



**Fondazione Ambiente
ISSAERE 2010**

Turin, September 10, 2010

**REGULATION OF LOCAL PUBLIC
SERVICES AND COMPETITION:**

**WATER AND WASTE
MANAGEMENT IN ITALY**

Luca Arnaudo

*Luiss Guido Carli University, Rome
Italian Competition Authority, Rome*

REGULATION OF LOCAL PUBLIC SERVICES AND COMPETITION

AN INTRODUCTION

Let's start with some (allegedly) socratic questions:

1. What is regulation?
2. What is a public service?
3. What is antitrust?

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About regulation

Regulation is "controlling human or societal behavior by rules or restrictions." (Koops et al., *Starting Points for ICT Regulations, Deconstructing Prevalent Policy One-liners*, Cambridge 2006)

It is deeply related to governance, intended as a term "to analytically describe interdependencies and complexities involved in the operation of a given community or institution, generally limited to a geographic area and even to a specific issue or resource."
(Finger et al. *The multi-governance of water*, NY 2006)

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About public services

Public services tend to be those considered so essential to modern life that for moral reasons their universal provision should be guaranteed, and they may be associated with fundamental human rights (such as the right to water). In other cases, public services may have a public order relevance (such as the case of waste management).

Even where public services are neither publicly provided nor publicly financed, for social and political reasons they are usually subject to regulation going beyond that applying to most economic sectors.

Main problems to be faced:

1. scarcity of resources (*e.g.* water);
2. optimal allocation of management and ownership rights of the infrastructures (risks of interest's conflicts).

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Industrial organization of public services and means of funding

- (a) contracting out capital projects to engineering and construction companies on a competitive bidding basis.
- (b) selective private sector participation:
- (c) BOOT (Build, Own, Operate, Transfer. After a finite period assets are transferred back to the original undertaker);
- (d) BOT (Build, Operate, Transfer but no ownership);
- (e) BOO (Build, Own, Operate but assets are not transferred);
- (f) companies fully or partially owned by municipalities or public corporations have been established in many EU Member States: these companies are able to raise money outside the public fiscal budgets and at the same time to benefit from lower debt cost;
- (g) contracts to private sector companies to undertake public services operation and investments. Companies take over responsibility for the supply of public services and funding is made available from capital markets.

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About public services in Italy

As we will deal with some local public services (hereinafter “LPS”), we have to focus on its (quite disappointing) legal framework.

As a matter of fact, starting from year 2000 Italy faced:

- 1) a complex evolution of LPS regulation (see decree 267/2000 and its frequent modifications);
- 2) major institutional changes (administrative devolution / local authorities ceased to be direct service providers in order to act as stakeholders and “watchdogs” of LPS companies). The national territory was divided into many “ATO” (acronym for “ambito territoriale ottimale”, meaning “optimal territorial unit for managing services”);
- 4) horizontal subsidiarity (private organizations provide public services).

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About public services in Italy

According to section 113 of decree 267/2000 LPS with economic relevance must be alternatively provided by:

1. private undertaking selected by means of public tender;
2. public-private partnership (“PPP”) with the private shareholder selected by means of public tender;
3. public undertaking (“in house providing”).

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About competition/antitrust law

It can vary from a legal system to another, but generally speaking has three main elements:

1. prohibiting agreements or practices that restrict free trading and competition between business (*e.g.* cartels);
2. banning abusive behavior by a firm dominating a market, or anti-competitive practices that tend to lead to such a dominant position (*e.g.* predatory pricing, tying, price gouging, refusal to deal, etc);
3. supervising the mergers and acquisitions of large corporations, including the creation of (major) joint ventures.

Note: in recent decades, antitrust has been increasingly viewed as a way to provide better public services (*see OECD guidelines*).

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Main EU competition provisions are the following:

Art. 101 TFEU provides that shall be prohibited as incompatible with the common market all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market.

Please note: in the explanatory clauses of §1, bid rigging is not foreseen. However, this is a major antitrust issue and one of the most related to public services.

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Art. 102 TFEU provides that any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.

