



Recommendation of the Council
concerning Structural Separation
in Regulated Industries

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Background Information

The Recommendation concerning Structural Separation in Regulated Industries was adopted by the OECD Council on 26 April 2001 on the proposal of the Competition Committee. The Recommendation calls for Adherents to consider structural separation, in particular the pros and cons of separating the structure of a regulated firm's activities. When a firm provides products or services regulated by government, structural separation may be required so as not to hinder the entry of competitors in the market. "Structural separation" of a firm may be important to advance the process of market liberalisation. It is applied notably in sectors such as electricity and telecommunications where the main service (or product) is generally provided by a supplier and other firms commercialise the end product or service to consumers. The issuing of a recommendation became necessary to draw attention to the benefits of structural separation but also to clarify since it may not always bring economic and public benefits that justify its implementation. Governments should therefore carefully assess the costs and benefits of structural versus behavioural measures especially in the context of privatisation, liberalisation or regulatory reform.

THE COUNCIL,

HAVING REGARD to Article 5 b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1960;

HAVING REGARD to the agreement reached at the 1997 Meeting of the Council at Ministerial level to reform economic regulations in all sectors to stimulate competition [C/MIN(97)10], and in particular to:

- “i) Separate potentially competitive activities from regulated utility networks, and otherwise restructure as needed to reduce the market power of incumbents;
- ii) Guarantee access to essential network facilities to all market entrants on a transparent and non-discriminatory basis”;

HAVING REGARD to the report Structural Separation in Regulated Industries [DAFFE/CLP(2001)11], the Report by the Competition Committee to the Council on Experiences on the Implementation of the Recommendation concerning Separation in Regulated Industries [C(2006)65], the Report by the Competition Committee on the Implementation of the Recommendation of the Council concerning Structural Separation in Regulated Industries [C(2011)135 and CORR1]; and the Report on the Implementation of the Recommendation of the Council concerning Structural Separation in Regulated Industries [C(2016)11, Annex I];

RECOGNISING that recent experience shows that structural separation has been considered not just with respect to network utilities, but also in a number of other vertically integrated industries where only some activities are subject to competitive constraints;

RECOGNISING that there are differences in the characteristics of industries and countries, differences in the processes of regulatory reform and differences in the recognition of the effectiveness of structural measures, behavioural measures and so on, and that such differences should be taken into account when considering structural issues;

RECOGNISING that regulated firms, often operate in both non-competitive and in competitive complementary activities;

RECOGNISING that the degree of competition which can be sustained in the competitive complementary activities varies, but that when these activities can sustain effective competition it is desirable to facilitate such competition as a tool for controlling costs, promoting innovation, and enhancing the quality of the regulation overall, ultimately to the benefit of final users and consumers;

RECOGNISING that, in this context, the regulated firm has the ability, in the absence of antitrust or regulatory controls, to restrict competition by restricting the quality or other terms at which rival upstream or downstream firms are granted access to the services of the non-competitive activity, restricting the capacity of the non-competitive activity so as to limit the scope for new entry in the complementary activity, or using regulatory and legal processes to delay the provision of access;

RECOGNISING that, depending upon the structure of the industry, a regulated firm which operates in both a non-competitive activity and a competitive complementary activity may also have an incentive to restrict competition in the complementary activity;

RECOGNISING that such restrictions of competition generally harm efficiency and consumers;

RECOGNISING that there are a variety of policies that can be pursued which seek to enhance competition and the quality of regulation by addressing the incentives and/or the ability of the regulated firm to control access. These policies can be broadly divided into those which primarily address the incentives of the regulated firm (such as vertical ownership separation or club or joint ownership), which may be called structural policies, and those which primarily address the ability of the regulated firm to deny access (such as access regulation), which may be called behavioural policies;

CONSIDERING that behavioural policies, unlike structural policies, do not eliminate the incentive of the regulated firm to restrict competition;

