



EC COMPETITION
POLICY NEWSLETTER

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- Re-organisation of cartel work
- Oral hearings and the role of the Hearing Officers
- The Tetra Judgement
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- Antitrust — Merger control — State aid control



EUROPEAN COMMISSION

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Corrigendum to the table of contents and page 79 of the Spring issue, nr 1, 2005:

The article on page 79, 'First experiences with the new merger regulation: Piaggio / Aprilia', was written by Mario TODINO, Alberto BACCHIEGA and Lucilia FALSARELLA.

The State Aid Action Plan — a clear, comprehensive and predictable framework for state aid

A comprehensive five year reform of state aid policy to promote growth, jobs and cohesion

The guiding principles for a comprehensive reform of state aid rules and procedures over the next five years have been outlined in a State Aid Action Plan, recently adopted by the European Commission. Interested parties are invited to submit comments on the Action Plan by 15 September 2005, after which the Commission will present detailed reform proposals.

The complete text of the Action Plan is published on page 3 of this Newsletter. The article “Reforming state aid policy to best contribute to the Lisbon Strategy for growth and jobs” on page 29 gives further comments.

In particular, the Commission intends to reform the state aid rules to encourage Member States to

contribute to the Lisbon Strategy by better focussing aid on improving the competitiveness of EU industry and creating sustainable jobs (more aid for R & D, innovation and risk capital for small firms), on ensuring social and regional cohesion and improving public services. The Commission also aims to simplify and streamline procedures, so that less aid will have to be notified, relevant rules will be easier to apply, and decision-making will be faster.

Further information, as well as the text of the Action Plan in all of EU’s official languages, can be found on DG Competition’s web site:

http://europa.eu.int/comm/competition/state_aid/others/action_plan/

STATE AID ACTION PLAN

Less and better targeted state aid: a roadmap for state aid reform 2005 – 2009

(Consultation document)

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Introduction

1. Specific challenges call for a **comprehensive reform of state aid policy at this moment**. Time has come to build a momentum within the Commission and in partnership with Member States and stakeholders, so that state aid rules better contribute to sustainable growth, competitiveness, social and regional cohesion and environmental protection.
2. This Action Plan is a **consultation document** presenting an indicative roadmap for state aid reform during the period 2005/2009, which the Commission will conduct in close cooperation with Member States and stakeholders.
3. **The services of the Commission would welcome any comments on this Action Plan before 15 September 2005**. Moreover, stakeholders will also be involved in the elaboration of each concrete proposal.
4. Comments should be sent to the European Commission with the reference *State aid reform* by email to STATEAIDGREFFE@CEC.EU.INT or by post to:

DG Competition
State Aid Register
SPA 3, office 6/5
B-1049 Brussels
Belgium.

I. A MODERNISED STATE AID POLICY IN THE CONTEXT OF THE LISBON STRATEGY FOR GROWTH AND JOBS

I.1. Rationale for state aid policy: why does the EU need a state aid policy?

5. Ever since the signing of the Treaty of Rome in 1957, state aid policy has been an integral part of competition policy and the European Commission has been in charge of preventing that aid granted by Member States unduly distorts competition.
6. **Competition policy** rests upon the idea that a market-based economy provides the best guarantee for raising living conditions in the EU to the benefit of citizens, one of the primary objectives of the EU Treaty. Functioning markets are an essential element in providing consumers with the products they wish to obtain, at low prices. Competition is furthermore essential to enhance the competitiveness of the Euro-

pean economy, as it creates an environment in which efficient and innovative companies are rewarded properly.

7. State aid control comes from the need to **maintain a level playing field** for all undertakings active in the Single European Market, no matter in which Member State they are established. There is a particular need to be concerned with those state aid measures, which provide unwarranted selective advantages to some firms, preventing or delaying the market forces from rewarding the most competitive firms, thereby decreasing overall European competitiveness. It may also lead to a build-up of market power in the hands of some firms, for instance when companies that do not receive state aid (e.g. non-domestic firms) have to cut down on their market presence, or where state aid is used to erect entry barriers. As a result of such distortions of competition, customers may be faced with higher prices, lower quality goods and less innovation.
8. Further, it is important to realise that **state aid does not come for free**. Nor is state aid a miracle solution that can instantly cure all problems. Tax payers in the end have to finance state aid and there are opportunity costs to it. Giving aid to undertakings means taking funding away from other policy areas. State resources are limited and they are needed for many essential purposes, such as the educational system, the health system, national security, social protection and others. It is therefore necessary for Member States to make choices transparently and to prioritise action.
9. Article 87 of **the EC Treaty** prohibits any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain firms or the production of certain goods in so far as it affects trade between Member States. The Treaty has given the Commission the task to monitor proposed and existing state aid measures by Member States to ensure that they do not distort intra-community competition and trade to an extent contrary to the common interest. It falls under its responsibility to make sure that the level playing field would be maintained between Member States, no matter their different levels of resources and their different traditions of state intervention in the markets.
10. The Treaty explicitly allows exceptions to the ban on state aid where the proposed aid schemes may have a beneficial impact in overall Union terms. State aid may be declared

compatible with the Treaty provided it fulfils clearly defined **objectives of common interest** and does not distort intra-community competition and trade to an extent contrary to the common interest. State aid measures can sometimes be effective tools for achieving objectives of common interest. They can correct market failures, thereby improving the functioning of markets and enhancing European competitiveness. They can also help promote e.g. social and regional cohesion, sustainable development and cultural diversity, irrespective of the correction of market failures.