Art. 106 TFEU provides that in the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the Treaty rules on competition (including those related to state aids) and on internal markets. Undertakings entrusted with the operation of services of general economic interest (or having the character of a revenue producing monopoly) shall be subject to the rules above mentioned in so far as the application of such rules does not obstruct the performance of the particular tasks assigned to them.

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Competition enforcement must always take into consideration the structure and features of the relevant markets/industries.

With regards to the markets related to public services, remember the difference between:

1. competition in the market;
2. competition for the market.

Competition in the market is direct competition among many undertakings for the supply of the same services/products.

Due to the structure of many markets, it is not always possible.

Take the case of water services: “Water and sewerage undertakers have strong natural monopolies within their allocated region because it is not economically viable to have more than one network in a region. Competition therefore only takes place between them in two different ways: *a)* at the time where the licence is granted by the government (...) *b)* residually along the allocated regions’ borders” (EC Commission, dec. *IV/M.567 – Lyonnaise des Eaux / Northumbrian Water*, 21 December 1995, para. 11).

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Competition for the market is the one in which utility companies compete for contracts to provide services to the market: the winner of any competitive bidding process will obtain an exclusive right to provide services for a specified period. It is considered by many experts to be the most relevant to implementing competitive influence in the water and waste management markets.

However, it may arise:

A. Regulatory problems

1. asymmetry of information (both between the public authority and the contracting companies, and between contracting companies when the contract is tendered for renewal);
2. “regulatory capture”.

B. Competition problems

1. possible lack of enough bidders;
2. restrictive agreements between bidders.

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About antitrust in Italy

The Italian Competition Authority (hereinafter “ICA”) has been established by Law no. 287 of 10 October 1990. Being an independent authority it has the status of a public agency whose decisions are taken on the basis of the Act without any possibility of interference by the Government.

The ICA is a collegiate body, composed of several members who take their decisions by majority vote. It has a Chairman and four Members appointed jointly by the Presidents of the Senate and the Chamber of Deputies.

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The ICA is responsible for enforcing the Italian competition law, and hence for controlling:

- a) agreements that impede competition;
- b) abuses of dominant position;
- c) mergers and acquisitions which create or strengthen a dominant position with the effect of eliminating or restricting competition.

Apart from the ordinary investigative proceedings (and possible application of fines), when the operation of the market or a particular sector suggests that competition is being impeded, the ICA may act on its own initiative, and also at the request of any authority or agency, and carry out general fact-finding inquiries into that market or sector.

REGULATION OF LOCAL PUBLIC SERVICES AND COMPETITION

WATER SUPPLY SERVICES IN ITALY

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WATER SUPPLY SERVICES IN ITALY

All over the world, LPS of water supply and sanitation requires many services to be organized in an industrial way. Here follows a list of the main ones:

WATER ABSTRACTION: it involves taking water from the environment for subsequent treatment and supply. Types of source include rivers, reservoirs, lakes and underground aquifers. In some countries (UK) water abstraction is controlled through abstraction licenses, by government environmental protection agencies. In other countries (Sweden, Denmark, Germany, Italy) abstraction is controlled by regulatory authorities at a local regional or municipal level, conforming to national guidelines.

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WATER TREATMENT: it involves purifying raw water for input to the distribution system. Prime objective of water treatment is disinfection, usually to be made by plants through chemical processes;

WATER DISTRIBUTION: it involves the transport of water from treatment plants to individual users via a network of underground pipes (plus infrastructures such as pumps, water towers, valves, meters, etc.). In the majority of EU Member States, water distribution networks are locally based and are often restricted to the geographical areas for which the municipality or municipal utility has responsibility. In general these networks were constructed and operated as public service monopolies by municipalities or regional authorities.

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WASTEWATER COLLECTION: the modern sewerage system is the basis of effective public health control. It is required to transport a variety of wastewaters cost-effectively to a site where sewage treatment can be performed before discharge to a receiving water. Wastewater collection system management is strictly linked to the management of urban drainage, resulting from rainfall, and its safe and efficient discharge to rivers. This element of the water industry chain has in Europe lent itself to natural monopoly because of the important role in which municipalities have played in constructing and managing collection systems. The wastewater collection and drainage is surely a part of the water cycle that local government authorities are most likely to still operate and fund from local taxation rather than from specific charge.

