Competition
benefits us all.

Competition
is a duty
of all public
authorities.

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CNC
COMISIÓN NACIONAL DE LA COMPETENCIA

Contents

Presentation

Whether as individual consumers or businesses, we all go to the market to satisfy our needs for goods and services. In this process the existence of free competition is the best guarantee that we can all choose the product or service best suited to our preferences and needs and obtain the best quality for our money at all times.

A competitive playing field spurs businesses to improve the quality of their products and services and keep their prices in check. Competition thus comes to the forefront as a key stimulus for innovation, technological innovation and the quest for more efficient means of production.

Safeguarding competition is a goal incumbent on all government authorities. This objective is rooted in article 38 of the Spanish Constitution, which recognises the right to engage in free enterprise within the framework of a market economy, while at the same time charging "government authorities" with guaranteeing and protecting that right.

What can government do to contribute to safeguarding competition? The task of investigating and sanctioning conducts of enterprises or other market players that seek to restrict competition, for example, by agreeing price minimums, rests with Spain's competition authority, the Comisión Nacional de la Competencia (CNC), and with its counterparts in the regional governments (Autonomous Communities). But, beyond actions of this type, officials can and must do something of yet even greater importance: regulate efficiently from the standpoint of competition.

That is to say, they must make sure that it is not governments themselves that are unduly inhibiting competition through their policymaking or administrative acts.

The CNC has already advocated this approach in its Report *Recommendations to Public Authorities for More Efficient and Pro-competitive Market Regulation,* published in June 2008. That report lays down the principles of good pro-competition regulation: necessity and proportionality, least distortion, effectiveness, transparency and predictability.

Subsequent to that Report, in line with what has been done by our partner countries and international organisations such as the European Commission and the OECD, our aim now is to offer government authorities a tool that can give them guidance and support in designing laws and regulations in a way that avoids introducing unjustified restrictions of competition.

The purpose of this Guide is therefore to help authorities to better comply with their duty to protect free enterprise and the proper functioning of markets. As instrument to pursue this end the CNC proposes the *Competition Assessment Report,* already referred to in the *Recommendations* issued by the CNC.

Application of the guidelines contained in this Guide by a given government administration will not diminish the functions which rest with the CNC under the Spanish Competition Act 15/2007 of 3 July 2007 (Ley de Defensa de la Competencia — LDC) or, as applicable, with regional competition authorities, in particular, as regards the prosecution of prohibited conducts, issuing of reports on legislative developments that affect competition, and the authority to bring challenges before the competent jurisdiction against administrative acts and legislation of lower ranking than the LDC that give rise to obstacles for the maintenance of effective competition in markets.

Luis Berenguer Fuster
President

What is the Competition Assessment Report?

The analysis and assessment of the competition implications of a legislative or regulatory proposal.

The name *Memoria de Competencia* has been used for the sake of consistency with the other reports that must accompany all legislative developments: the *Memoria Justificativa* (explanatory report), the *Memoria Económica* (economic report) and the *Memoria de Impacto de Género* (gender impact report).

Why is it done?

The approval of a new law or regulation is capable of giving rise to effects on how free competition works in markets. Those effects may be negative, that is, harmful to competition, to free enterprise and to consumer interests.

Consequently, this requires that whenever new legislation is proposed, it should be evaluated from the very outset in terms of whether it will introduce negative effects on competition that are not justified by the objectives pursued by the law or regulation or which could be mitigated by using some other regulatory alternative.

In which cases should it be done?

In the opinion of the CNC, this type of analysis and assessment should be done at all levels of government action.

This means it should not just be confined to legislation of highest ranking, such as statutes and royal decrees, but instead be applied to rules of lower priority (orders, resolutions, etc.) and even administrative acts, given that restrictions on competition are often introduced not in the basic texts, but in the rules that implement and apply them.

Who should prepare the report?

The bodies proposing the law or regulation, as occurs with the other analyses incorporated into the explanatory, economic and gender impact reports.

The reason is that the aim of the report is not so much to produce a document stating that a regulatory development restricts market competition unduly or disproportionately, or that some other regulatory alternative would have been more appropriate from the standpoint of competition, as it is to have the proposing authority be aware of these questions and avoid the problem.

When is it done?

From the moment the proposal begins to be designed. The drafters of the law or regulation or of the administrative act should be mindful, from the very beginning, of the need to analyse and assess the effect on competition in order to avoid developing proposals that are flawed as from the first drafts.

What are the advantages of preparing this assessment?

Regulation that achieves its objectives effectively without unduly hampering competition.

Therefore, making a competition impact analysis can only give rise to higher quality regulations, policy and administrative action, more in keeping with the constitutional principle of free enterprise in a market economy.

How should it be prepared?

This Guide offers a procedure for analysing and assessing the competition implications of a legislative development or administrative action. The approach has been made deliberately simple and straightforward, arranged in three steps.

Step 1. Identification

Identify the possible negative effects on competition that may be generated by the projected law or action. Identification is based on applying a checklist of key questions that, in a highly intuitive manner, help the user to "think" from the competition perspective and spot possible problems.

If no potential competition problems are identified in the proposal, the reasons for this conclusion must be described in the Competition Assessment Report before the procedure can be considered completed.

If, on the other hand, the proposal is found to include provisions or mechanisms capable of restricting competition, then the next steps in the analysis will have to be carried out.

Step 2. Justification

Justify the restrictions on competition that have been identified. This involves analysing the objective pursued by the regulation in order to evaluate how necessary those anti-competitive constraints are for achieving that purpose and their proportionality.

