

Deregulation and Competition Policy in Public Utilities Sector
-Report of Study Group on Government Regulations and Competition
Policy-

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Fair Trade Commission

The Japan Fair Trade Commission (FTC) has held meetings of the Study Group on Government Regulations and Competition Policy, (chaired by Professor TSURUTA Toshimasa of Senshu University) since June 1999. Covering electricity, gas, domestic airlines and telecommunications now under deregulation, the Group studied how to promote market entry and to ensure fair competition between new entrants and incumbent firms. It also reviewed competition policy in the public utilities sector as a whole and worked out agenda for the future. The summary of the discussions is as follows:

1 Basic position on promoting competition in the public utilities sector

(1) What are problems?

Regulatory reforms, including the deregulation of market entry, are under way in the public utilities sector. However, problems arise from the fact that incumbents enjoying the dominant market position exclusively hold network facilities (hereinafter referred to as “network”) that are crucial for market entry. In reality, mere deregulation does not make it easier for new comers to enter the market. There are remarkable gaps in the competitive conditions between incumbents and newcomers.

(2) Basic position

In order to promote effective competition, it is important to take a following package of measures in conjunction with the deregulation of market entry.

- i) Establishing a framework to ensure market entry, including making networks held by incumbents are opened to newcomers.
- ii) Ensuring fair competitive conditions between incumbents and newcomers.
- iii) Enforcing the Antimonopoly Act strictly against anticompetitive activities.

In case competition is not facilitated effectively even with the above measures, another important option is reviewing the structure of dominant incumbents.

2 Establishing a framework that ensures new market entry

In order to ensure new entry into deregulated public utilities markets, networks held by incumbent operators should be opened to newcomers under the principles of nondiscrimination, fairness and transparency, and infrastructure-based competition should be encouraged.

(1) Networks

A. Opening of networks

Networks, including high-voltage transmission of the electricity industry, gas pipe lines of the gas service and local residential telephony of the telecommunications industry, are essential for operating respective businesses. However in most cases, newcomers find it extremely difficult to build such networks on their own. In order to facilitate market entry and to promote competition, it is important to establish a system enabling newcomers to get access to networks held by incumbent operators. Such system should include establishment of rules for interconnection procedure, reason to reject the interconnection, rates and conditions for

using the networks and dispute settlement.

B. Promoting to build alternative networks

What is important to eliminate network bottlenecks is to encourage new entry and competition on infrastructure basis. For this end, it is necessary to review regulations that hamper the construction of alternative networks and to establish rules to facilitate open access to existing utility poles, pipes and other facilities.

(2) Allocation of rare resources vital for business operations

As to the allocation of such rare resources as landing slots at congested airports and frequencies of mobile communications business, it would be necessary to take measures for preventing such resources from becoming vested rights. It would also be necessary that the allocation must be transparent and done under a system, like competitive bidding, where the result can reflect operators efficiency as possible.

(3) Ensuring fair access to the public-run facilities

In industries that rely on facilities run by public entities like airport, it would be necessary for the public entity to work out transparent rules for access, to announce them publicly and to enforce them fairly.

(4) Improving the infrastructure of markets

In addition to the above-mentioned measures to ensure new entry, it is important to improve the infrastructure of markets so that competition could be effective there. What have to be studied include the introduction of a pool market in the electricity sector and the pipe networks and the increase of the licensed operators of retail transmission in the gas sector.

3 Ensuring fair competitive conditions between newcomers and incumbent operators

What is necessary to promote fair and free competition in the deregulated public utilities sector is to ensure fair competitive conditions between newcomers and incumbent firms.

- (1) Prevention of cross-subsidization from monopolized operations to competitive operations.

A monopolized operator in the public utilities sector is guaranteed to make profit certain extent under full cost pricing. Therefore, it is necessary to institutionalize a system to prevent an in-house cross-subsidization from monopolized operations to competitive operations in the deregulated market.

- (2) Ensuring the neutrality in operating networks

A. Ensuring fair cost for network access

With regard to the network access fee, it is necessary to create a system where adequate fee is ensured through fair cost sharing. Therefore, the accounting of the department running the networks must be separated from the other business operation, and a system should be created to have a third party check the accounting.

B. Ensuring the neutrality in operating networks

Measures to operate the networks neutrality should not be limited to firewalls. A third party should monitor the management by transparent way and take corrective measures when needed.

4 Organization of incumbent dominant operator

It would be needed to review organization, including vertical integration and relations with affiliates of dominant incumbent operators in order to promote competition.

In case that above-mentioned measures fail to promote effective competition, one of alternative measures may be reviewing the structure of dominant incumbent operators, including the nature of their vertical integration and relations with their affiliates while giving due consideration to the efficiency of the integration and shareholders' interest.

In case that monitoring of firewalls by a third party is found to have limitations in ensuring the neutrality of the network operation, functional unbundling or structural separation might have to be considered.

5. Prevention of anticompetitive activities and strict enforcement of the Antimonopoly Act

Strict enforcement of the Antimonopoly Act against anticompetitive activities in the public utilities sector is required.