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The water industry chain

Water management is naturally structured as a vertical chain: the activities of water abstraction, treatment, distribution, wastewater collection, wastewater treatment and disposal all follow naturally from each other. However, the fact that there is a natural chain does not mean that the activities cannot be separated.

Indeed, from an economic and managerial point of view they can be separated.

Theoretical benefits of separating the activities: they can be provided by different entities in a competitive environment, e.g. by means of

- (a) sub-contracting the operation and/or the maintenance of the assets;
- (b) outsourcing of certain operational functions;
- (c) competitive bidding to a third party.

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However, water industry does not fit easily into standard economic theory with regards to market competition, mainly because of:

- (1) significant externalities (social costs and benefits);
- (2) many parts of the industry are widely viewed as natural monopolies;
- (3) significant sunk costs in the infrastructures;
- (4) significant transportation costs.

Please also note:

The water industry is very capital intensive, with a high proportion of fixed assets having a very long “industrial life” (up to 100 years and more).

Due to the economic characteristics of the network, this part of the supply chain can be considered a natural monopoly.

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Since 1990's, it has been emphasised private sector provision of municipal water services as a potential solution to the major problems in the sector. This recommendation is based on an overall analysis of the disappointing performance of many governments in this particular area, characterized by low coverage rates, high loss rates, low levels of cost recovery and the poor quality of water provided.

Consequently, governments in many countries have signed long-term contracts for the private provision of these services in major metropolitan areas. Given the massive scale of the investments and services required, most contracts have been awarded to major consortia with multinational companies (mainly European) as partners.

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Large private companies can add value by bringing specialized management experience and large-scale financing to situations where these are lacking. Conversely, other models-from public companies to public service provision-can be just as efficient and effective as private sector service provision.

Irrespective of the approach chosen, governments must maintain a major responsibility for providing an effective and efficient regulatory framework within which the service providers operate.

Also, quite separately from water service provision, it is the government's responsibility to provide a framework of water use rights-respecting the customary rights of traditional water users and indigenous peoples.

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The Italian legal framework and administrative organization of the water services

1. starting from 1994, the whole national territory has been divided into 92 ATO: each of them had to reorganize and merge all the water services previously managed separately into a single operating company;
2. services has to be managed by companies appointed according to the law (remember decree 267/2000);
3. general technical provisions had to be adopted by a National Water Authority (“NWA”) in coordination with local water authorities.

What happened: elegantly speaking, a big mess, mainly due to the lack of a serious institutional supervision and to the fierce resistance to the reform by local administrations (see *NWA Report*, July 2010).

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As a consequence, on one hand the management of water services in Italy remains very fragmentated and badly needs big infrastructure investments.

According to the latest NWA Report, Italy needs to invest some €50 billion in its water and wastewater sector over the next 20 years.

On the other hand few big companies arose and gained important market shares. As a consequence, serious competition problems have been targeted in the past.

Since 2003 ICA has issued many recommendations and warning notes about irregularities found in tender procedures for the awarding of water services management. Moreover, in 2007-2008 two antitrust proceedings have also been carried out.

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ICA case I/670

In may 2006 ICA opened an investigation proceeding (ref. case I/670) against Acea S.p.A. (“ACEA”), Suez Environnement S.A. (“SUEZ”) and Publiacqua S.p.A. (“PBA”) for alleged infringements of article 81 TCE (now article 101 TFEU). The proceeding was closed on november 2007 with ACEA and SUEZ condemned to an administrative fine.

The proceeding was one of the very few related to water industry in Europe: *e.g.* EU Commission only dealt with mergers among water management companies (mainly in UK), but did not adopt any infringement decision.

The proceeding faced some serious problems, mainly:

1. lack of reliable information;
2. difficult definition of the relevant market.

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ICA case I/670

With regards to the lack of reliable information, this is a serious and still pending issue.

