG Competition found that within Belgium there was full separation in Flanders and accounting separation in Wallonia. The Commission found that as a consequence there was no retail competition in Wallonia and the opposite in Flanders (Commission:2006:144). All scores were normalised as a percentage.

#### 7.2.3.4.2. Companies' status

The scores for regulatory implementation and market share can be correlated against different forms of company structure. National regulatory regimes are divided into those where firms are state owned and vertically integrated against ones where firms are not in this category. According to the theory behind the hypothesis, the NRAs should be less

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<sup>211</sup> The full range was accounting separation, functional separation, legal separation, ownership separation, and full divestment.

effective and the retail market shares of state owned entities are likely to be higher in the retail sector where there are state-owned vertically integrated operators. This should be true both in comparison to (i) national regimes where the operator is either state owned or privately owned but in either case not vertically integrated (table 7.5 below) ; and (ii) national regimes where the operator is privately owned and vertically integrated (table 7.6 below).

#### 7.2.3.4.3. Implementation and market share outcomes

The difference in the mean scores was tested to determine if the difference was significantly different from zero.<sup>212</sup> In the case of state-owned vertically integrated undertakings, the mean score for effective implementation is 64.4 per cent compared to a situation of either privately owned vertically integrated undertakings (VIUs) or no vertical integration, where the mean score was 75.3 per cent. The difference between the means is significantly different from zero at 4.4 per cent. When this scenario (Pooled 1) is compared with one that only includes privately owned VIUs (Pooled 2), the scores are 64.4 per cent against 80.8 percent with an even stronger result for the z-test of 1.2 per cent.

The difference may arise due to situations where there is false separation, i.e. the state has separated the network and retail arms but continues to own them both and there are cooperative mechanisms that result in the state-owned retail arm being favoured by the state-owned network. The market share findings also seem to support the regulatory score findings. The figures used to compare the situation where there are state-owned VIUs operators against purely private competitors are the more robust, with a z-test statistic of 6.6 per cent. This analysis gives an indication that there tends to be weaker regulation of the incumbent where there is state ownership.

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<sup>212</sup>For the workings, see Annex Eleven.

**Table 7.5. Correlation of state ownership of a vertically integrated company with scores for effective regulation and market share (Pooled 1)**

<b>Pooled 1</b>		Normalised score	Mean market share incumbent
State-owned VIU	Mean	0.644	79.2
	<i>Observations</i>	42.0	39.0
	<i>Standard deviation</i>	0.194	19.7
Private and/or non-VIU	Mean	0.753	70.0
	<i>Observations</i>	35.0	30.0
	<i>Standard deviation</i>	0.262	25.3
Significance	z-test	4.4%	10.0%

**Table 7.6. Correlation comparing with private vertically integrated companies only  
(Pooled 2)**

<b>Pooled 2</b>		Normalised score	Mean market share incumbent
State-owned VIU	Mean	0.644	79.2
	<i>Observations</i>	42.0	39.0
	<i>Standard deviation</i>	0.192	19.7
Private VIU	Mean	0.808	67.6
	<i>Observations</i>	15.0	13.0
	<i>Standard deviation</i>	0.226	19.7
Significance	z-test	1.2%	6.6%

#### 7.2.3.4.4. Consistency with other quantitative research

These findings are consistent with other analyses. Bauer found that regulated interconnection prices in 2000 varied between member states, depending on the ownership status of the incumbent with higher prices where there was state ownership (Bauer:2003:40). Beltratti et al also found that contrary to expected theory, greater government control over privatised firms positively affected rather than negatively affected market valuations in Europe. According to their research, this reflected more

frequent financial aid accruing to privatised firms that remain under government control (Beltratti et al:2004:1).

### **7.3. Strengths and weaknesses of the research**

#### **7.3.1. Strengths**

The strength of the findings in this thesis is that they are based on detailed and comprehensive analysis of all of the acts of delegation in each case including the draft legislation. Such detailed analysis has not been a common feature of studies applying principal and agent theory to the adoption of NRAs and Agencies. The consequences of observing the detail, justify this forensic approach. It is possible to precisely identify the different legislators published preferences and the different and contrasting panoplies of control which they prefer. It is therefore possible to trace which principals achieve their objective of incorporating their controls in legislation.

Comparison between sectors and between different institutional arrangements within sectors also allows us to test whether hypotheses about causes are consistent with the evidence. This thesis is the first occasion on which an explanation of the choice between NRAs and Agencies has been tested in cases where there is a range of different institutional outcomes (in cases where the purposes of regulation are similar).

