

## COMPETITION FOR THE MARKET AND LIBERALIZATION: THE FRENCH EXPERIENCE

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**Abstract:** *Progressing from a state controlled economy to a fully liberalized market economy takes considerable efforts. Depending on the specificities of the markets and the sectors regulated, the opening of markets to competition can take different forms. Competition on the market is considered to be the traditional form of competition. Certain economic sectors, however, are not prone to this traditional form of competition, specifically in situations where natural monopolies seem to be the only viable solutions. This is where competition for the market can be a good substitute.*

*Competition for the market implies that a bidding process is organized to select the operator, which will be allowed to serve demand on a given market for a given time. Going through this bidding process is meant to introduce market mechanisms or, in other words, ex ante competition. As such, competition for the market contributes to put competitive pressure on monopolists, which is beneficial to consumers and users not only in terms of price and service quality, but also in terms of adjustment between supply and demand and access to information.*

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*Experience has shown, however, that several factors can hinder the expected benefits derived from competition for the market. In light of these difficulties, the French Competition Authority de la concurrence has developed solutions to unleash the full potential of competition for the market.*

*Naturally, once markets are liberalized, comes the time for regulation through enforcement actions as well as continued advocacy efforts toward government, incumbent operators and new market players.*

### 1. PROGRESSING FROM A STATE CONTROLLED ECONOMY TO A FULLY LIBERALIZED MARKET ECONOMY TAKES CONSIDERABLE EFFORTS

In France, the move to open markets to competition, which were previously governed by state monopolies, encountered strong resistance by fear of losing quality public service delivery.

At the time, change toward liberalization was indeed presented more like a constraint to comply with European law than an opportunity to do better and to benefit from more choice, lower prices, and innovative products.

The introduction of competition therefore inevitably requires an initial phase during which we have to explain to our government and parliament the benefits created by a more competitive economy.

The later phase, logically, is competition regulation through enforcement actions and continued advocacy efforts toward our

government but also toward incumbent operators and new market players.

## 2. COMPETITION ON THE MARKET AND COMPETITION FOR THE MARKET

Practically speaking, the opening of markets to competition can take different forms depending on the specificities of the markets and the sectors regulated.

Competition on the market is considered to be the traditional form of competition when competing market players offer the same products or services on a given market.

Certain economic sectors, however, are not prone to this traditional form of competition, specifically in situations where natural monopolies seem to be the only viable solutions. This is where competition for the market can be a good substitute.

Competition for the market implies that a bidding process is organized to select the operator, which will be allowed to serve demand on a given market for a given time.

Going through this bidding process is meant to introduce market mechanisms or, in other words, *ex ante* competition. The goal of having several operators bid for one market is to ensure that prices applied *ex post* are close to those of a competitive market. As such, competition for the market contributes to put competitive pressure on monopolists, which is beneficial to consumers and users not only in terms of price and service quality, but also in terms of adjustment between supply and demand and access to information.

Two examples of such market organization exist in France:

i. Highway companies hold geographic monopolies and each one operates a private monopoly on the highway whose concession right was granted to the company. This is a system of competition for the market where competition only takes place at the time of the award of the contract. It is only at that time that the holder of the concession right has negotiating power to set his conditions. He then loses his power until the end of the concession contract, which, in the particular case of highways, has a duration of several decades. The French Competition Authority, in the context of its opinion on highway concessions<sup>1</sup>, has thus sought to encourage the State to regain control in its upcoming renegotiation with highway companies.

ii. Local urban passenger transport is another sector characterized by such competition for the market. The French Competition Authority has therefore developed a rich consultative and decision-making practice in that sector. Public service delegations, akin to concessions, are the means by which local authorities in charge of delivering public transport services have sought to fulfill their mandate in France. Such concessions mix public aids with user remuneration, the core of the financing being derived from users. French law requires that

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<sup>1</sup> Opinion 14-A-13 of September 17, 2014.

such authorities organize a bidding contest<sup>2</sup> and follow certain requirements<sup>3</sup>.