In order to promote fair and free competition in the deregulated public utilities sector, the “prior restrictions” by sectoral laws should be replaced by “ex post defacto checking” by the Antimonopoly Act. Particularly when a dominant firm violates the Antimonopoly Act by refusing or restricting the interconnection to its networks without a reasonable ground, such practices must be strictly eliminated by the Antimonopoly Act.

Industry-by-industry guidelines covering the conducts that might violate the Antimonopoly Act are necessary.
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In addition to strict enforcement of the Antimonopoly Act against anticompetitive activities by dominant firms, the FTC should work out guidelines covering the conducts that might violate the law in each industry in order to prevent illegal practices and further promote fair and free competition.

6. Roles of the competition authority in regulatory reforms in the public utilities sector

(1) Roles of the competition authority in regulatory reforms

A. Competition Advocacy

Survey, research and policy proposal concerning competition policy, all of which are the prime duties of the FTC, should be further strengthened.

The FTC has actively been conducting surveys and researches concerning competition policy and made proposals in regulated areas,

including public utilities sector. Since those are the FTC's prime duties, the FTC should execute these duties more energetically.

B. Sharing and collaboration with other regulatory agencies

The FTC's active participation at the stage of designing a new system and after reform is necessary. And an actual scheme to ensure it should be explored.

In carrying out regulatory reforms in the public utilities sector, measures for introducing sufficient competition and a new framework for it are required. The FTC should participate actively at the stage of designing a new system and after reforms. It is necessary to explore an actual scheme to ensure it.

It would be necessary that the FTC and relevant sectoral agencies collaborate to work out industry-by-industry guidelines.

In order to bring about effective competition in the deregulated market, in addition to the above-mentioned guidelines concerning the Antimonopoly Act violation, the FTC should collaborate with sectoral agencies to work out industry-by-industry guidelines that describe desirable business practices for promoting competition.

C. Monitoring of the regulatory reforms and regulatory agencies based on sectoral laws.

The FTC should closely monitor how regulatory reforms are carried out by relevant sectoral agencies, and should enforce the law strictly against the Antimonopoly Act violations. It is therefore needed to strengthen the FTC's function and capacity.

With a view to promoting fair and free competition in the deregulated markets, the FTC should closely monitor how regulatory reforms are carried out by relevant sectoral agencies. Moreover, the FTC should watch the reformed market more closely and crack down the violations of the Antimonopoly Act. For this end, it is necessary to strengthen the FTC's function and capacity.

It is necessary to whether neutral organizations work out enforce and monitor the competition rules pursuant to the sectoral laws and settle disputes.

It is necessary to study whether organizations neutral and independent from departments for industrial promotion at sectoral agencies should work out, enforce and monitor competition rules pursuant to sectoral laws and settle disputes.

(2) Relations between Antimonopoly Act and sectoral laws

Further discussions must be done to see if sectoral laws, in addition to the Antimonopoly Act, also need clauses for promoting competition.

With regulatory reforms under way in the public utilities sector, sectoral laws covering various industries are being revised: “Prior restrictions” are replaced by “ex post facto checking” and regulations to promote competition are introduced. Studies should be conducted further to see if additional regulation by sectoral laws are needed on top of regulation by the Antimonopoly Act. When they are found needed, the regulations in sectoral laws must be consistent with those in the Antimonopoly Act. Coordination with the FTC is needed for this end.

(3) Position on the “asymmetrical regulation” against dominant operators (regulation on dominant operators) by the sectoral laws

Properly speaking, the situation where there is no dominant operator in the market, in other words, where no regulation on dominant operators is needed is desirable.

The basic stance is that anticompetitive activities by dominant operators should be handled by the Antimonopoly Act. Intensive discussions are needed to see if such regulations are to be introduced in sectoral laws on top of regulations by the Antimonopoly Act.

Even after liberalization, dominant operators that are given the monopolistic position by sectoral laws exist in public utilities sector. It is highly probable that incumbents resort to anticompetitive activities. In

order to promote fair and free competition, it is necessary to eliminate or prevent anticompetitive activities of dominant operators by the Antimonopoly Act, which is a general law aiming at the promotion of competition.

Speaking of considering the introduction of regulations on dominant operators in addition to those of the Antimonopoly Act, desirable situation is that no dominant operators exists in the market, in other words, no regulation on dominant operators is needed. Relevant sectoral agencies, therefore should take necessary measures including reviewing the structure of dominant firms in order to bring about the situation where no regulation on dominant operators is needed.

The regulation on dominant operators while imposing special regulations on them, enable maximum deregulation can be done for other operators in the market. If it is enforced arbitrarily, however, it can distort fair competitive conditions.

Careful discussions, therefore, should be done to determine if such additional regulations are really necessary on top of those by the Antimonopoly Act.

If the regulations on dominant operators are to be introduced, in order to ensure that contents of the regulations are consistent with those of the Antimonopoly Act, adequate coordination with the FTC, which enforce the law, is considered to be crucial.