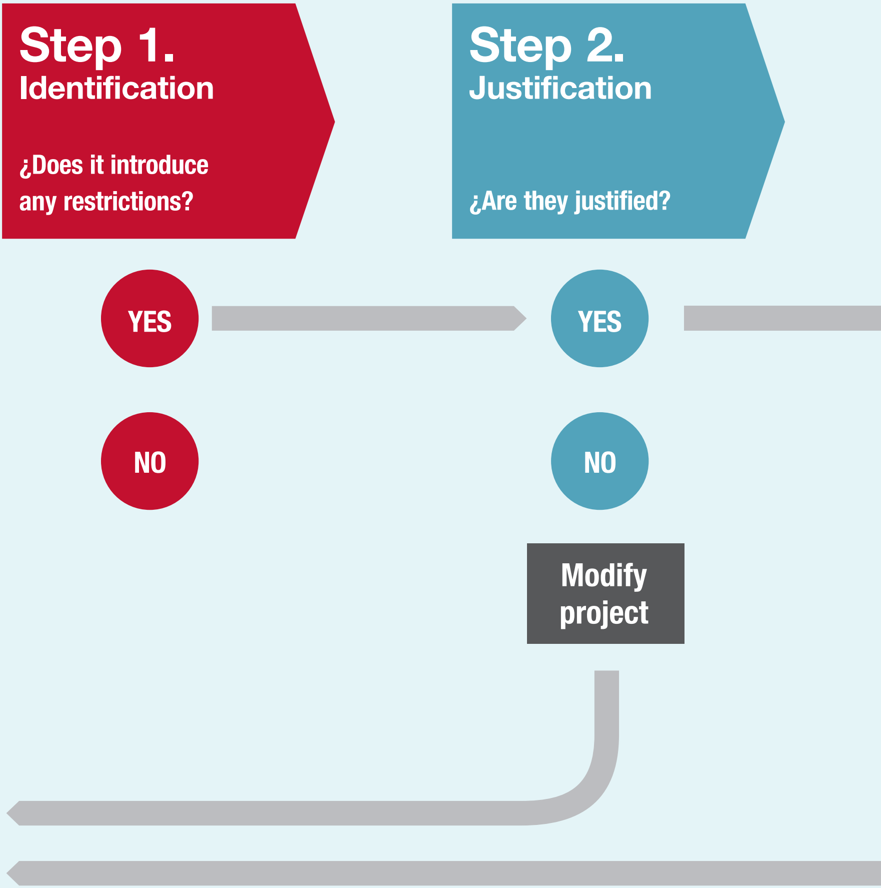
If the anti-competitive restriction whose introduction is proposed cannot be justified, then the proposal will have to be modified accordingly.

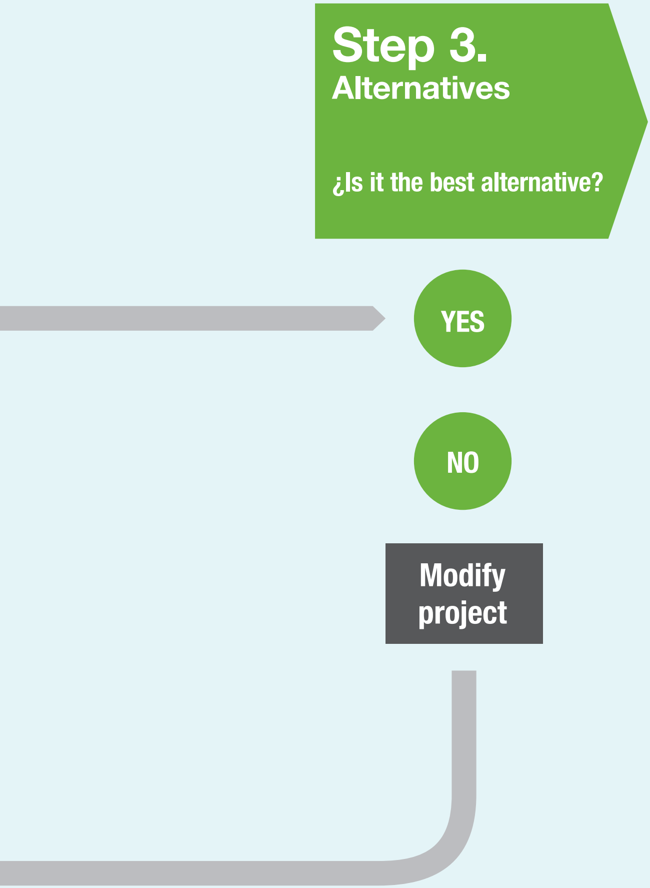
If, conversely, justification can be found for the restriction's necessity and proportionality, then we must consider whether the measure is properly designed or if there is a regulatory alternative with less anti-competitive effect. This is an indispensable task and the purpose of the next step.

Step 3. Alternatives

Analyse the regulatory alternatives. This involves determining if there is an alternative mechanism that allows the same objective to be achieved but without constraining competition or, at the least, restricting it to a lesser degree.

If such a less restrictive regulatory alternative is identified, then it should be adopted.


Step 1.
Identification
¿Does it introduce any restrictions?
Step 2.
Justification
¿Are they justified?
YES
NO
YES
NO
Modify project


Step 3.
Alternatives
¿Is it the best alternative?
YES
NO
Modify project

Step 1.

Identification

Identification

How do we determine if a proposal is likely to have detrimental effects on competition?

A good part of regulatory proposals and administrative measures can impact how competition functions.