Take the case of the *2010 NWA Report*:

“Il rapporto presenta l’aggiornamento al 2008 dei dati relativi allo stato di attuazione del SII, agli investimenti, alle tariffe, e rispetto alle precedenti versioni ha aggiunto un nuovo capitolo sulle perdite idriche (...) Per ciò che riguarda la percentuale di risposte ai questionari si sottolinea una tendenza di crescita rispetto agli anni precedenti, anche se il grado di completezza e di qualità delle risposte non soddisfa ancora le aspettative della Commissione. In particolare si è rilevato come all’aumentare del livello di dettaglio delle domande si sia verificato un evidente scadimento della quantità e della qualità delle risposte. Infine, **come per le precedenti rilevazioni, rimane irrisolto il problema della validazione dei dati**. In tal senso (...) si sono già attivati controlli di coerenza che hanno evitato l’inserimento di dati errati, ma ancora molto si deve fare per migliorare la qualità dei dati”.

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ICA case I/670

With regards to the relevant market definition, it is a pivotal issue of any antitrust proceeding and it needs a very accurate survey of all the relevant data available.

Relevant market defines the market in which one or more goods compete: therefore, it defines whether two or more products can be considered substitute goods and whether they constitute a particular and separate market for competition analysis. The extent to which firms are able to increase their prices above normal competition levels depends on the possibility for consumers to buy substitute goods and the ability for other firms to supply those products. The fewer the substitute products and/or the more difficult it is for other firms to begin to supply those products, the less elastic the demand curve is and the more probable is to find higher prices.

The relevant market combines the product market and the geographic market, defined as follows:

1. A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices and their intended use;
2. A relevant geographic market comprises the area in which the firms concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous.

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In its decision, ICA stated that the relevant market for the case was the one of the management of water services in Italy.

Please consider that, if from the demand side each OTP could be considered as a geographical relevant market (legal monopoly), from the supply side few companies are competing for being awarded with the water management everywhere (not only in Italy). As a matter of fact, an in-depth analysis of the main features of public tenders in Italy and of the national competition environment supported the market definition of ICA.

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ICA case I/670

Main market data related to the management of water services in Italy
(year 2006, source: ICA)

| undertaking | no. of customers | cubic meters sold | value of the sales |
|----------------------------|-----------------------|---------------------------|---------------------------|
| ACEA | 4.835.025 | 513.824.937 | 487.798.976 |
| Acquedotto Pugliese | 4.039.000 | 237.000.000 | 320.000.000 |
| Hera | [2.000.000-3.000.000] | [200.000.000-300.000.000] | [300.000.000-400.000.000] |
| Smat Torino | 2.016.799 | 186.098.003 | 204.450.000 |
| Cap Milano | 1.744.464 | 222.962.159 | 71.802.334 |
| Iride | 1.183.267 | 44.268.000 | 172.300.000 |
| Arin Napoli | 980.000 | 153.256.000 | 91.361.000 |
| Veolia | [300.000-700.000] | [30.000.000-40.000.000] | [50.000.000-60.000.000] |
| SUEZ | 244.519 | 19.758.780 | 30.047.316 |

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ICA case I/670

With regards to the business conducts of the companies involved in the proceeding, ICA found an illicit agreement between ACEA and SUEZ dating back to 2001 for coordinating themselves in the Italian water market, mainly by participating together to public tenders.

More specifically, ACEA and SUEZ participated together to four tenders in Tuscany and agreed upon a “safe harbour” for the water activities of ACEA in Lazio.

Note: Italian law allows companies to participate together to public bids by means of so called “temporary association” in order to let also small companies to have a chance to participate to big tenders.

In the case of ACEA and SUEZ, they were very big market players: they could participate alone to the public tenders, but they decided not to do it upon strategic (and not industrial) purposes, in order to abolish competition among themselves and avoid competition pressures.

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ICA case I/670

ICA found ACEA and SUEZ responsible for having entered an illicit agreement and fined them for respectively 8 and 3 euro millions.

ACEA and SUEZ appealed and the Lazio Administrative Tribunal quashed the ICA decision, mainly by refusing its market definition (see judgement no. 6238/2008).

ICA appealed against the Tribunal in front of the Administrative Supreme Court: final decision is still to be adopted.

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ICA case A/395

In november 2007 ICA opened an investigation proceeding (ref. case A/395) against Acquedotto Pugliese S.p.A. (“AQP”) for alleged infringements of article 82 TCE (now article 102 TFEU). The proceeding was closed on october 2008 by accepting a series of remedies proposed by AQP, after the completion of a market test.

