

Conflict between Regulation and Competition Agencies: Lessons from Experience of Turkey¹

Regulation of infrastructure industries, namely electricity, natural gas, telecommunications and water sectors is a hot issue in many developing economies. Large-scale privatizations and establishment of independent regulatory bodies for infrastructure industries has been a recent trend in many developing economies. Most of those countries also enacted competition laws and established independent agencies to avoid practices restricting competition, abuse of dominance and anti-competitive mergers. Consequently, in some countries, competitive process in some infrastructure industries is under the oversight of two distinct bodies: a competition authority which has economy-wide powers and a sector-specific regulator.

In this paper, by reviewing Turkish experience in telecommunications industry, we suggest that a co-existence of independent regulation and competition authority may be beneficial to make utilities industries competitive, provided that the borders between jurisdictions of two independent authorities are clearly drawn and collaboration / dispute resolution mechanisms are clearly defined. Absence of these conditions may lead to legal uncertainty and institutional conflict that may hinder competition in these markets.

First section of the paper provides a conceptual framework of tensions between competition authority and sector-specific regulator. Section 2 provides information on the legal and regulatory framework of Turkish telecommunications

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industry. Section 3 presents two case studies from Turkish telecommunications industry and offers a synthesis about the collaboration mechanisms between competition agencies and sectoral regulators. Section 4 concludes.

1. Regulation vs. Competition

Creation of competitive market structures in infrastructure industries is vital for sustainable economic growth as competition in these industries will provide lower prices and efficient supply of important inputs to the other sectors of economy. Meanwhile, regulation of utilities is a complicated issue. In many instances, more regulation is preferred to free-market, since pricing, access and universal service issues are very sensitive for these industries (Siclen, 2000). Consequently, infrastructure industries are generally over-regulated. There are two broad categories for the factors that result in overregulation: Firstly, there is a time inconsistency problem concerning the competitive process. The outcomes of competition policy are obtained in the long-run, while political authorities are generally concerned with short-run. This time inconsistency results in a conflict between several other objectives of government and establishment of competitive markets. For instance, government may want to maximize revenue from privatization of a public utility company, while establishment of a competitive market prior to liberalization will lower that revenue (OECD, 1999). Secondly, the decision making and regulatory mechanisms may be captured by vested interests in the industry. This regulatory capture may stem from either direct involvement of market actors in the regulatory process or their indirect effect through their links within bureaucracy (Viscusi et al., 1995).

Activities of the competition authority to establish competitive market structures provide an important mechanism to balance the government's or regulator's objectives. The establishment of more competitive markets will enhance long-term productivity and growth; while, government's short-run objective to maximize privatization profit, for instance, acts as an indirect tax on consumers, since the new owner of the utility firm will enjoy monopoly profits to cover its

privatization payments rather than engaging in competitive pricing. Concerning the regulatory capture problem, as also acknowledged by OECD (1999), in general, economy-wide agencies are more immune to regulatory capture than sector-specific regulators. As a result, a competition authority should balance any anti-competitive capture of regulators towards a more competitive market structure, if the regulator's actions are not exempt from competition scrutiny.

A co-existence of independent regulation and competition authority might make utilities industries competitive. However, the institutional framework outlined above necessarily creates tensions between an independent competition authority and sectoral regulators. In the remainder of the paper, we will provide examples of these tensions from Turkish experience in telecommunications industry, which witnessed substantial reforms towards liberalization in the last decade², and provide a framework for their co-existence by utilizing these experiences.

2. Legal and Regulatory Framework in Turkish Telecommunications Industry³

The monopoly of the incumbent operator, Turk Telekomünikasyon A.S. (TTAS), over the fixed line infrastructure and voices services has ended at the end of 2003. The Telecommunications Authority (TA) an independent regulatory body was established by the Telecommunications Law⁴ in 2000. TA was authorized to issue regulations for the telecommunications industry, determine operators which are responsible to provide interconnection and roaming services, regulate or set tariffs, monitor compliance and impose fines in case of non-compliance.

² The liberalization in Turkish energy markets has been relatively slow compared to telecommunications market, as in most countries. In the provision of water, liberalization efforts are negligible. Partly because of this reason, more conflicts between regulatory and competition agencies appeared in telecommunications industry, which will be the focus of this paper.

³ For an extensive review, see Atiyas (2006).