That is why the first step we must take is none other than to identity those cases in which the initiative can affect competition negatively.

Toward this end, the following box includes a brief checklist, in line with the one utilised by the OECD, that allows us to quickly and easily spot the existence of features of the proposal that may affect competition.

It is important to bear in mind that this first step does not involve trying to assess whether those aspects are or are not justified. The point is to identify them only, without prejudging, at this point, their necessity and appropriateness.

The checklist of questions consists of three core questions. Each of them is broken down into a series of cases meant to serve as illustrative examples, but which should not be taken as a complete and closed set.

Does the proposal have the potential to produce any of the following three effects on competition?

1. Does it limit the number or range of operators in the market?

This may be the case if the proposal:

1.1 Grants exclusive rights for an operator.
1.2 Establishes a licensing, permit or authorisation process to operate in the market.
1.3 Limits the ability of some types of operators to provide their goods.
1.4 Significantly raises cost of market entry or exit by an operator.
1.5 Creates a geographical barrier to the free movement of goods and services.

2. Does it limit the ability of operators to compete?

This may be the case if the proposal:

2.1 Controls or substantially influences the prices for products.
2.2 Limits the possibilities of operators to market their products.
2.3 Limits the possibilities of operators to advertise their products.
2.4 Requires technical or quality standards for products that provide an advantage to some operators over others.
2.5 Treats operators already present in the market differently from new entrants.

3. Does it reduce the incentives of operators to compete?

This may be the case if the proposal:

3.1 Creates a self-regulatory or co-regulatory regime.
3.2 Requires or encourages publication of information on operator outputs, prices, sales or costs.
3.3 Increases the costs for a customer of changing suppliers, reducing mobility of consumers.
3.4 Creates regulatory uncertainty for new entrants.

We will now analyse in greater detail how each case mentioned in the above box can be harmful to competition. For the sake of better understanding, examples are given; remember that these are illustrative examples in which potential competition problems are identified, without any assessment being made.

It is also important to keep in mind account that the classification used here is only used for the sake of organising the discussion, and should not be interpreted as establishing rigid categories. Quite the contrary, the problems identified can at times fall into more than one category.

1

The proposal limits the number or range of operators in the market

In general terms, competition is invigorated where there exists a large number of operators competing on price and in the quality and variety of goods or services in the market in question.

Conversely, if the proposed regulation or administrative measure directly or indirectly provokes a reduction in the number of players in a market, competition will be diminished because of the lessened pressure to compete and the greater possibilities of engaging in anti-competitive conduct, such as price-fixing or market-sharing agreements.

1.1

Grants exclusive rights for an operator

When an operator enjoys exclusive rights in a market, competition “in the market” is eliminated.

Establishing exclusivity to operate in a market is perhaps the most severe restriction of competition, as it means creating a legal monopoly, that is, a situation in which consumers have only one supplier to go to in order to acquire a product or service.

Indeed, no competition exists “in the market” in such situation, and only competition “for the market” is possible, that is, ex-ante competition between operators through different channels (competitive tenders, auctions, etc.) to obtain the right to do business in the market to the exclusion of all others.

Example: Intercity passenger transport by road

The type of transport is a public service of the government, provided by being allocated to an undertaking by public bid for the corresponding exclusive government concession. The concession system makes competition “in the market” impossible (in this category of transportation, though other forms of transportation may exist), because there is a single service provider and the price of the service is conditioned by the government concession.

There can only be competition “for the market”, in the form of the competitive tenders for award of the concessions. This competition “for the market” in turn is diminished if the concession terms are too long or if there exist barriers to entry in the concession market, such as, for example, preferential treatment for incumbent concessionaires when a new tender is held.

1.2

Establishes a licensing, permit or authorisation process to operate in the market

Licences, permits or authorisations required for operation limit entry by competitors in a market.

The very act of establishing a licensing system, permits or authorisations to be able to do business in a given market generates a restriction of competition by limiting the operators who can compete there. Such restriction can be accentuated by the characteristics of the licensing system.

Thus, on the one hand, the specific requirements established for obtaining the licence, permit or authorisation will have an influence, as these are the conditions that define the “barriers” to entry in the market. The type of requirements that may be imposed is very diverse: minimum capital, number of employees, size of premises, formal qualifications, proven experience, geographical location, etc.

Furthermore, the negative effect on competition will be further aggravated if the number of licences, permits or authorisations to be granted is fixed, because such arrangements can prevent even operators who meet all the requirements from competing in the market.

Lastly, it must not be overlooked that overly lengthy procedures for obtaining licences, permits or authorisations give time advantages to incumbent operators over those looking to enter the market.

Example: Opening of pharmacies

On the one hand, there is a formal qualification requirement, as only pharmacists can own and operate pharmacies. The requirements for opening these outlets sometimes include proof of prior experience in the local area in question.

Also, the number of pharmacies may be limited as a function of the population and the stipulated distance between pharmacies.

Example: Second licence for large department stores

Opening large retail establishments is subject to fulfilment of requirements of an economic nature. For example, grant of the authorisation is made conditional on evidence that the area in question does not have sufficient commercial services and on the effects the new large shopping complex will have on those services.

Example: Reservation of activity for degree holders

Reserving an activity for holders of a specific formal qualification can be done through a concrete law or regulation or by means of the requirements laid down for professionals to be able to provide their services. Both situations can prevent competition from other professionals who hold different but equally suitable qualifications for pursing that activity.