The proceeding has been provoked by some complaints filed by consumers: according to them, AQP supplied drinkable water and sewerage services through its pipeline grid only after having exploited an illicit exclusive rights of building the connections to its infrastructure.

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ICA case A/395

ICA interpreted Italian water law by excluding from the legal monopoly of the so-called “integrated water service” the provider's rights to build the connections to the pipeline grid. By imposing such preemptive condition, AQP could infringe competition law by means of an abuse of dominant position.

Note: the disputed right has been established through a unilateral regulation adopted by AQP, while the local competent water authority had still to be set up.

Moreover, AQP requested a fixed price for the building activities, irrespective of the real costs to be beared (850 euro for connections spanning from 0 to 7 meters, plus a series of extra-fees): this could also be considered an abuse of dominant position.

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ICA case A/395

According to section 14 of Italian competition law AQP proposed – and ICA accepted – some remedies in order to solve the alleged competition problems stemming from its previous conducts.

More in details:

1. AQP committed itself to propose to the local water competent authority some modifications of its regulation in order to allow the customers to build the connections themselves. AQP would only maintain the right to check the quality of the connections;
2. in case of connections built directly by AQP, customers will not pay in advance the whole amount as a precondition for receiving the water services.

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WASTE MANAGEMENT IN ITALY

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WASTE MANAGEMENT IN ITALY

Waste management is usually organized on a municipal basis.

As in most other countries, in Italy until few decades ago waste management was substantially concerned with collection and removal of waste from urban areas. Quantities were reasonably small, and the composition of waste was by far dominated by organic materials; disposal therefore was hardly perceived as a problem. (see Massarutto, *Municipal waste management in Italy*, Ciriec Paper, 2010)

Please note: since the 40's, municipalities have a legal obligation to organize garbage collection services. Historically, they contracted out services to small local companies or organized the services by means of 100% publicly owned companies: companies operating services under this regime normally enjoy a legal monopoly, that is exploited in agreement with the municipality.

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A big reform of environmental local services has been launched in the late 90's: following the model already adopted by water services, according to decree 22/1997 municipalities were forced to find a “cooperative solution”. While remaining responsible for the provision of service, municipalities thus delegate to own companies the task of operating it, adopting the technological and organizational choices and realizing investments.

Decree 22/1997 also provided for the establishment of collective systems aimed at implementing the producer's responsibility principle, with particular respect to packaging waste. The chosen approach, rather different than that adopted in other EU countries, was that of creating a mandatory association with the participation of industry producing and commercializing packaged goods and financed through a charge levied on raw packaging.

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Difference between municipal waste and business waste

As far as municipal waste is concerned, local authorities have (still) the legal obligation to provide collection systems and the corresponding right to impose a local tax aimed at cost recovery.

Municipalities enjoy some freedom about how to fulfil this responsibility:

The operators to which municipalities entrust the collection service become legally responsible for the waste they collect, and have to dispose of it according to the prescriptions of regional plans.

Until 2008, municipalities could freely choose among in-house delegation or tendering; law 112/2008 now obliges them to tender anyway, while publicly owned companies can participate to the tender.

In-house delegation without tender remains as a last resort. This legislative provision, however, is far from being fully implemented.

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The regime of business waste is based on the legal responsibility of waste owners to dispose of them in an authorized way, namely *(i)* running their own treatment and disposal phases or more easily *(ii)* entrusting them to specialized operators. Companies providing these services operate on the national market under a regime of authorization.

Important to be noted, integration of commercial and municipal waste takes place in the field of recycling. Once the industry is structured with a focus on materials (rather than on the origin of waste), it makes sense to manage jointly flows of similar materials arising from different flows and to integrate them in order to achieve materials of definite chemical and physical characteristics.

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WASTE MANAGEMENT IN ITALY

Packaging waste management and competition

As far as packaging waste and other specific waste flows are concerned, the law has established the creation of mandatory associations of producers, on which the responsibility to achieve targets is posed. In the case of packaging, the national consortium “CONAI” signs an agreement with municipalities fixing a negotiated price.

The price is established in order to minimize the total cost and let the consortium some freedom in the choice regarding both the location of sorting facilities and the areas where to concentrate efforts.