11. However, state aid should only be used when it is an appropriate instrument for meeting a well defined objective, when it creates the right incentives, is proportionate and when it distorts competition to the least possible extent. For that reason, appreciating the compatibility of state aid is fundamentally about balancing the negative effects of aid on competition with its positive effects in terms of common interest.
12. While the horizontal state aid rules in principle cover all sectors, certain sectors have very specific rules and due to the special nature of the rules governing agriculture, fishery, coal production and transport, special rules apply. While the principles put forward in the Action Plan should apply to all sectors, it does not address the reform of these rules. The objectives of the EURATOM Treaty and the obligations regarding the World Trade Organization have also to be taken into consideration.

I.2. New challenges for the EC state aid policy

13. There are new challenges facing state aid policy at this moment, which call for action. As was clearly expressed by the European Council of November 2004, there is a need for **renewed impetus to the so-called Lisbon Strategy**. The Commission Communication to the 2005 Spring European Council '*Working together for growth and jobs, a new start for the Lisbon Strategy*', has already set out a new Lisbon Action Programme where state aid control plays an important role.
14. The **European Council** of March 2005 has called on 'Member States to continue working towards a reduction in the general level of State aid, while making allowance for any market failures. This movement must be accompanied by a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimisa-

tion of human capital. The reform of regional aid should also foster a high level of investment and ensure a reduction in disparities in accordance with the Lisbon objectives'.

15. State aid policy safeguards competition in the Single Market and it is closely linked to many objectives of common interest, like services of general economic interest, regional and social cohesion, employment, research and development, environmental protection and the protection and promotion of cultural diversity. It must contribute by itself and by reinforcing other policies to making Europe a more attractive place to invest and work, building up knowledge and innovation for growth and creating more and better jobs.
16. **The enlargement** in 2004 was unprecedented in size. This underlines the need for adaptations of state aid policy and for better governance to ensure an effective control in the enlarged Union.
17. Besides, **the increasing complexity and number of documents** progressively adopted by the Commission over time have created a need to streamline state aid policy, focus attention on the most distortive types of aid and make state aid control more predictable and user-friendly, thereby minimising legal uncertainty and the administrative burden both for the Commission and for Member States. There is also a need to strengthen the commitment of Member States to their obligation to enforce state aid rules. Finally, there is a **need to increase transparency** and advocacy about state aid policy to allow undertakings, the academic world, competition specialists, consumers and the broader public to get involved and act against unlawful aid, in particular before national judges.

I.3. How to face the new challenges?

18. To face the new challenges requires a thorough modification of the existing state aid rules, as regards both substance and procedures. Any effective assessment of the allocation or distribution effects of State aid must take into account their actual contribution to commonly agreed, politically desirable objectives. The aim is to present a comprehensive and consistent reform package based on the following elements:
 - less and better targeted state aid;
 - a refined economic approach;

- more effective procedures, better enforcement, higher predictability and enhanced transparency;
 - a shared responsibility between the Commission and Member States: the Commission cannot improve state aid rules and practice without the effective support of Member States and their full commitment to comply with their obligations to notify any envisaged aid and to enforce the rules properly.
19. Economic and legal analyses are used to fulfil the Commission's obligations under the Treaty, in some cases to determine when a measure is state aid (e.g. application of the market investor principle or evaluation of the justification of certain measures by the nature or general scheme of the fiscal system) and in particular to determine when state aid can be declared compatible with the Treaty. In assessing whether an aid measure can be deemed compatible with the common market, the Commission balances the positive impact of the aid measure (reaching an objective of common interest) against its potentially negative side effects (distortions of trade and competition). It is for Member States to provide the necessary evidence in this respect, prior to any implementation of the envisaged measure.
20. The Commission will continue to develop criteria to fulfil its assessment of aid compatibility, in particular through analyses of specific sectors. In general, the positive impact of an aid depends on: i) how accurately the accepted objective of common interest (whether social, regional, economic or cultural) has been identified, ii) whether state aid is an appropriate instrument for dealing with the problem as opposed to other policy instruments and iii) whether the aid creates the needed incentives and is proportionate. On the other hand, the level of distortion created by an aid generally depends on: i) the procedure for selecting beneficiaries and the conditions attached to the aid, ii) characteristics of the market and of the beneficiary and iii) the amount and type of aid. For example, restructuring aid or investment aid to large companies should be carefully monitored to clearly address an objective of common interest, since the impact of such measures on competition and trade will normally be significant.
21. To best contribute to the re-launched Lisbon Strategy for growth and jobs, the Commission will, when relevant, strengthen its **economic approach to State aid analysis**. An economic approach is an instrument to better focus and target certain state aid **towards the objectives of the re-launched Lisbon Strategy**.
22. Making more use of a refined economic approach is a means to ensure a proper and more transparent evaluation of the distortions to competition and trade associated with state aid measures. This approach can also help investigate the reasons why the market by itself does not deliver the desired objectives of common interest and in consequence evaluate the benefits of state aid measures in reaching these objectives.
23. One key element in that respect is the **analysis of market failures**, such as externalities, imperfect information or coordination problems, which may be reasons **why the markets do not achieve desired objectives of common interest**, in particular if they are of an economic nature. In those cases, identifying the market failure at stake will help evaluate better whether state aid could be justified and acceptable, would represent the most appropriate solution, and how it should be implemented to achieve the desired objective without distorting competition and trade to an extent contrary to the common interest.