1.3

Limits the possibilities of some types of operators to offer their products

This limitation usually arises in the sale of goods to the public sector. Given the large volume of purchases made by government, restricting the participation of suppliers in those procurement processes can severely hamper competition in certain markets.

At times, government seeks to give some level of preference to operators with special characteristics, such as small businesses, participants in certain employment policies, enterprises from targeted regions or companies that sell a given variety of products.

All this reduces the possibility for some operators to compete in the market, and this is even more harmful when the public sector is the lone or principal customer for the product or service in question.

Example: Classification system in construction and service contracts

This classification system is a method for ex ante, one-time accreditation of the economic capacity, creditworthiness and technical capabilities of enterprises that want to obtain certain government contracts. The result of the classification will determine which contracts they can bid for according to their subject matter and value, with the operators being classified into predefined groups, subgroups and categories. The way such systems are designed can generate barriers to entry that restrict competition; in particular, they can contribute to disqualifying operators who are otherwise financially and technically qualified from obtaining the contract in question.

Example: Specifications of tenders for government contracts

The tender specifications document known as "pliego" is the prime competitive element in government procurement procedures. The criteria and weightings used to evaluate and score bids are discretionary elements of the contracting authority which will in great measure determine the result of the tender. Those criteria can restrict the ability of new operators to enter a market, for example, where the rules on how awards are to be made are imprecise, or certain factors that favour incumbent operators are overweighted in the evaluation process.

1.4

Significantly raises cost of market entry or exit by an operator

Rules that raise the costs of entry to or exit from a market tend to discourage new entrants, thus reducing the number of potential competitors.

Entry costs, for example, can be increased where more demanding requirements are imposed for demonstrating a new entrant's financial or operating capacity: requiring a minimum capital figure, previous raw material supply contracts, certain fixed assets or staffing levels, etc. All of these conditions force the new operator to make greater outlays or initial investments to be able to enter the market and can impact its decision on entry.

Market exit costs, on the other hand, can be made higher, for example, by stricter than normal ecological or health and safety requirements in certain industrial facilities. Since these imply the need for specific investments, such conditions can raise the cost of closing a business line. Higher costs of this type can also influence the decision on whether or not to enter a market.

In short, the effect of such measures can be to reduce the number of operators, given that higher entry and exit costs will affect the business' margin and deter entry by new operators.

Example: Driving schools

The regulations on driving schools mandate a minimum size for the premises used by these companies: classroom of 20 m^2 or of 30 m^2 in some cases, reception and information area, and director's office.

These rules also stipulate that the number of vehicles cannot be lower than the number of teachers working at the centre.

Example: Provision of funeral services

There are legal rules regulating entry in this market with requirements regarding the number of coffins available, funeral vehicles, staffing levels, etc.

1.5

Creates a geographical barrier to the free movement of goods and services

In general, these restrictions artificially reduce the size of the market and thus lower the number of potential competitors.

When geographical barriers to the free movement of goods and services are introduced, consumers see a narrowing of variety on the supply side.

In effect, reducing the geographical scope of the market constrains product innovation and differentiation, with the attendant harm to consumers, who see a limiting of the products and services available to them.

Such arrangements can also give rise to greater concentration in the power of operators, making collusion easier, for example, to engage in price fixing or conducts that constitute abuse of dominant positions.

Example: Funeral transportation

The original regulation on funeral transportation limited the provision of this service to companies established in the same municipality as the transportation origin. Lawmakers later corrected this situation by removing this rule, so that the relevant authorisations now entitle the holders to perform funeral transport services irrespective of the route.

Example: Elevator maintenance companies

Provision of this service is conditional on the operator's registration in a local register of maintenance companies. The relevant regulations require the company to have a permanent delegation in the local area in question in order to be inscribed in the register.

Example: Mandatory membership in professional association limited to a specific geographical area

Requiring that a professional must belong to the official professional association in an Autonomous Community, when the same profession can be pursued in the rest of the country without such membership requirement, restricts the number and variety of professionals whom consumers in that Autonomous Community can deal with.

2

The proposal limits the possibility of operators to compete

The fact that a proposed regulation or an administrative actions does not limit the number of operators does not mean that it does not introduce other types of elements that hinder operators who are "permitted" to enter the market from freely competing there.

2.1

Controls or substantially influences the prices for goods or services

Price controls usually take the form of government setting minimum or maximum prices for certain products, severely or completely hindering the ability of operators to pursue price reduction or differentiation strategies to compete in the market.

Prices may be controlled either directly, with the regulation itself laying down certain price limits or conditions, or indirectly, in those cases where the regulation leaves the establishment or control of prices in the hands of a specific institution, organisation or entity.

When maximum prices are set, the intensity of competition between operators may be lessened in such way that they all end up applying the maximum price without discounts for consumers and customers. They also act as a disincentive for suppliers who prefer to compete on innovation or quality instead of on price.

Minimum prices have the effect, amongst others, of protecting entrenched operators from price competition, as the presence of a price floor can deter more efficient suppliers (who may have lower costs or better technology) from offering their products at prices below the minimum.

Lastly, it must be considered that prices initially designed as illustrative can end up functioning as fixed prices in the market, with the consequent impact on competition, because they serve as a natural benchmark that makes it easier for rival suppliers to coordinate their pricing strategies.

Example: Book prices

The legal regulations governing the book trade stipulate that books will have a fixed price, and limit retailer discounts to no more than 5% below that fixed price.

Example: Fees of “procuradores” and illustrative fees of professional associations

The mandatory fee or charge payable to the court attorneys known as “procuradores” are fixed in a Royal Decree, although variations of up to 12% above or below the stipulated level are allowed.