However, it is not straightforward that transport services warrant, in every instance, a market organization which relies on public tenders rather than an all-out opening of the market to all apt and potential entrants. A case in point is the opinion the French Competition Authority issued regarding sea passenger transport from and to Corsica<sup>4</sup>:

iii. The French Competition Authority assessed the need for organizing the route from Marseille to Corsica on the basis of the granting of exclusive operating rights to one operator under a public service delegation: given the low occupancy rate of boats connecting Corsica from Marseille, resulting in unnecessary public expenditures, moreover detrimental to competition, the Autorité recommended at the very least to audit both demand and capacity to evaluate the need to reconsider the perimeter of the concession, if not abandon it altogether. A key measure of the need to proceed by the grant of exclusive rights is whether the market is faced by a lack of private initiative.

iv. The Autorité favored, in this case, a system of general obligations of public service applicable to all network lines generalizing

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<sup>2</sup> Law of January 29, 1993 on the prevention of corruption and transparency of economic activities and public procedures.

<sup>3</sup> Law of July 12, 1999 on reinforcing and simplifying inter-municipal cooperation. Law of December 11, 2001 on emergency measures for economic and financial reform.

<sup>4</sup> Opinion 12-A-05 of February 17, 2012.

social tariffs already applied on these two lines. The Autorité's recommendation was thus to shift from a model of competition for the market to a model of competition in the market.

Having browsed the circumstances in which competition for the market can arise, the question for debate is how the system has worked so far in practice.

### 3. THE CHALLENGES OF A COMPETITION FOR THE MARKET MODEL

As already mentioned, the rationale behind competition for the market is to create *ex ante* competition. It means that there should be a sufficient number of candidates, credible and effective, to maintain competitive pressure on incumbent operators.

But experience has shown that competition for the market, at least in the sector of passenger transport, faces certain obstacles, which may limit the expected benefits derived from this form of competition.

*i) The first factor for successful competition for the market is the precise characterization of the service required and clear definition of the award criteria*

In its opinion regarding the opening of a regular public transport service for passengers by river shuttles on the Seine river, the French Competition Authority indicated that "*the public service mission should clearly be defined by public authorities*"<sup>5</sup>. Likewise, in its opinion on

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<sup>5</sup> Opinion 09-A-44 of July 29, 2009.

maritime services to Corsica<sup>6</sup>, the clear and precise definition of the characteristics of the public service was presented as a necessary condition for the existence of an effective competition for the market.

Indeed, if the public authority is unable to precisely specify the purpose of the request for proposals (RFP), certain potential bidders – generally, competitors of the incumbent operator – may be discouraged from participating in the bidding process due to, *inter alia*, the cost of researching information to enable them to respond. As the Autorité has emphasized, “*by improving the quality of information they provide, [transport organizing authorities] reduce the cost of information acquisition borne by transporters (...) [which] is likely to encourage them to file more (...) bids*”<sup>7</sup>.

It was said in the same decision that “*(...) the cost of preparing an offer or the insufficient quality of an RFP may dissuade potential competitors from bidding*”, and a “*reduction in the number of candidates in future RFPs is likely to have two results: a price deterioration in bids submitted to transport organizing authorities and less variety in responses to RFPs*”.

In addition to the cost of preparing a response to an RFP, other obstacles can hinder participation of potential candidates to bidding procedures, such as linguistic barriers for foreign competitors and various administrative burdens.

Among administrative burdens, the very short delay for submitting bids or obligations made to the bid winner to change its ships’ flag, amend the choice of law provision of its employment contracts, have French-speaking staff, provide development projects for the locality, hold a distribution network already in place, and provide a large fleet of ships of less than twenty years of age have been considered by the French Competition Authority to strongly discourage participation in the renewal of the public service delegation contract for ferry services to Corsica from the port of Marseille<sup>8</sup>.

*ii) The lack of competition in contract renewals is another major factor for the effectiveness of competition for the market*

At the contract’s renewal stage, the incumbent operator may have a clear advantage, which is a significant obstacle to effective competition.

In the passenger transport sector, the cost and nature of tangible assets are not a significant obstacle to participation as the rolling stock, which represents a significant part of the capital required for providing the service, is a mobile asset easily transferable from one network to another and happens to be, in most cases, owned by the organizing authorities. As for basic facilities, such as terminals and depots, they are the ownership of local authorities.

However, the experience acquired by the incumbent operator with the organizing

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<sup>6</sup> Opinion 12-A-05 of February 17, 2012.

<sup>7</sup> Decision 10-DCC-198 of December 30, 2010 Veolia Transport and Transdev.