State aid in the context of the Lisbon Strategy

Competition is vital for the economy to be efficient, to untap Europe's growth potential to the benefit of the European citizens. In this context, 'efficiency' refers to the extent to which welfare is optimized in a particular market or in the economy at large. A '**market failure**' is consequently a situation where the market does not lead to an economically efficient outcome. Market failures have different origins, and notably:

- *Externalities*: externalities exist where actors do not take full account of the consequences of their actions on other actors in society. Market players may not have to pay for the full social cost of their actions (negative externalities) like in the case of pollution through industrial activity. Market players may also be unable to reap the full benefits of their actions (positive externalities) like in the fields of research and innovation.
- *Public goods*: public goods are goods which are beneficial for society but which are not normally provided by the market given that it is difficult or impossible to exclude any-

one from using the goods (and hence making them pay for the goods). This can be the case of national defense and some types of public broadcasting.

- *Imperfect information:* imperfect information may lead to transaction costs, agency costs, moral hazard or antiselection, which in turn lead to inefficient market outcomes. A well-known example of imperfect information can be found in the financial market, where start-up firms usually face problems in finding adequate funding.
- *Coordination problems:* markets may also not function efficiently when there is a coordination problem between market actors. Coordination problems may exist for example in the field of standards setting, in transport infrastructures, or in the area of innovation.
- *Market power:* Another reason why the market may not lead to an efficient outcome is the existence of market power, for instance in a situation of monopoly.

When markets do not achieve economic efficiency, Member States or the Union may want to intervene in order to correct the market failures. Some of the above-mentioned situations may be solved by regulatory or other means. In certain cases, however, Member States may envisage to use state aid. One important justification for state aid is therefore the existence of a market failure.

However, it is not enough for state aid to target a market failure. Before resorting to State aid, which is in general only the 'second best' option to achieve optimal allocation of resources, it should be verified whether other less distortive measures could remedy the market failure. State aid should be the appropriate policy instrument and should be designed so that it effectively solves the market failure, by creating an incentive effect and being proportionate. In addition, state aid should not distort competition to an extent contrary to the common interest.

In the context of the re-launched Lisbon Strategy, the European Council has invited Member States to pay attention to market failures. Moreover, an effort to ensure social and economic cohesion and sustainable development should also be made.

II. FOCUSING ON THE KEY PRIORITIES

II.1. Targeting Innovation and R&D to strengthen the knowledge society

24. Europe's future economic development depends on its ability to create and grow high-value, innovative and research-based sectors capable of competing with the best in the world. This priority of knowledge and innovation has been clearly endorsed in the Communication to the Spring European Council.
25. In this context, in 2005, the Commission will adopt a **Communication on state aid and innovation** which will analyse the need and the potential to adapt existing rules in order to create the appropriate framework conditions to foster innovation in the EU. This will complement the Competitiveness and Innovation Framework Programme. Innovation is related to a process connecting knowledge and technology with the exploitation of market opportunities for new or improved products, services and business processes compared to those already available on the common market and encompassing a certain degree of risk. This process may be hampered by market failures (mostly externalities, public goods and imperfect information leading to inefficient dissemination, insufficient funding and labour market mismatches). State aid can be justified when it is necessary to increase the incentive to innovate and when it does not lead to a crowding out of private initiatives or to unfair competition.
26. The Commission's Vade mecum on Innovation has shown that a number of possibilities already exist to grant aid to target the market failures which are hampering innovation activities, but that the rules could nevertheless be improved. Additional possibilities will be analysed to cover measures which can boost innovation in the common interest. Particular attention will e.g. be paid to the specific situation of small and medium-sized enterprises, to the role of intermediaries (e.g. clusters, technology centres) and to highly-skilled researchers working in the area of innovation. The specific amendments suggested in the Communication will subsequently be made when the relevant rules are revised.
27. In addition, the Commission will modify the Community **Framework for Research and Development**, in the light of the Lisbon and Barcelona objectives. This review will also seek to better take into account the priorities

of the Community's R&D policy such as the promotion of cross-border research cooperation, public-private research partnerships, dissemination of research results and important research projects of common European interest. State aid to R&D could enable Member States to target market failures and provide the right incentives for industry to invest more in R&D. The Commission will base the review of the framework on an approach better reflecting an interactive industrial innovation process which can also take account of continuous feedback from the market.