In fact, the price results roughly from a national average and is aimed to compensate the differential cost between separate collection and undifferentiated collection and disposal.

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WASTE MANAGEMENT IN ITALY

CONAI is the National Packaging Consortium, a private consortium of firms (more than 1.400.000) working towards the recovery and recycling of packaging issued for consumption on national territory, with the aim of meeting statutory targets. It has been created following decree 22/1997 provisions: it is the biggest consortium in Europe. In order to guarantee the recovery of packaging from public collection, CONAI has stipulated a framework agreement (Accordo Quadro) with ANCI, the national association of Italian municipalities, that lays down conditions for the take-back of packaging waste collected by town councils.

Within the ANCI-CONAI agreement, the Consortia may stipulate appropriate contracts with municipalities and waste collection service companies for the take-back of used packaging. To date, 7,000 municipalities have signed contracts and 90% of the population is now served within the framework.

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WASTE MANAGEMENT IN ITALY

CONAI system is based on the activities of the six Material Consortia representing Steel, Aluminium, Paper, Wood, Plastic and Glass, which are the raw materials used in packaging production. The Consortia, whose associates are the Producers, include all the main companies which define the life cycle of each material. CONAI directs and co-ordinates the activities of the six Consortia. Material Consortia operations cover the whole country and are concerned with every kind of packaging. The collection and recycling of packaging waste is regulated by agreements stipulated between Consortia and Municipalities.

The Consortia are:

CNA - National Consortium for the recovery and recycling of steel packaging;

CIAL - Aluminium packaging Consortium;

COMIECO - National Consortium for the recovery and recycling of paper and board packaging;

RILEGNO - National Consortium for the collection, recovery and recycling of wood packaging;

COREPLA - National Consortium for the collection, recovery and recycling of plastic packaging waste;

COREVE - Glass recovery Consortium.

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After the waste collection CONAI and its appendix-consortia ensure that separately collected waste is addressed to sorting facilities and recycled. It does not own and operate directly; rather, there are a number of private companies operating under a complex range of contracts. Sometimes the ownership of materials and the economic risk of successive marketing remains on Conai, while private companies operate on a manufacturing account base; but it is also frequent that materials are transferred in a definitive way, with processing companies assuming also the risk of marketing.

The CONAI-Consortia system has made a network of 450 platforms available to companies, for the take-back of secondary and tertiary packaging from industrial and commercial activities not covered by the public service. These are distributed throughout the national territory and process packaging material with no additional cost to companies.

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ICA INQUIRY IC26

The CONAI system maintains to be a success story in terms of collecting and recycling results achieved: In 2009 an overall 8,000,100 tonnes of packaging waste were recovered from municipal and non-municipal collection, equal to 68.5% of the total placed on the market.

However, its organization raised serious competition concerns, mainly with regards to the transfer of the waste materials. After having received several complaints by private undertakings active in the waste recycling industry, in 2005 ICA opened a general fact-finding inquiry into the packaging waste recycling sector.

The inquiry ended up in June 2008.

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ICA INQUIRY IC26

Final results of the inquiry were a general survey of the current state of packaging waste management system and competition in Italy. As a preliminary condition for improving competition in the sector, ICA stated that some general provisions should be amended in order to solve many conflicts of interest among municipalities and waste management companies.

With regards to the consortium system, ICA considered that consortia should be only one of the possible management solutions and law should not privilege it.

ICA also sent many recommendations to CONAI in order to make more transparent and competition-friendly its activities.

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More in details, ICA found that some consortia (COREVE and COMIECO) were acting with a serious lack of competition guarantees, mainly by avoiding public bids procedures.

ICA also stated that the general agreement among ANCI and the material consortia should allow municipalities to choose when giving the waste collected to the consortia and when sell it directly in the markets of packaging waste.

In december 2008 a new general agreement has been closed by accepting most of ICA's recommendations.

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ICA INQUIRY IC26

After the publication of ICA's fact-finding inquiry, COREVE changed its procedures and adopted a new tender system, while COMIECO kept its previous system.

In march 2010 ICA opened an investigative proceedings against COMIECO for alleged infringements of article 101 TFEU.
The proceedings is still open.