The examination of functional pressures in the utility sectors has previously been very limited. Moravcisk's claim that functionalists tended to engage in supply-side reductionism would appear to be validated (Moravcisk:1993:481). Sandholz in his analysis of telecommunications lists those interests that could be interested in cross-border trade without any attempt to weigh that against the contrary interests (Sandholz:1998:140). The thesis found that in the two utility sectors that the preponderant weight of economic interest lies with actors dominating national markets not with cross-border actors.

There has been very little academic examination of regulatory implementation in the context of EU laws that delegate to NRAs and Agencies: none have done so on a comparative basis and, none have done so comparing outcomes between those delivered by NRAs and those delivered by Agencies respectively.

The reliability of the findings is intended to be bolstered by the application of several methods. This approach is rare and follows the precedent set by Coen and Thatcher (Coen and Thatcher:2008; Thatcher and Coen:2008). This thesis also follows the precedent set by Coen et al. and analyses the views of participants concerning the operation of the regulatory regime (Coen et al.:2002).

### **7.3.2. Weaknesses**

A weakness of the study is its small *N* nature. The approach would have to be applied to a larger number of cases for the findings to be considered valid. However, the high-level comparison of the entire existing population of cases in this conclusion, suggests that this approach may be promising.

It would be ideal to be able to trace the formation of all national ministerial preferences as regards national negotiating positions on the relevant legislation. This would require an in-depth study of national policy formation in each sector and would likely require techniques that illuminate hidden preferences.

It would also be ideal for there to be academic as opposed to industry association investigation into the full detail of regulatory implementation. However, the resources required would be very extensive. For example, the direct costs to ECTA of preparing a telecommunications scorecard are in the region of 150,000 euros without taking into account the extensive resources devoted by the member companies and national associations of members of the association in providing the data for the scoring of each national study (Interview:2008).

## **7.4. Central theoretical conclusions**

The empirical findings generated by the thesis permit some development of the theories that have been used to explain regulatory developments in the EU.

The explanatory value of a theory based on “isomorphism and a logic of appropriateness” (Thatcher:2007:258) is limited. As the case studies found, the EU principals are inconsistent in their preferences for the selection of the controlling delegate across three similar issue areas. They are also inconsistent within issue areas – in none of the case studies do the legislators make consistent choices.

Variation in the selection of regulatory institutions is not explicable as the alleged consequence of constitutional propriety (Thatcher:2001: 559,570 and 577). The Council itself is inconsistent in its deployment of this argument both within and across sectors.

The theory that Member States have exited the market through privatisation and wish to create a regulatory state to manage it on a neutral basis and are content to see it subjected to supranational control (Majone:1994; Thatcher:2007) is far from an accurate description of what has happened in all sectors of the European political economy. It is specifically inaccurate for some of the sectors which these theories used to prove their case, such as telecoms. Empirically, the thesis has found that Member States have retained ownership stakes in significant areas of the economy.

In addition, in these sectors, where state ownership has been retained, the economic and political strength of the domestically-focussed state-owned firms can far outweigh that of new cross-border entities. These findings of the thesis support Moravcsik's view that it is necessary to be wary of "supply-side reductionism" and necessary to investigate the nature of demand for EU regulation (Moravcsik:1993:482).

Most of the literature on EU regulatory Agencies and NRAs has explained their creation in functional terms – typically emphasising the role which each type of selected body could play in enhancing the expertise, independence and credibility of regulation; building consensus among national regulators; and promoting a level regulatory playing field (Everson:1995; Kreher:1997; Majone:2000). While there may be functional benefits to be gained from creating EU-level regulatory bodies, their design is not necessarily determined by the standard functional imperatives – indeed, sometimes such delegates, at least from the perspective of actually meeting functions such as credible commitment, may be designed by principals to be ineffective.

The assessments that EU legislative requirement for *independent* NRAs actually requires independence and that the directives which they are meant to apply actually contain binding requirements have been made without carefully examining the acts of delegation (Levi-Faur:2004:8; Majone:2001:111; Thatcher:2007:5). For the reasons explained in the literature review and the theory section, we can expect Agencies to be independent of any individual Member State, we cannot necessarily expect the same of an NRA. The

empirical evidence supplied here as to the difference in the outcomes of the acts of *independent* NRAs when there is state ownership, suggests that they are not necessarily independent. This finding is supported by the testimony provided by stakeholders.