For other self-regulated professions, the law allows their professional associations to establish illustrative fee schedules.

Example: Retail markups in pharmacies

The regulations governing the healthcare sector set the retail margins that can be obtained by pharmacies and wholesalers.

Example: Collective bargaining agreements

There are cases where industry agreements regulate not just the salaries employers must pay to their workers, but also set minimum mandatory prices below which companies in the sector cannot offer their services.

2.2

Limits the possibilities of operators to market their products

Regulations that limit the freedom of operators to market their products restrict some of the instruments those operators can use to compete in their prices and in the quality of the goods and services.

Suppliers competing in a market, especially if they offer very similar or easily substitutable products, must look for ways to differentiate their products and services, not just in price but in quality and innovation as well.

This makes it important that the possibilities for different operators to pursue their business differently not be unduly restricted, because this makes it harder for consumers with distinct tastes and preferences to benefit from likewise diverse offerings.

Example: Regulation of business hours, discount sale calendars and terms of payment

Regulations on retailing regulate store hours and, at the same time, limit the number of sales seasons retailers can offer each year, fixing their calendar timing and length.

Example: Tobacco sales

Tobacco sector regulations prohibit sales except in the network of official tobacco and stamp outlets or through vending machines at marked up prices.

Example: Travel agencies

Regulations require that premises of travel agencies be used only for activities proper to such agencies and independently of other adjoining business premises.

Example: Vehicle rental

The regulations provide that leasing vehicles with drivers must be contracted before the service is rendered in the offices or premises of lessor companies located in the municipality covered by the relevant authorisation.

Example: Production quotas

Some rules designed to protect the origin and quality of agricultural products allow the semi-autonomous bodies that govern denominations of origin, known in Spain as Consejos Reguladores de las Denominaciones de Origen, to establish production ceilings, along with upper limits on product brought to market.

2.3

Limits the possibilities of operators to advertise their products

Advertising restrictions hinder the free play of the market by constraining the ability of consumers to draw comparisons between goods and services offered by different operators.

Restrictions on advertising and on promotional strategies can reduce a company's capacity to inform potential consumers of its presence in the market and of the nature of the products it is able to offer.

Such limitations are especially harmful to new entrants in the market, as they may need such promotional activities to appeal to prospective customers. They are also detrimental to the more efficient operators, because operators are thus prevented from advertising the advantages they have to offer to consumers.

In this regard, the restrictions on price-comparison advertising has the clear effect of reducing the degree of competition in the market and, ultimately, preventing consumers from benefiting from competition between operators. Such comparative advertising techniques are mainly used by new entrants, who find that contrasting the advantages of their goods and services with those offered by the entrenched operators to be a useful and effective means of positioning themselves in the market.

Example: Advertising of professional services

On many occasions, advertising of the services governed in Spain by the professional associations known as *Colegios*, “colleges”, is limited by the rules of those bodies, which can even prohibit making comparisons with other professionals or references to the prices or fees charged.

2.4

Requires technical or quality standards for products that provide an advantage to some operators over others

Technical or quality standards can sometimes be more easily met by certain operators than by others, with the consequent effect on their ability to compete in the market.

Quality requirements may go so far as to restrict the freedom of suppliers to offer products of different qualities with the aim of satisfying different types of demand.

Technical standards can likewise limit the production or innovation possibilities of certain operators vis-à-vis others.

Example: Cement

The technical Instruction for reception of cement in force in 2003 established the obligation to carry out testing to identify imported products, even where they bore the *CE marking*. This meant, in practice, that the technical specifications of the product where checked and verified, and thus subjected to a redundant quality control that acted as a barrier to entry for these imports.

Example: Cable telecommunications

The original regulations on cable telecommunications temporarily limited the services provided by cable network operators to television broadcasting and certain value-added services, with a temporary prohibition on being able to offer telephony and other services, even those these were technically feasible. This created a different playing field for telephony carriers as a function of the technology they used.

Example: Catering in low-cost flights

Many consumers prefer to fly with a low-cost airline even though it does not provide paid onboard meals. Putting a rule in place that requires airlines to provide onboard meals free of charge would ignore the interests of part of the demand in this market and restrict the freedom of operators to offer differentiated products with the aim of meeting a differentiated demand.

2.5

Treats operators already present in the market differently from new entrants

Any treatment that places some operators in a privileged position with respect to others distorts competition in a market.

Examples of regulations that may affect different market players differently, place some of them in a more advantageous situation than others, include the obligation to use a certain technology, normally the one already utilised by the market incumbents, instead of an alternative.

Another type of regulation that frequently privileges entrenched operators over new entrants are the so-called “grandfather clauses” that require newcomers to the market to meet more stringent standards than the current operators, with the latter remaining subject to the previous less restrictive rules.

Example: Authorisations for new operators of over-the-road freight carriers

Regulations on authorisations for carriage of goods by road stipulate that to obtain new authorisations, the applicant must have at least three vehicles that have been in service less than five months. There was also a requirement on minimum number of drivers, but this has been eliminated.

3

The proposal reduces the incentives of operators to compete

This section analyses those aspects of regulations that can affect the decisions of players in a market and which, though they may appear not to have a direct effect on competition, do have an indirect impact because they lessen the incentives of operators to compete.

3.1

Creates a self-regulatory or co-regulatory regime

There is the risk that rules developed by an industry or by professional associations with the aim of regulating the pursuit of the activity will have an anti-competitive impact.