⁴ "Law Amending Certain Articles of the Telegram and Telephone Law, Law on Organisation and Responsibilities of the Ministry of Transport and Wireless Law, Law on Savings and Aid Fund of the Posts Telegraphs and Telephone Administration and Organisational Charts attached to the Decree with the Force of Law on the General Cadrees and Procedures" Act No: 4502, Date of Adoption: 27.1.2000. Available: <http://www.tk.gov.tr/doc/4502english.doc>

On the other hand, the economy-wide anti-trust powers are vested at Turkish Competition Authority (TCA), an autonomous administrative agency established by The Competition Act of 1994⁵. The Competition Act has provisions parallel to the EU competition regime. It prohibits agreements restricting competition and abuse of dominance, and establishes a merger control regime. The decision-making authority of the TCA is the Competition Board. TCA's power virtually covers all markets and all forms of economic activity.

For telecommunications industry, the law does not draw a clear border between the tasks TA and TCA. *Regarding ex-post competition investigations*, Telecommunications Law provides the TA with the authority to investigate anticompetitive practices in the industry, while the economy-wide authority of TCA –stemming from the Competition Law- still encompasses telecommunications markets. Telecommunications Law (article 16) does not deny TCA's authority in the sector, but merely obliges it to the TA's opinion into consideration before taking any decisions regarding the telecommunications industry. On the contrary, it does not require the TA to seek the opinion of the TCA. *Regarding the ex-ante regulation*, the TA's authority is clear. Nevertheless, in certain cases if “the occurrence of serious and irreparable damages is likely until the final decision,” TCA has power to “take interim measures which have a nature of maintaining the situation before the infringement and which shall not exceed the scope of the final decision.”⁶ This power to take interim measures can be interpreted as if the authority of TCA extends to the ex-ante regulatory area. A protocol signed between two authorities to set rules on their coordination but the protocol has never been effectively implemented⁷.

⁵ The Act on the Protection of Competition. Act No: 4054, Date of Adoption: 7 December 1994. Available: <http://www.rekabet.gov.tr/word/ekanut.doc>

⁶ Article 9/4 of Competition Act

⁷ Atiyas (2006) offers an explanation for this situation: “At the risk of oversimplifying, one can say that the Telecommunications Authority is of the opinion that the Competition Authority does not have the authority to carry out competition investigations in the telecommunications sector. This position has not been openly stated in any policy document, but seems to be reflecting the dominant feeling at the TA.”

3. Two Case Studies from Turkish Telecommunications Industry

A conflict case study: The National Roaming Case

When competition authority and sector specific regulator both have powers on competition issues, they may both wish to attack anti-competitive conduct using their own tools. This double attack usually creates legal uncertainty, rather than a solid response to anti-competitive behavior and may pave the way for more prolonged anti-competitive conduct.

An example of such legal uncertainty is the roaming case of TCA, which was brought by the new entrant into the mobile telecommunications market, Aria, against the incumbent operators, Turkcell and Telsim. Aria, a joint venture of Telecom Italia and a prominent Turkish bank, entered the market in 2001, seven years later than the two incumbent operators, and has been promised a national roaming right in its concession agreement until it establishes its own nation-wide network, which it was obliged to do in three years. Apart from general competition law concerns regarding essential facility, the roaming issue is explicitly stated in the Telecommunications Law (article 10), which requires “mobile telecommunication, data operators or operators of other services and infrastructure as determined by the [Telecommunications] Authority are also required to satisfy reasonable, economically proportionate and technically feasible roaming requests of other operators.” This law makes Turkey one of the few countries where there exists an explicit policy of mandatory roaming.

Roaming is very critical for new entrants in mobile telecommunications market. Delays in attaining full coverage would seriously increase the cost of attracting subscribers, and the resulting delay in revenues would jeopardize the viability of the new entrant against the incumbents which are strengthening their dominance through the network externalities provided by new subscribers. After unsuccessful negotiations with incumbents, Aria applied to Telecommunications Authority in early 2001. After another stage of unsuccessful negotiations, in October 2001, TA determined the terms and conditions of the roaming agreement and asked the parties to accept them. Aria accepted, while the

incumbents declined and filed applications to International Court of Arbitration at the International Chamber, arguing that their initial concession agreements (signed in 1998) with the Turkish government did not involve a mandatory roaming obligation. In the meantime, they also sought for a preliminary injunction decision at the local administrative courts, arguing that and if they are forced to mandatory roaming and win the international arbitration (which Turkcell eventually lost in 2003), they may incur unrecoverable losses. Incumbent operators obtained preliminary injunctions in a few weeks. Consequently, Telecommunications Authority has been unable to force the incumbents to open their facility to Aria.