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<sup>8</sup> Decision 06-MC-03 of December 11, 2006 and decision 09-D-10 of February 27, 2009.

authority on the network's and demand's characteristics, as well as the contract's requirements (including the more or less mandatory nature of quality objectives) gives it an undeniable advantage over its rivals<sup>9</sup>. A market test conducted by the French Competition Authority for the Veolia Transport-Transdev merger in the urban transport sector clearly revealed that *"the incumbent operator benefits from an advantage over its rivals, which correlates, primarily, with its in-depth knowledge of the network."*<sup>10</sup>

This reflects the fact that "pure" bidding markets are extremely rare in practice and that market deficiencies can easily lead to incumbencies. Such incumbency advantages were appraised, in quantitative terms, through the observation of renewal rates and the extent to which the parties have already won tenders in the same geographic zone. Another interesting feature observed by the French Competition Authority in the context of merger control is that of possible correlations between the margin levels of the winning bidder and the number of competing bidders.

*iii) A third factor is the – perhaps higher – risk of collusion in the context of competition for the market*

As much as competition on the market, competition for the market can be undermined by cartels. Some even maintain that competition for the market, because bidding procedures may facilitate exchanges of

information, is more open to collusion than competition on posted-prices markets.

An aggravating factor is the existence of multimodal operators having multi-markets contacts. If the Autorité recognized that intermodal supply *"opens the possibility to develop cost synergies, [which] can be pro competitive because, by increasing production as a whole, they yield cost and then price reductions for the benefit of buyers"*<sup>11</sup>, it also warned that *"a deviation on one of the markets can lead to retaliation on all others, which is likely to strengthen the stability of a possible coordination"*.

#### 4. SOLUTIONS FOR EFFECTIVE COMPETITION FOR THE MARKET

In light of these difficulties, the Autorité proposed several solutions to try to unleash the full potential of competition for the market:

*i) Developing the skills of organizing authorities to foster a larger participation*

This is what the French Competition Authority advocated back in 2010 in its Veolia Transport-Transdev merger decision<sup>12</sup>: *"The professionalization of organizing authorities regulating transport, by providing better information to respondents (through clearer and more sophisticated RFPs), can actually have a positive impact in stimulating the number of candidates."*

This recommendation applies particularly to the urban transport sector, where the growing demand for intermodal passenger transport, combined with the extension of transport areas due to the development of inter-municipality,

<sup>9</sup> Decision 10-DCC-02 of January 12, 2010 Keolis and Effia.

<sup>10</sup> Decision 10-DCC-198, cit.

<sup>11</sup> Decision 10-DCC-198, cit.

<sup>12</sup> Decision 10-DCC-198, cit.

complicates the bidding process. The Autorité recommended for this sector that organizing authorities should use project management support services as these services "*could enable better identification of their urban transport needs [and] (...) thereby promoting improvement of selection criteria used in RFPs. Such improvement could [therefore] lead to better allocation of (...) contracts*".<sup>13</sup> The Autorité made the same suggestions in the maritime transport sector for services to Corsica<sup>14</sup>.

*ii) Improving contracts by facilitating asset transferability and offering network allotment to limit advantages to incumbent operators*

Introducing right to audit clauses in contracts in order to assess the contractor's assets at the beginning and at the end of the contract, as well as the characteristics of the investments made during the time of the contract, can help determine the possible indemnity for the incumbent contractor. In situations where the duration of the contract is inferior to the lifetime of the assets (making investment amortization more risky), having a clear assessment of the capital of the incumbent contractor is valuable information at the time of the contract's renewal because the capital used can then be more easily transferred and sold to potential new contractors.

Clauses providing for the transfer of personnel and the transfer of intellectual property and software from one contractor to another can also be introduced to reduce comparative advantages of the incumbent.

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<sup>13</sup> Decision 10-DCC-198, cit.

<sup>14</sup> Opinion 12-A-05, cit.

If all such solutions can clarify the contract exit terms for the current contractor and reduce the bid costs for new candidates, contractors should, however, not be discouraged from investing.

Allotment of networks can also be a means to reduce information asymmetries between public authorities and contractors. Allotment consists of dividing the contract into several lots, either by type of transport or by line or geographical area to enable increased competition. The French Competition Authority pointed out in its opinion on public passenger road and rail transport<sup>15</sup> that "*Dividing networks into lots, whether according to transport methods (metro, tramway, bus) or geographically, could stimulate competition, facilitate the entry of new operators and the emergence of new services*", even though "*the question of allotment of urban transport networks raises a certain number of issues, including that of reconciling the expected performance gains from increased competition with the potential costs of coordination between different lot operators in the same network*". Studies and international experience have, indeed, shown that the loss of economies of scale generated by network fragmenting is more than offset by the benefits of increased competition.