When a professional association or some other organisation takes full responsibility for regulating the conduct of its members, without government legislative backing, the term “self-regulation” is used. Where the government provides legislative backing to rules developed by the professional associations or other entities, this is described as “co-regulation”.

In practice, there is a significant risk that the rules developed by the industry or professional associations will have negative effects on competition. In particular, the fact that it is the market participants themselves who regulate their activity can give rise to restrictions on entry of new operators in the market or that reduce the ability of operators to compete.

Example: The self-regulated professions

The regulation of the professional associations know as Professional Colleges give these bodies power to regulate the professional activity, which they have used to dictate a series of compulsory rules for their members on matters of prices, advertising and other questions that have major implications for competition.

3.2

Requires or encourages publication of information on operator outputs, prices, sales or costs

Operators can use information on output, prices, sales or costs of their competitors to coordinate their behaviour in the market, to the detriment of consumers. Such coordination is more common in markets with few participants, homogeneous products and high entry barriers.

Certainly, consumers can find it difficult in markets with a great variety of differentiated products to get an idea of the prices that best suit them of those offered by the different operators.

In this regard, requiring suppliers to publish certain information on the products they offer and their prices, for the sake of making it easier for consumers to research the market, can have pro-competitive effects, but these must be analysed together with the possible anti-competitive effect.

Indeed, publishing such information can in some cases facilitate coordination of prices between competitors, such that the net effect for consumers may be less beneficial than expected or even negative.

Example: Energy sector

The potential effect on competition of information disclosure requirement will depend on characteristics of the market such as number of operators, degree of product differentiation, etc.

Example: Illustrative fee schedules

The regulation on Professional Colleges allows those professional associations to approve and publish illustrative fee schedules.

3.3

Increases the costs for a customer of changing suppliers, reducing mobility of consumers

Consumers who are not satisfied with their supplier of goods or services can choose to switch to another supplier. Regulations that hinder or make it less convenient for consumers to switch from one operator to another tend to reduce the incentives for competition between suppliers.

What are known as “switching costs”, can be defined as the costs borne by consumers in changing their supplier of a product. If the product offered to a consumer is expensive or of low quality, if switching costs are low, the consumer finds it easy to opt for alternatives that are less expensive or more suitable in some other way. At the same time, in these circumstances, suppliers will have more incentives to cut prices or offer better products and advertise them to consumers, as they can boost their sales in return.

Arrangements that impose a minimum on the duration of contracts, or minimum notification periods for rescinding them, or conditions on switching suppliers can lessen the incentive for rivalry between operators and, more significantly, for entry of new operators.

Example: Mobile telephony portability

Regulations can contribute to lowering switching costs in a market. For example, the rule that guarantees consumers portability of their number when they switch to another mobile telephony carrier makes such changes easier, eliminating the bothersome and costly need for customers to change their phone numbers each time they switch to another carrier.

3.4

Creates regulatory uncertainty for new entrants

The lack of a clear regulatory framework discourages operators from entering a market.

A new entrant in a market must of course be prepared to take on the risks inherent in any business or profession, but where those risks are heightened by the regulatory framework, then new competitors are discouraged from entering the market.

This occurs when regulations do not design a clearly defined and predictable framework of action. This problem can be especially important precisely in those cases where the proposals seek to open up certain sectors to competition, because if the entry conditions are not defined clearly or take too long to be developed, the goal of attracting new competitors may be thwarted.

Example: Licensing of major commercial complexes

The lack of specificity in the rules governing the events in which the licence to open a large commercial facility will be granted can curb the entry of new competitors. This is further aggravated where very high fees are set for applying for the licence.

Example: External occupational hazard prevention services

The regulations originally allowed work accident and occupational disease mutual societies that officially collaborated with the Spanish Social Security system to combine their traditional activities with the provision of external prevention services. In order to prevent those mutual societies from enjoying advantages vis-à-vis other prevention entities, there was a fundamental need to regulate the conditions for using the resources earmarked for that collaboration with Social Security. However, the legal uncertainty and complexity of the regulation in this area, gave rise, as stated by the Court of Auditors itself, to conducts that may have constituted anti-competitive practices derived from the regulatory framework.

At the end of this first step (Identification), there are two possible situations:

The proposal is not found to entail any restriction of competition

- In this case, there is no need to continue with the competition impact assessment procedure. Nevertheless, the Competition Assessment Report will have to give a reasoned description of the grounds for reaching this conclusion before the procedure can be considered closed.

One or more restrictions of competition have been identified in the proposal

- In this case the next steps in the procedure must be followed, in order to be able to assess the necessity and advisability of the restrictions on competition expected to be introduced.

Warning: The Services Directive

In relation to the provision of services, before going on to analyse the necessity and advisability of the anti-competitive restrictions identified, it must be checked that those restrictions are not included amongst those prohibited by the Services Directive (Directive 2006/123/EC).

Checking that the restriction or requirement is not prohibited is necessary in all cases, but it is rendered especially important by the novelty and significance of the Services Directive.

In this regard it should be recalled that the conditions that are prohibited by the Services Directive include, amongst others, making startup or pursuit of a service activity subject to fulfilment of any of the following:

- Nationality or residency requirements for the service provider.
- Restrictions on the freedom of a provider to choose the type of establishment.
- Requirements of an economic nature, including, amongst others, making the granting of authorisation subject to proof of the existence of an economic need or market demand, an assessment of the potential or current economic effects of the activity.
- The direct or indirect involvement of competing operators, including on a consultative basis, in the granting of authorisations to operate, subject to regulatory exceptions.
- An obligation that the establishment of financial guarantees or taking out of insurance be done with a provider or body established in Spain.
- An obligation to have been pre-registered, for a given period, in the registers of providers held in Spanish territory or to have previously exercised the activity for a given period in said territory.