28. The framework should also take account of the growing importance of public private partnerships in the R&D field. In particular, it should provide for adequate provisions for collaborative research including the ownership of, access to and exploitation of Intellectual Property Rights obtained in such projects. Furthermore, the need to allow for aid for dissemination will have to be considered in the course of the review. The Commission will also consider if the scope of the framework should be extended to cover types of aid in favour of certain innovative activities, not already covered by existing guidelines or regulations thereby creating a **Framework for R&D and innovation**. In addition, if the Commission can establish clear and general compatibility criteria on the basis of experience, it will exempt certain aid measures from the obligation to notify to the Commission.

II.2. Creating a better business climate and stimulating entrepreneurship

29. Urgent action is needed to improve the business climate, notably by reducing the total administrative burden, simplifying and improving the quality of legislation, facilitating the rapid start-up of new enterprises, and creating an environment more supportive to business.
30. To facilitate the rapid start-up of new enterprises, the Commission will review the **Communication on risk capital**. The aim of the review will be to contribute to a culture of entrepreneurship and further stimulate investment in the form of risk capital, in particular in favour of start-ups and young, innovative SMEs, where this can properly address identified market failures. In particular, the Commission will focus on the need to further increase the flexibility of the rules to take into account diversity, especially as regards the level of the safe-harbour investment tranches for which the so-called 'equity gap' is presumed to exist.

II.3. Investing in Human Capital

31. The achievement of a high level of employment, sustainable growth and economic and social cohesion are key objectives of the Community. The European Employment Strategy (EES), which is a cornerstone of the revised Lisbon Strategy, promotes a high level of employment together with a skilled, trained and adaptable workforce. This requires a substantial investment in human capital. In this context, state aid could be justified when it is necessary to provide the right incentives for employers to engage more workers, particularly those who have difficulties to access and remain on the labour market, and to provide appropriate training for workers. Furthermore, strengthening the adaptability and upgrading skills of workers and enterprises overall, and improving the quality of education and training provisions are a key to improve the capacity of the EU to anticipate, trigger and absorb economic change of an ever accelerating pace.
32. The block exemption regulations for training and employment aids both expire at the end of 2006. The Commission intends to simplify and consolidate these block exemptions in the context of a general block exemption regulation, taking account of the principles set out above.

II.4. High quality Services of General Economic Interest

33. The provision of effective and high quality **Services of General Economic Interest (SGEI)** is a key component of the European welfare state and is essential for ensuring social and territorial cohesion, including in the field of education, training and culture, and for the exercise of an effective citizenship. High quality SGEI also contribute to the competitiveness of the European economy. Member States enjoy a wide margin of discretion when deciding whether and in what way to finance the provision of services of general economic interest. However, to avoid distortion of competition the compensations granted should make the performing of public service missions feasible without leading to overcompensation and undue distortions of competition.
34. The White paper on services of general interest announced that the Commission would adopt legislative texts to provide more guidance on this principle. To increase legal certainty, the Commission will adopt a Decision on the basis of Article 86.3, and guidelines to specify under which conditions public service compensations which constitute state aid are compatible

with the Treaty. The Commission Decision would grant an exemption of notification for small scale compensations. Special conditions should also apply to hospitals and social housing companies. Finally, the Commission will adapt the transparency directive, to take account of the evolution of the jurisprudence of the European Courts.

II.5. Better prioritization through simplification and consolidation

35. To ensure better governance and facilitate the granting of aid, which is clearly compatible with the Treaty, the Commission will issue a **general block exemption** regulation to exempt certain categories of aid from the obligation to notify to the Commission. The regulation will be based on the principle that state aid policy should focus on the most distortive types of aid and that it should set clear 'positive' and 'negative' priorities.
36. The Council has enabled the Commission, through the Enabling Regulation, to exempt certain areas in which the Commission can define general compatibility criteria, which should lead to the same interpretations in different Member States. The Commission has the power under certain conditions to exempt aid related to SMEs, R&D, environment, employment, training and regional development. In the general block exemption, the Commission intends to **simplify and consolidate** the existing block exemptions (training, SME and employment) and integrate a **broader range of exemptions**, notably as regards aid to support SMEs and R&D. Categories of aid which can be clearly defined may fall within the scope of a block exemption regulation, whilst for some forms of aid which cannot be precisely defined in advance, guidelines may constitute a more flexible instrument.
37. The Commission will also consider integrating some categories of aid, such as regional and environmental state aid and rescue aid for SMEs while addressing the problems raised by cumulation of different types of aids. The Commission will also consider exempting larger amounts of aid than presently, on the basis of economic analysis and experience. However, this will be made on the condition of greater responsibility by Member States in **complying with the rules and criteria** set by the block exemptions.
38. In addition, the threshold under which Member States may grant **de minimis aid** without

further specific requirements will be increased to take account of the evolution of the economy.