CONSIDERING that despite the best efforts of regulators, regulatory controls of a behavioural nature which are intended to control the ability of an integrated regulated firm to restrict competition may result in less competition than would be the case if the regulated firm did not have the incentive to restrict competition;

CONSIDERING that, as a result, the efficiency and effectiveness of regulation of the non-competitive activity, the available capacity for providing access, the number of access agreements and the ease with which they are reached and the overall level of competition in the competitive activity may be higher under structural policies;

CONSIDERING that, under such circumstances, it is all the more necessary that, to prevent and tackle restrictions of competition, competition authorities have appropriate tools, in particular the capacity to take adequate interim measures;

CONSIDERING that certain forms of partial separation of a regulated firm (such as accounting separation or functional separation) may not eliminate the incentive of the regulated firm to restrict competition and therefore may be less effective in general at facilitating competition than structural policies, although they may play a useful and important role in supporting certain policies such as access regulation;

RECOGNISING that, in some circumstances, allowing a regulated firm operating in a non-competitive activity to compete in a complementary competitive activity allows the regulated firm to attain significant economic efficiencies or to provide a given level of universal services or service reliability;

RECOGNISING that structural decisions in regulated industries often require sensitive, complex, and high-profile trade-offs, requiring independence from the regulated industry and requiring expertise, experience, and transparency in assessing competitive effects and comparing these with any economic efficiencies of integration; and

RECOGNISING that the boundaries between activities which are potentially competitive and activities which may be non-competitive are subject to change and that it would be costly and inefficient to continuously adjust the degree of vertical separation;

On the proposal of the Competition Committee:

I. AGREES that, for the purpose of the present Recommendation, the following definitions are used:

- Firm refers to a legal entity or a group of legal entities where the degree of inter-linkages (such as shareholding) among the entities in the group is sufficient for these entities to be considered as a single entity for the purposes of national laws controlling economic concentrations;
- Regulated firm refers to a firm, whether privately or publicly owned, which is subject to economic regulation intended to constrain the exercise of market power by that firm;
- Non-competitive activity is an economic market, defined according to generally accepted competition principles, in which, as a result of regulation or underlying properties of demand and supply in the market, one firm in the market has substantial and enduring market power;
- Competitive activity is an economic market, defined according to generally accepted competition principles, in which the interaction among actual and potential suppliers would act to effectively limit the market power of any one supplier;
- Complementary refers to products (and services) that enhance each other. Products that are complementary to the regulated firm's non-competitive activity therefore include (1) products bought by the firm from (upstream) suppliers, (2) products sold by the firm to (downstream) customers, and (3) other products used in conjunction with the firm's non-

competitive product, and where competitors' success in providing such products depends on their or their customers' ability to obtain access to the non-competitive product.

II. RECOMMENDS that, when faced with a situation in which a regulated firm is or may in the future be operating simultaneously in a non-competitive activity and a potentially competitive complementary activity, Members and non-Members having adhered to the Recommendation (hereafter the "Adherents") carefully balance the benefits and costs of structural measures against the benefits and costs of behavioural measures. To this effect:

- The benefits and costs to be balanced include the effects on competition, effects on the quality and cost of regulation, effects on corporate incentives to invest, the transition costs of structural modifications and the economic and public benefits of vertical integration, based on the economic characteristics of the industry in the country under review.
- The benefits and costs to be balanced should be those recognised by the relevant agency(ies) including the competition authority, based on principles defined by the Adherent. This balancing should occur especially in the context of privatisation, liberalisation, regulatory reform and, on some occasions, may also be relevant to market studies conducted by competition authorities.

III. INVITES the Secretary-General and Adherents to disseminate this Recommendation.

IV. INVITES non-Adherents to take account of and adhere to this Recommendation.

V. INSTRUCTS the Competition Committee to:

1. Serve periodically, or at the request of the Adherents, as a forum for consultations on matters related to the Recommendation; and
2. Monitor the implementation of this Recommendation and report thereon to the Council no later than five years following its revision and thereafter as appropriate.

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