Step 2.

Justification

Is the restriction of competition justified?

After identifying the possible constraints on competition entailed by the proposal, the next step is to evaluate the necessity and appropriateness of such restrictions.

This will require, at this stage of the procedure, answering the question as to **WHY** the restriction on competition is being introduced. What is its purpose, the precise objective pursued? In short, what is its justification?

To conduct this analysis and set it down in the Competition Assessment Report, the following aspects must be addressed:

a.

Clear and detailed definition of the proposal's objective or objectives

The need to give a clear definition of the purpose pursued by a regulation or administrative measure may appear somewhat obvious. But it is not uncommon to find legal instruments whose aims are stated vaguely or imprecisely, or with regulatory or policy proposals proclaiming the pursuit of different objectives that are, at times, barely compatible with each other, without making clear what specific objective is pursued by each of the measures contained in the proposal. Or with regulatory developments that include provisions not justified by a direct bearing on the announced goal.

This is why the clear definition of objectives is an indispensable part of helping us to understand WHY the intervention is being proposed.

A number of recommendations or criteria should be kept in mind in order to carry out this definition process properly:

- *Avoid confusing the objective of the rule or administrative action with the means or instrument used to achieve it.*

  Sometimes this confusion may arise because what is described as the objective is actually the "object" of the rule, that is, a mere description of its content, of what the regulation is about— this constitutes the instrument, not its ultimate aim or objective.

  Confusing objective with instrument makes it impossible to conduct an analysis of alternatives, that is, a comparison of the different instruments that could be used to attain the same goal.

Example: Rules on licensing to operate as clinical analysis laboratory

The objective of the regulation of this sector is not to establish the rules for licensing operators in the clinical analysis market; that is the instrument.

The ultimate objective, would be to protect the health of the citizenry.

- *Specify the objective.* The answer to the question WHY? should be as specific as possible, describing the concrete purpose pursued and the group affected by that objective.

  This means the justification for the proposed regulation or measure should avoid relying on general allusions to "reasons of public interest", "improving quality of life", "planning and regulation of the activity", "improving economic conditions", "filling in a regulatory gap", "response to sector demands", etc. Assertions of this type are not conducive to a proper assessment of the proposal, because they do not allow the objective pursued by the policy or action to be known in sufficient detail.

  And it must not be forgotten that defending competition is certainly also in the "public interest", can contribute toward "improving economic conditions" and, ultimately, toward "improving the quality of life of the citizenry".

  Furthermore, a policy's contribution to an overly vague and generic objective will be difficult to appreciate, whereas its accompanying constraint on competition can cause very specific harm, thereby calling into question the proposal's proportionality.

  Therefore, when overly generalised replied are obtained, we should continue asking WHY and FOR WHOM, in order to arrive at more specific objectives.

Example: Specific commercial licenses

- *Restriction of competition identified:* limits the number of operators in the market.
- *Aim pursued:* regulate the activity — *too generic!*
- *More specific objectives:* town planning, protect small retailers, …

Example: Classification system for certain government contracts

- *Restriction of competition identified:* limits the number of operators in the market. May generate entry barriers.
- *Aim pursued:* ensure the economic capacity and technical capabilities of bidders, reduce transaction costs.

Example: Establishment of production quotas

- *Restriction of competition identified:* limits the ability of operators to compete.
- *Aimed pursued:* regulate the activity — *too generic!*
- *More specific objectives:* regulate product quality, income support, avoid encroachment, …

- *Analyse consistency.* We must check that the specific objectives identified and the instruments proposed for achieving them are consistent with the rest of the objectives pursued by the proposed regulation or policy.

  The point here is to ensure the effectiveness of the proposal, that is, that achievement of the concrete objective proposed, and which justifies the constraint on competition, will not be hindered by other objectives contained in the policy under consideration, because this would mean an anti-competitive restriction is being introduced for no reason.

- *Identify the legal grounds for the objective.* If the proposal is going to pit a public interest objective against the defence of competition, the legal basis for that objective must be identified clearly, more than just mere reference to the enabling title that allows its implementation by the proposing government authority.

b.

Justification that the restriction is necessary (cause-effect relation)

This is an especially important issue and involves demonstrating a cause-effect relation between the instrument and the objectives.

After the specific objective or objectives pursued by the regulation have been identified, an explanation must be given of HOW the restriction of competition identified can contribute to their achievement.

In other words, a reasoned demonstration must be given of why the constraint is necessary for obtaining the objective.

Example: Licences

After the specific purpose for which a licensing system is established has been defined, each and every one of the requirements introduced for obtaining the licence and which can affect competition must have a clear and direct bearing on that objective.

The following needs to be taken into account in order for the analysis of necessity to be optimally rigorous:

- *Perform an integral analysis.* The initial identification phase may have pinpointed several interrelated constraints on competition. In this case, it is advisable to conduct a dual analysis, specifying the justification for each constraint, along with the reasons for the restrictions as a whole, in order to assess whether the proposal is truly coherent.

  This is especially important if the project contains several measures with the same objective, because those measures may overlap in ways that do not enhance their effectiveness but do compound their negative effects on competition. Along these same lines, an analysis would be needed of the proposed measures' relation to and coherence with the existing ones.

c.