After these unsuccessful attempts, Aria filed a complaint to TCA in December 2001. Aria argued that the two incumbent undertakings have a jointly dominant position in the market, and their refusal to supply roaming services constitutes an abuse of dominance and hence a violation of Competition Act. TCA had two issues to decide before taking the case. First, TCA had to decide whether the case is at TCA's jurisdiction or not. TCA decided that the ex-post competition investigations are clearly in TCA's jurisdiction and hence started an investigation according to the Competition Law. Second, TCA had to consider Aria's request for interim measures (under the Competition Act) to end infringement by forcing the incumbents to sign roaming agreements. The Board refrained to impose such an obligation in order not to breach the ex-ante regulation power of TA.

The TCA's investigation lasted one and a half year and resulted in June 2003. The incumbents were found to have abused their dominance by declining Aria's requests for roaming and they faced the ever-large fine that TCA imposed in a case⁸. The Board also has power to force the undertakings to terminate their infringement of the Competition Act once the infringement is established⁹. In this stage, although it had power to determine the conditions of the roaming

⁸ Decision no: 03-40/432-186. Date: September 6, 2003.

⁹ Competition Act, Article 9/1: "If the Board, [...] establishes that articles 4, 6 and 7 of this Act are infringed, it notifies the undertaking [...] concerned of the decision encompassing those behaviour to be fulfilled or avoided so as to establish competition and maintain the situation before infringement [...]."

agreement between the parties, the Board again refrained to breach the jurisdiction of the regulatory authority and asked the TA to do so.

Meanwhile, deprived of national roaming, Aria had been unable to attract new subscribers and because of its losses went to international arbitration against Turkish government. At the end, the issue was resolved through meetings of prime ministers of Italy and Turkey, as Turkish government compensated the Telecom Italia's losses in Aria by merging it with the state owned fourth mobile telecommunications operator. In summary, although it was promised in its concession agreement, Aria, a new entrant to mobile telecommunications market, was denied of its right to access to infrastructure for two years. It would have established its own infrastructure in three years according to the very same concession agreement. However, after two years of regulatory and antitrust battle, Aria left the market.

The roaming case illustrates typical unfavorable outcomes of legal uncertainty. Firstly, as two authorities have powers regarding the same issue, the investigated undertakings argue in sector-specific regulator that the investigated conduct falls into the jurisdiction of competition authority; and vice-versa in competition authority. The process is delayed and even it is halted by the courts. Secondly, while regulatory authority's decisions were halted by the courts, the competition authority hesitated to take active action in order not to infringe the authority of the regulator. This is why TCA refrained to take interim measures and the infringement continued during the one and a half years of investigation. Moreover, because of the same reason, TCA hesitated to force roaming even after the abuse is legally established. It merely asked TA to do so and did not get a reply. Apparently, two agencies did not have good communication channels and have not collaborated effectively. Absence of a clear dialogue mechanism between two agencies made it impossible to have an effective division of tasks.

A collaboration case study: Competitive Market Design in Fixed-Line Privatization

Such a formal division of tasks has been achieved between TCA and Turkish Privatization Authority (TPA) on reviews of acquisitions through privatizations. The collaboration of two agencies is based on a communiqué of Competition Board¹⁰. Mentioned communiqué also establishes a strict time table for TCA and TPA while delineating their respective roles in the privatization transactions. With that communiqué, TCA has the jurisdiction in both ex-ante and ex-post privatization proceedings. Ex-ante review is achieved by TCA, in the pre-notification stage, by forming its opinion on the conditions of the bid in order to make them compatible with the competition legislation. After the bid, TCA reviews the first three bidders. Although the ex-ante opinion of TCA is not binding on TPA, competition authority may not approve the transaction after the bid in the notification stage. This mechanism has been very successful in maximizing the role of TCA in the establishment of competitive market structures after privatizations. Regarding telecommunications industry, this dialogue mechanism, up to now, has been beneficial through the privatization process of Turk Telekom A.Ş. (TTAS), the fixed line telephone operator. Below, we first review this experience and then suggest that it is possible to get inspiration from this partnership in designing a collaboration mechanism between competition and regulatory authorities.

The fixed line operator's privatization is a typical case of a potential conflict between short-term revenue-maximizing government and long-term promotion of competition because of the time-inconsistency problem as explained in Section 2. Privatizing infrastructure monopolies in "monopoly" form is a transfer of monopoly rents to the acquirer and hence raises the price of the privatized undertaking. Nevertheless, such a privatization strategy will yield a lot of competition problems in the future, especially about the access to infrastructure issues. Hence, a competitive market design in the privatization process is an efficient way of sustaining effective competition in infrastructure markets. An active involvement of competition authority in the privatization process may be beneficial in this market design process.