II.6. A focused regional aid policy

39. As was clearly expressed in its Communication to the Spring European Council, the Commission is fully committed to sustainable development and to modernising and advancing Europe's social model. This commitment also applies to state aid policy.
40. In this context, cohesion in particular is an important element of the Lisbon strategy: reducing disparities between the regions of Europe is a factor of stability and a tremendous growth potential. Past enlargements have shown that there is scope for win-win development between richer and poorer regions. State aid policy can contribute to such a positive outcome, by preventing a damaging subsidy race between regions, and by creating the right incentives for growth and jobs, in the least-developed regions and elsewhere.
41. The Commission's regional aid policy needs to be updated to take account of developments in the seven years since the last guidelines were adopted in 1998, in particular enlargement. The Commission has launched a review of the **Community guidelines on regional aid (or 'RAG')**, and has the intention to integrate the **Multisectoral Framework on regional aid for large investment projects**. This review will take account of the Third Cohesion Report, which suggests organising future cohesion policy around three main objectives: a) convergence; b) regional competitiveness and employment; and c) European territorial co-operation. These objectives also underlie the Commission's proposals for the structural fund regulations.
42. Given the necessity to use investment aid to large firms sparingly in order to preserve its effectiveness in promoting overall, long-term competitiveness through a reduction of regional disparities, this type of aid could mainly be concentrated on the least-developed regions.
43. Regional aid must be seen in the context of the possibilities for granting aid for horizontal purposes envisaged in this Communication, in particular for aid measures more directly linked to the pursuit of the Lisbon agenda. It will be necessary to examine whether and to which extent regional bonuses present in current horizontal texts should be maintained.

44. The Commission will also examine what levels of aid can be justified outside the least-developed regions, what the aid differentials should be, what categories of undertaking should benefit and for which categories of aid. All this should will the Member States sufficient flexibility to develop policies at national level to promote regional competitiveness and employment and European territorial cooperation, while meeting the overall objective of 'less and better targeted aid'.

II.7. Encouraging an environmentally sustainable future

45. Environmental protection is in itself essential. It can also be a source of competitive advantage for Europe, by providing opportunities for innovation, new markets and increased competitiveness through resource efficiency and investment.
46. The **Community guidelines on state aid for environmental protection** are applicable until 2007. In 2005, the Commission will start reflecting on ways and means to better address the challenges and opportunities that sustainable development creates, as set out in the Lisbon and Sustainable Development Strategies, especially with the aim of ensuring a full internalisation of environmental costs. In particular, the Commission will attempt to encourage eco-innovation and improvements in productivity through eco-efficiency in line with the Environmental Technologies Action Plan (ETAP). Certain measures might also be exempted under the general block exemption from the obligation to notify the aid.

II.8. Setting up modern transport, energy and information and communication technology infrastructures

47. The Lisbon Action Plan stresses that modern transport, energy and information and communication technology infrastructures throughout the EU territory are a prerequisite for reaping the benefits of a re-invigorated Lisbon Strategy. It therefore invites Member States to fulfil their commitments in terms of investments for Transport and Energy Networks. Member States increasingly rely on Public Private Partnerships to build infrastructures. It is thus important that state aid rules are clear for the assessment of public resources involved in Public Private Partnerships. More generally, as a consequence of the recent opening of formerly state-controlled markets, public bodies

are increasingly involved in a number of markets. This may raise legal issues regarding the applicability of state aid rules. The Commission will consider the need to issue guidance in those matters.

III. MODERNISING THE PRACTICES AND PROCEDURES OF STATE AID

III.1. Better governance — a shared responsibility with Member States

48. Currently, there are certain **shortcomings in the practices and procedures** of state aid policy, which can be observed in the long time frame for the treatment of cases. To a certain extent the reason for this delay is to be found in the many obligatory requirements in the Council procedural regulation N° 659/1999 (ex: linguistic coverage and publication requirements), and if no action is taken this time frame is even likely to increase due to enlargement. Longer time frames are clearly an unacceptable outcome, bearing in mind that a trade off might exist between the duration of the procedure and ensuring an effective control while safeguarding the rights of third parties.
49. Where possible **within the scope of the current procedural regulations**, the Commission will in the short term improve its internal practice and administration, and increase efficiency, enforcement and monitoring. Since the success will depend on the practices in Member States too, they should also make an effort to improve their efficiency, transparency and implementation of state aid policy.
50. The Commission will consider issuing **best practices guidelines** after consulting Member States as well as the public on how procedures could be improved to better administrate state aid control. It will notably try to instil more predictable timelines; clear intermediary steps in the procedure and ensure higher transparency by providing more information on Internet. The Commission will also reduce delays by encouraging a higher quality of notifications and by discouraging incomplete notifications by a more systematic use of the information injunction, requesting Member States to provide complete information within a certain period.
51. While the Commission has the competence to adopt detailed state aid rules, the successful implementation of the rules and procedures