Justification of the proportionality of the restriction

Introducing a restriction of competition is always a "cost" of the proposal in question.

For this reason a restriction will be considered disproportionate when achievement of an objective that only entails a relative or marginal improvement in terms of social wellbeing nevertheless generates serious harm to society due to the severe constraints on economic activity that it implies.

At the end of this second step (Justification), there are two possible situations:

The anti-competitive restriction entailed by the proposal cannot be justified because:

- it is actually the ultimate objective of the proposal that clashes with the functioning of the market (e.g., it seeks to regulate output, prices or protect some competitors vis-à-vis others, etc.); or
- the cause-effect relationship has not been demonstrated, because the anti-competitive constraint's contribution to achieving the specific objective pursued does not exist or is too vague; or
- the proportionality of the measure has not been demonstrated, because the benefits to society of the proposal would be less than the societal harm caused by the restrictions of competition that it would introduce.

In these cases, the proposal should be revised.

In conducting this revision, it may be useful to take into account the existence of regulatory alternatives, as discussed in step three.

The restriction of competition entailed by the proposal has been justified

In this case, the third and last step will still have to be carried out, in order to assess if there are regulatory alternatives that are less harmful to competition.

Step 3.

Alternatives

Is it the best alternative?

An objective can be achieved using different regulatory instruments. The impact of each on the conditions of competition is not to be ignored.

Failure to weigh these questions can lead to the imposition of overly restrictive measures, when the purpose pursued might have been safeguarded equally well with less inhibitive mechanisms.

There is a tendency to take a "maximalist" approach when seeking to justify constraints on competition, that is, arguing that though various mechanisms are possible, the most restrictive one is the one that will contribute the most to attaining the stated objectives. But we should shun such regulatory overkill; even where a more restrictive regulation may best contribute to achieving the goal pursued by the proposal, it must still be demonstrated that the enhanced contribution offsets the greater harm caused by the restriction.

If the objectives are procured reasonably well will less restrictive mechanisms, then preference should be given to the latter.

The alternatives to be considered must be weighed having regard to the concrete circumstances of each case. Nevertheless, in the accompanying box we offer a non-exhaustive number of examples that may give guidance on assessing possible alternatives.

Example: Regulatory alternatives

- *Regulate the objective, but not the procedure*. Establish in the regulation requirements, for example, regarding quality or safety, and allow operators in the market to apply diverse procedures or technologies to fulfil those requirements instead of obliging them to apply specific standards. This would give market operators more room for manoeuvring, differentiation and innovation.

- *Regulation of market entry.* Where policymakers believe there is justification for regulating entry in a market, there are numerous mechanisms that allow this objective to be achieved, but with progressively greater impact on competition: administrative authorisation, which allows authorities to verify that entrants meet certain objective requirements; licensing systems, which, in addition to establishing requirements as in the case of administrative authorisations, can also serve to fix the number of operators in the market, thereby limiting entry; and concession arrangements, which can involve operator of a service by a single entity on a monopoly basis, limiting competition as from the time the concession is awarded.

  These alternatives have a very different impact from the standpoint of barriers to entry in the market, so it must be examined whether the objective pursued can be attained with the least restrictive mechanism so that no unnecessary distortions of competition are introduced. In any event, wherever a market-type mechanism can ensure provision of the service, the concession scheme should be replaced by a prior administrative authorisation system.

- *Rights of exclusivity.* Where the need for establishing exclusivity rights (for example, through a concession) is justified, regulators must procure that, at least, competition "for the market" is not unduly inhibited.

  So, on the one hand, concession systems that establish conditions or requirements that can harm certain operators compared with others should be avoided, as they reduce the number of competitors "for the market".

  On the other hand, in some cases the heavy investments required for producing the product or providing the service under exclusivity may require that the concessions have fairly long durations so that an adequate return can be made on those investments. But this is only justified in relation to specific investments in assets that cannot be reused in other activities and, even in this case, regulators must be mindful that the longer the term, the lower the already limited possibilities of competing "for the market".

- *Licences or authorisations.* The organisation of quick, streamlined procedures for obtaining licences, permits or authorisations tends to favour competition, inasmuch as they limit the unfair time advantage enjoyed by the already entrenched operators versus new operators seeking to enter the market.

  Similarly, a clear and objective definition of the requirements for obtaining those licences or authorisations will also serve to foster competition.

- *Temporary nature of restrictions.* If the need for a constraint of competition is demonstrated, it will preferably be temporary and thus be subject to review at the end of a prescribed time period.

- *Alternatives to price regulation.* To achieve the objective of a minimum quality for the product or service, instead of establishing fixed minimum prices or illustrative prices (whose contribution to ensuring a minimum quality, moreover, is dubious to say the least), consideration can be given to alternatives that promote better information for consumers (preparation of mandatory budgets, price advertising, information campaigns, price statistics, etc.) or which directly address quality assurance (monitoring of the activity, sanctions for breaches of minimum quality standards, etc.).

- *Minimise the impact*. If only part of the activity requires compliance with certain anti-competitive requirements, those requirements should not be extended to the rest of the operations carried on by the same operator or to other directly or indirectly related businesses.

- *Do not regulate.* Always consider the alternative of not regulating or of using alternative instruments instead of regulations: information campaigns, fees, etc.

This final phase should help policymakers choose the best regulatory alternative amongst all possible choices, that is, the one that achieves the same objective but minimising, or even eliminating, the negative impact on competition.

In any event, the Competition Assessment Report must describe what other alternatives have been analysed and why the alternative chosen was considered the least harmful to competition.

Guide

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