Decision-making rules for determining the design of regulatory institutions do not, as Sandholz suggested (Sandholz:1999:163) always allow the Commission to by-pass the Member States. Tracking legislation through pre-legislative negotiations in the case studies makes it clear that it is the Council's institutional design preferences which dominate. This domination is consistent over time. Sandholz and Sweet believed that the Commission could escape the control of the Council by innovative competition law practice and that the Court would support the Commission when it did so (Sandholz and Sweet:1998:18). The evidence in the case studies is that the Commission would indeed seek to use competition law, often on innovative basis. However, the evidence as to the Court's activities is more consistent with the theory of Garrett et al, who theorised that there were circumstances in which the Court would not back the Commission (Garrett et al:1998). Those circumstances applied in the utility sectors, where enacting sector specific legislation in competition areas seems to have acted as a signal to the Court of the extent to which the Council was prepared to tolerate europeanisation. This provides supporting evidence for those approaches which suggest that there are clear limits to the extent to which the European institutions can escape member state principals where the latter have a collective preference (Kelemen and Menon:2005; Menon:2008:249; Kassim and Menon:2010).

The assumption that competition law is a perfectly malleable instrument for market opening (Sandholz:1999:135) is also challenged. The evidence from the case studies is that it was also technically inadequate to deal with standards issues and with some types of competition issues.

The theory advanced in the thesis was that Member States would prefer NRAs to be the bodies controlling implementation in those cases where there was distributional conflict and Agencies and/or the Commission where there was not. The empirical findings with respect to the acts of delegation suggest the hypothesis is largely correct. Findings for the pharmaceutical case study suggest that the finding needs to be nuanced – there may be

sectors where distributional issues are not as salient for national politicians as other issues.

The thesis also investigated regulatory implementation in order to see whether it varied with the type of institution adopted. The results in the case study suggest that outcomes do vary by type of institution. The case studies also found that performance varied between NRAs depending on whether the regulated entity was state owned.

The argument was made that networks of NRAs were not the functional equivalent of Agencies as some have suggested (Eberlein and Grande:2005). Notably in pharmaceuticals, the network of national regulators which had existed prior to the existence of the Agency failed utterly to give rise to “deliberative supranationalism”. In addition, the views of NRA officials were sought to see whether they thought the theorised conditions existed to create such a functional equivalence. They did not in the two utility sectors with respect to access issues. Conversely, the conditions were perceived to exist to a greater with respect to safety issues in the two sectors where Agencies had been created (although the extent to which the conditions existed was limited).

It has been suggested that networks of NRAs can be considered to be in receipt of a “double” delegation of power to make decisions (Coen and Thatcher:2008). This can but may not necessarily be the case. The concept is certainly a good description of what happens in the case of Agency creation, although the principals there are the Commission, the Parliament and the Council. The thesis suggests that the same principals are also the relevant ones in respect of access issues in telecoms and rail. There NRAs do not play an autonomous role as principals and the networks are not delegated any power to make substantive decisions.

The relative failure of networks of NRAs strongly suggests that hierarchy matters as far as effective implementation is concerned. None of the case studies in the thesis provide support for “new Governance” or “ pro-integration discursive decision-making” (Sabel and Zeitlin:2009:281) as mechanisms for effective delivery. Indeed, the pharmaceuticals example would appear to provide both a cut and dry example of the total failure of a

network to deliver and an example of how rapidly that could change when the informal network was subsumed within a hierarchical supranational rule-making process.

The theoretical considerations advanced here could be viewed as confirming a primarily negative view of the feasibility of effective integration. However, correctly interpreting the extent to which regulatory bodies are “under control” and to which principals allows us to identify to what extent they can be considered “national” or “European” in their configuration. This in turn potentially allows us to reorient some of the theoretical conclusions regarding “europeanisation”. As a consequence of assuming europeanisation in terms of the creation of European institutions and authoritative rules in utility areas (Levi-Faur:2004:9), but finding regime patterns that are indistinguishable from the rest of the world, Levi-Faur has concluded that Europeanisation might have an indistinguishable effect from the impacts of globalisation in general (Levi-Faur:2004:25).

However, I would argue that he chose to examine the wrong sectors. He chose as his evidence of europeanisation the creation of *independent* national regulators in telecommunications and electricity. He then found that institutional arrangements are not much different in Europe than South America. However, that is because not much europeanisation as defined by Levi-Faur has actually occurred in the European utility sectors. A conclusion that might more accurately be drawn from the case studies in this thesis is that the extent of europeanisation in the development of the institutions (i.e. whether an Agency and/or the Commission has a controlling power) is a significant variable in determining the extent of central penetration of national systems of governance, and this can be observed in the different post-delegation outcomes that arise under different forms of governance.

However, the extent of the europeanisation of the institutions and the adoption of authoritative rules is determined by EU legislation; a process that the case studies demonstrate is usually dominated by the member states. The case studies further indicate that member states distributive concerns are a significant determinant of their willingness to vote for europeanisation. Where distributive effects are low, member states are willing to create institutions such as Agencies that help set binding rules at EU level i.e europeanise. Where distributive effects are potentially high, they create NRAs and discretionary rules.



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