depends to a large extent on Member States. In the context of enlargement, the screening of state aid measures was conducted by operationally independent monitoring authorities in the new Member States. This has been a valuable experience which should be taken into account when considering further cooperation between the Commission and all Member States. In this context, the Commission will examine whether **independent authorities** in Member States could play a role as regards facilitating the task of the Commission in terms of state aid enforcement (detection and provisional recovery of illegal aid, execution of recovery decisions).

III.2. Less bureaucracy and better targeted enforcement and monitoring

52. Best practices guidelines together with the general block exemption and the increased *de minimis* ceiling are expected to reduce both the time it takes before the Commission reaches its decisions and the administrative burden for Member States. But **Member States should engage more actively** to ensure that the conditions for the exemptions are fully respected and that necessary information is kept in accordance with the relevant rules, in order to enable the Commission to verify the compatibility in case of doubts or complaint.
53. The effectiveness and credibility of state aid control presupposes a **proper enforcement** of the Commission's decisions, especially as regards the recovery of illegal and incompatible state aid. Recent experience has shown that the implementation of recovery decisions by Member States is not satisfactory and, moreover, that conditional or positive decisions are sometimes not correctly implemented by the Member States. The Commission will therefore:
 - Seek to achieve a more immediate and effective execution of recovery decisions, which will ensure equality of treatment of all beneficiaries. To this effect, the Commission will monitor more closely the execution of recovery decisions by Member States. Recovery has to be carried out in accordance with national procedures. But where it appears that recovery is not carried out in an immediate and effective manner, the Commission will more actively pursue non-compliance under Articles 88(2), 226 and 228 of the Treaty;
 - Request more transparency in the general principles of state aid control and consider establishing a network of state aid authorities or contact points in order to facilitate the flow of information and exchange of best practices;
 - Promote advocacy, awareness and understanding of state aid control at all levels to help the granting authorities in designing measures that are compatible with the treaty rules.
54. The Commission will step up its **monitoring of the compliance** by Member States of conditions laid down in state aid decisions, including the respect of the provisions of the block exemption regulations. It will also encourage Member States to engage in benchmarking to verify that state aid is achieving the objective and is the best type of state intervention for any given objective. This could be done in partnership with national Courts of Auditors.
55. The Commission will also engage in **advocacy** to encourage stakeholders to ensure that the rules of state aid are fully respected. Article 88 (3) EC has direct effect and gives national judges the power to suspend and provisionally recover aid granted illegally before its approval by the Commission. Private litigation in front of national courts could therefore provide increased discipline in the field of state aid. The awareness of company auditors, national market regulators and national Courts of Auditors could also be reinforced. To this effect, the Commission has launched a study focusing on two main aspects of enforcement of state aid law at national level; namely the role of national courts in the protection of rights conferred upon interested parties, notably competitors of the beneficiaries of unlawful aid, and the enforcement at national level of negative decisions, in particular those with recovery obligation.
56. One additional area where **national judges** could play a greater role could be in controlling whether measures deemed to fall under a block exemption or under the *de minimis* thresholds, and which have therefore not been notified to the Commission, actually fulfil the necessary criteria. If needed, the Commission will consider reviewing the Notice on cooperation between national courts and the Commission in the state aid field, in particular whether to expand its scope to other national bodies.

III.3. Adapting procedural rules to an enlarged European Union

57. The Commission will examine all possible actions to lower administrative costs and improve the procedural rules with a particular aim to reduce the time period for treatment of cases in which the Commission has opened procedure; to provide a clear incentive to comply with the obligation to notify aid measures and to achieve an enhanced efficiency, monitoring and enforcement. In this context, the Commission intends to present a consultation document in 2007 which will be discussed with Member States, and could lead to a **proposal for amendment of Council Regulation n° 659/1999 (procedural Regulation)**.

58. Possible options to consider are e.g.:

- To **save time and increase transparency**, the Commission could increase the use of the internet; the Commission could also commit to conclude its investigation in shorter time-frame, provided Member States ensure good co-operation, that procedures be opened in case of doubts, and that negative decisions could be adopted if all relevant information has not been submitted before a certain deadline. In addition, administrative procedures and linguistic issues such as translation requirements could be reviewed.
- To **ensure that aid measures are duly notified**, the scope of the recovery injunction could be expanded to invoke a systematic transitory recovery of non-notified aid and some sort of deterrence mechanism on Member States could be introduced for measures which have not been notified. For instance, periodical reviews of the track records of Member States in terms of notification could be implemented. Where it appears that a Member State fails in notifying properly its state aid, the Commission could pursue the non-compliance under Articles 226 and 228 of the Treaty to seek penalties.
- To **achieve greater efficiency**, the discussion and design of appropriate measures could be formalised more precisely. Also, the Commission could enhance the consultation of market participants and the gathering of relevant sectoral information through new instruments granting additional investigative powers. A written procedure for the Advisory Committee on state aid could also be foreseen.