¹⁰ Communiqué No. 1998/5. See <http://www.rekabet.gov.tr/word/tebligeng11.doc> for the full text.

TTAS held the legal monopoly right in fixed line telephone services in Turkey until 2004. It also operated the cable TV infrastructure. Attempts to privatize TTAS date back to early 1990s but had not been successful as courts annulled numerous efforts. In every attempt, government tried to privatize TTAS with all its monopoly position and legal rights on infrastructure.

During the consultative process between competition and privatization authorities, TCA foresee that the cable TV infrastructure may be viable alternative to fixed line telephone network¹¹. The cable TV network, has transformed its function through technological process making two-dimensional transmission possible and with its voice and broadband internet services developed as a potential competitor to the traditional fixed-line network. TCA requested divestiture of fixed-line and cable TV networks (including legal rights to own and operate them) in order to be sold to different owners. The Telecommunications Authority argued that such a divestiture is not necessary; however it does not have primary authority in privatization process. The privatization process has been completed in line with the opinion of TCA, as fixed-line network was privatized, while cable TV network was divested and kept under state ownership to be privatized later. Upon TCA's opinion, the fixed-line network was not sold to the dominant player in mobile telecommunications markets, again in order to sustain competition between converging infrastructures.

There can be three lessons that can be drawn from the involvement of competition authority in privatization process: First, market design is crucial for promotion of competition in infrastructure services and in each case, although each infrastructure is a natural monopoly on its own, there can be room for a more competitive market design such as discovering alternative networks and separating their ownership. Such design can be achieved on case-by-case basis and with active involvement of competition agencies in the process. Second, in

¹¹ For the full text of the TCA opinion (August 4, 2004) see <http://www.rekabet.gov.tr/pdf/ttasozellestirmesi.pdf> (in Turkish). For an English summary, see the 2004 Annual Report of the TCA, available at: <http://www.rekabet.gov.tr/word/annual2004.doc> (page 19).

order to balance the revenue-maximization motive of government, the competition agency's role should be clear in legal terms. Otherwise, legal uncertainty will avoid an effective market design. Competition agency's role should involve both consultation prior to privatization and approval after it. If prior consultation role is not given, the competition agency will face the options that are given to it. However, prior consultation process provides an opportunity to the competition agency to involve in the design process and offer more competitive alternatives. As the privatization of infrastructure utilities is a market design process rather than a mere acquisition, active involvement in the first stages is crucial for promotion of competition. Third, a more competitive market design will reduce the room for competition infringements in the future, hence further reducing risk of conflict between regulation and competition agencies.

Towards a synthesis

While designing a formal collaboration mechanism between competition authority and sector-specific regulatory agencies, it is possible to get inspiration from TCA – TPA partnership. Two points are crucial in this design: First, the establishment of clear rules about the roles of two institutions and procedures of collaboration by a formal communique or a law minimizes legal uncertainty. Second, if authorities over ex-ante protection of competition and ex-post competition investigations are clearly separated, there will be no ambiguity regarding the jurisdictions of the institutions. In this regard, it would be natural for the ex-post investigations to be in the jurisdiction of the competition authority and ex-ante regulation in the authority of the sector-specific regulator. Nevertheless, it will be better to oblige the sector-specific regulator to take opinion of competition authority while taking steps to protect competition. This opinion may not be binding, but it will have three functions: First, it will provide more competition insight to the regulator. Second, it will supply coherence between ex-post actions of the competition authority and ex-ante actions of the regulator. In other words, the regulator will have opportunity to get an idea of what will be the ex-post interpretation of competition authority of a certain conduct. Lastly, as explained in

Section 1, involvement of competition agency reduces the risk of regulatory capture problem.

4. Conclusion

In this paper, by reviewing Turkish experience in telecommunications markets, we suggest that a co-existence of independent regulation and competition authority may be beneficial to make utilities industries competitive provided that some conditions are fulfilled: (1) a clear division of powers between regulatory and competition authorities, preferably by law or a joint communiqué, leaving ex-ante regulation to the jurisdiction of former and ex-post competitive investigations to the jurisdiction of the later; (2) formal communication mechanisms between two bodies; (3) competitive market design in the privatization stage. This co-existence model will minimize the institutional conflicts, while promoting competition in the utility industries.

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