*iii) Implementing innovative solutions, such as the creation of a fund for the promotion of competition, to optimize bidding procedures*

In the merger between Veolia Transport and Transdev in the urban transport sector, the French Competition Authority authorized the commitment by the parties to finance the

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<sup>15</sup> Opinion 09-A-55, cit.

creation of a fund of 6.54 million Euros for the reimbursement of all or some of the bidding costs of unsuccessful candidates in RFPs for the transport network of which Veolia Transport or Transdev is an incumbent operator, and for the financing of project management support services for small local authorities.

Other innovative solutions have been negotiated by the French Competition Authority and parties, for example in the acquisition by GDF Suez of the sole control of Ne Varietur in the heating networks sector. GDF Suez was in charge of managing several localities' heating networks under public service delegation contracts. Because the proposed transaction would have resulted in a higher market concentration, GDF Suez offered commitments in which it allowed two local authorities to unilaterally terminate their ongoing public service delegation contracts with Ne Varietur's subsidiaries, without compensation, in order to foster competition for public service delegation contracts long before they were due to expire and in two regions where competitors had difficulties to penetrate the market. GDF Suez also undertook to allow a competing operator to unilaterally terminate its subcontracting agreement with Ne Varietur for the management of the heating network of a third locality in order to alleviate concerns about its capacity to exercise an independent competitive force on the market.

All in all, these solutions aim at promoting competition and contribute to reduce the risk of collusive behaviors.

## 5. THE TIME FOR REGULATION

Of course, after the award of the contract, comes the time for regulation.

Coming back to the case of highways, once the concession right is granted, it is no longer the domain of competition, but of regulation. Politically and democratically speaking, all monopolies must be regulated, all the more so for private monopolies.

Highways companies, holding private geographical monopolies, must be regulated to avoid that they constitute unjustified rents for themselves to the detriment of users held captive. In its opinion<sup>16</sup>, the French Competition Authority considered that the exceptional profitability of "historic" highway companies was largely unrelated to their costs and the risk involved, and was as such comparable to a guaranteed income. The Autorité therefore issued a number of recommendations to regulate the sector in a sense more favorable to the State and users. One of them is the introduction of a new formula for calculating tolls taking into account traffic growth.

In another case already mentioned regarding the maritime transport services by ferry to Corsica<sup>17</sup>, the Conseil, at the time, examined and sanctioned the improper practices of the incumbent operator, in a dominant position, who had submitted a global bid indivisibly grouping all network lines (without

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<sup>16</sup> Opinion 14-A-13, cit.

<sup>17</sup> Decision 09-D-10 of February 27, 2009; Paris Court of appeals, March 9, 2010; *Cour de cassation, chambre commerciale*, June 21, 2011 SNM – decision upheld.

simultaneous bids on each individual line). This was considered to be a tactic to exclude rivals and to restrict the ability of the organizing authority to compare the different competing bids.

The Conseil's decision was upheld by the Paris Court of appeals: *“in this case, SNCM, the incumbent operator, knew that it would be if not impossible, then much more difficult for other companies to submit a global bid and that it would, in all probability, be the only bidder, (...) as a result, by not giving the OTC [Office of Transport of Corsica] the means of checking its competitiveness line-by-line on opening of the bid envelopes, SNCM encouraged it to focus on the global bid thereby fostering the exclusion of operators whose bids were restricted to certain lines; (...) in doing so, it hampered competition both on prices and on the merits by taking advantage of its position as incumbent operator with a dominant position; (...) indeed the figures given by the Conseil de la concurrence (...) show clearly that the pricing in the SNCM bid of August 2006 was supra-competitive and did not reflect the improved performance expected from a global bid”*.

In the end, competition agencies must take care to contribute to the establishment of an environment, which allows local authorities to weigh the comparative advantages of direct or delegated intervention versus an all out opening of the market. As enforcers, we must also secure down the road the benefits of an effective framework for awarding concessions by pursuing collusive behaviors and foreclosing strategies.

This balance between soft and hard powers has helped us gain momentum in the liberalization of sectors of the economy but this is not the end of the story yet.

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