59. In addition the Commission will evaluate the need to enlarge the scope of **Council Regulation No 994/98 enabling** the Commission to block exempt additional types of measures, e.g. aid for culture and heritage conservation. In that context, the Commission intends to clarify the roles and uses of block exemptions and guidelines, and will consider the possibility of giving the block exemptions not only a positive effect like the one they already have, but also in certain cases a negative effect. This would mean that some criteria for exemption of notification would also be criteria for compatibility of aid, which would enable the national jurisdictions to apply block exemptions directly not only by declaring the compatibility by also the incompatibility of certain aid.

III.4. A comprehensive review of the remaining documents

60. The Commission has considered the necessity to review every single Commission document related to the granting of state aid. In the last stage of the reform the Commission will aim at reviewing the remaining documents, where necessary, so that the same principles are applied consistently and comprehensively in all state aid instruments.
61. Along those lines, the Commission will review the **Communication on short-term export-credit insurance**, and the methodology for the **calculation of reference and recovery rates**. Before the new **rescue and restructuring aids guidelines** published in 2004 lapse in 2009, the Commission will start reflecting upon the need to change some of the existing provisions of the guidelines. In particular, it will take into account the amendments of regional aid policy, the relationship with different national insolvency procedures and the rules for the social protection of the workforce of companies under restructuring.
62. Media, audiovisual services, creative industries and the cultural sector as a whole have a high potential in terms of innovation, competitiveness, growth and job creation. They are also key in preserving and promoting the rich cultural and linguistic diversity in the EU. In examining state aid issues in these sectors, the Commission fully takes into account the relevant Treaty provisions (particularly art. 151.4 and 87.3.d) and the Protocol on the system of public broadcasting in the Member States annexed to the Treaty of Amsterdam, and reflects the specific public interests attached to these activities. In that respect, it will revisit its

Communication on the application of state aid rules to public service broadcasting. Notably with the development of new digital technologies and of Internet-based services, new issues have arisen regarding the scope of public service broadcasting activities. It will also consider reviewing the **Communication on certain legal aspects relating to cinematographic and other audiovisual works (cinema communication)**. In addition, and on the basis of its experience in this field, the Commission could ask the Council to extend the scope of the Enabling Regulation, so that cinema can also benefit from a *block exemption*.

63. In addition, the Commission will engage in a broader thinking about the ways in which state aid is given to undertakings. Some aid measures are more transparent than others; some are more directly targeted towards precise objectives. This raises questions about the effectiveness and distortive effects of different forms of aid. Therefore, the Commission will issue a **consultation document on the aid element in different forms of aid**, in order to collect the view of member states and of undertakings. The consultation could indicate whether the Commission should systematically be stricter towards certain forms of aid than towards others.
64. To complement that general reflection, the Commission will revisit its **Notice on state**

aid in the form of guarantees to incorporate its experience and assess whether the current rules and criteria should be amended. In the same context, the Commission will consider revising its **Notice on the application of the state aid rules to measures relating to direct business taxation** published in 1998, in particular to examine whether it should be extended to indirect taxation.

65. Finally, the Commission will decide whether a **Framework for state aid to shipbuilding** is still needed or if the sector should simply be governed by horizontal rules.
66. Following agreement on a new Council regulation on rural development, expected for June 2005, the Commission will undertake a review of the existing specific measures for **state aid in the agricultural sector**. Draft proposals will be presented in time to allow for formal adoption in 2006 and application from 1 January 2007 onwards.

III.5. Establishing and evaluating the new practice for the future

67. After having finalised the comprehensive review of State aid, the Commission will conduct an evaluation exercise, in order to make sure that the new rules and practice of state aid policy work properly for the benefit of European citizens. If necessary, new actions will be proposed.

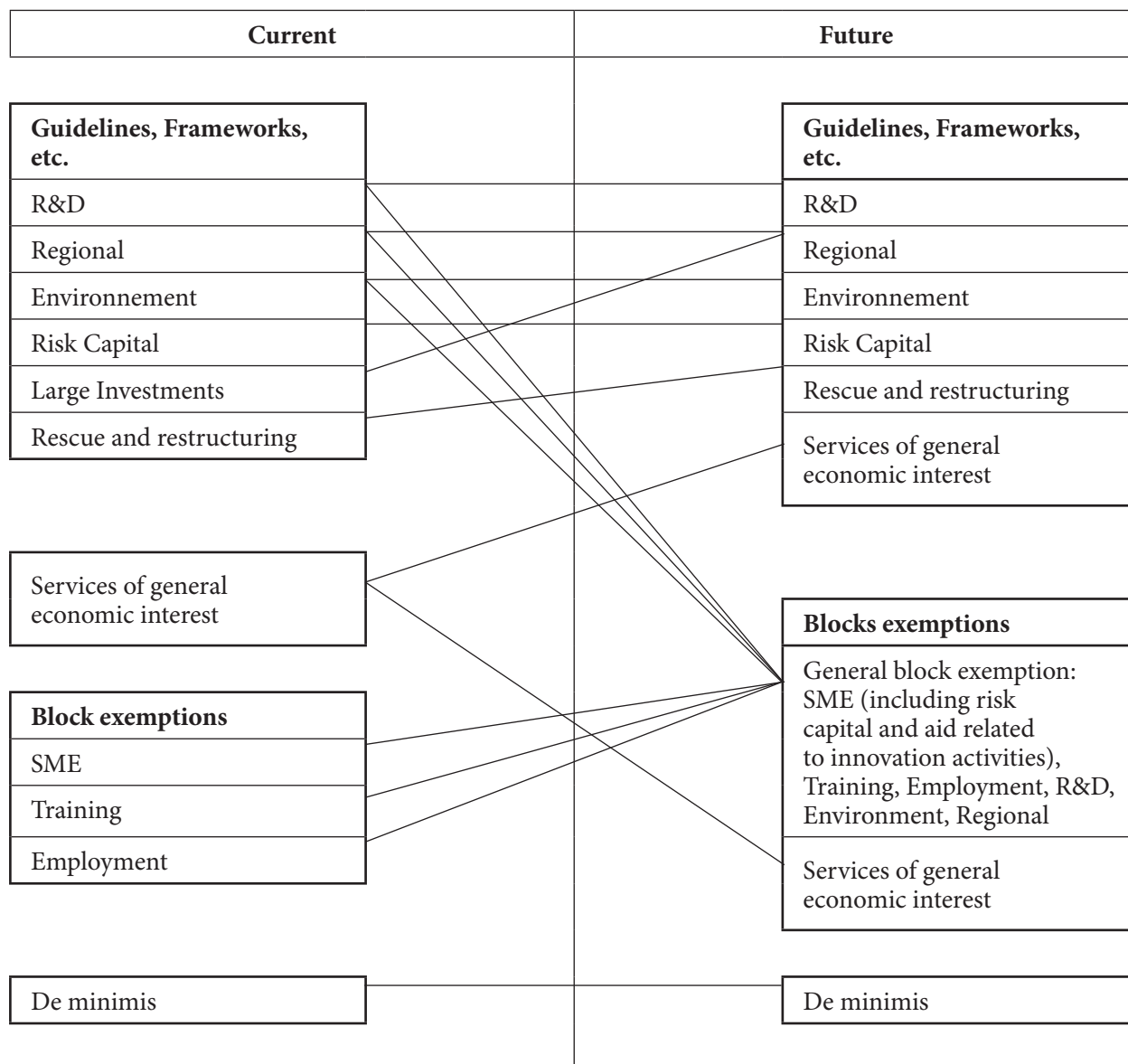
68. Figure 1 gives an overview of the road map 2005-2009 with an indicative division in three stages.

Figure 1:
Roadmap 2005 -2009 (indicative)

<i>Modifications</i>	2005/2006	2007/2008	2009
Substance	Road map for state aid reform 2005-2009 Regional aid guidelines General Block Exemption (SME, employment, training, R&D, <i>de minimis</i> , regional, environment) Communication interest rates Guidelines R&D and Innovation Communication short term credit insurance Communication risk capital Decision and guidelines on the Services of General Economic Interest and transparency directive Guidelines environment Framework on State aid to Shipbuilding	Assessment/ modification of the rescue and restructuring aid guidelines. Notice on state aid in form of guarantees Communication on direct business taxation Communication on state aid to public broadcasting. Possible additional block exemptions	Assessment of the reform and review of existing state aid rules
Consultation documents	Communication on innovation	Consultation document on possible modification of Council Regulation 659/99. Consultation document on the different forms of aid	
Procedure	Internal best practices guidelines Promotion of state aid advocacy. Increase monitoring of decisions and recovery Possible proposal for amendment of the Council Regulation No 994/98 (enabling regulation)	Possible proposal for amendment of Council Regulation 659/99 (procedural Regulation) Notice on cooperation between national courts and the Commission in the state aid field	

69. Figure 2 gives an overview of the expected major changes to the architecture of State aid rules.

Figure 2:
Expected major changes to the architecture



Enforcement of State aid recovery decisions

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The Procedural Regulation of 1999 provides that the Commission should order a Member State to recover any unlawful State aid that is found to be incompatible, except where such recovery would be contrary to a general principle of Community law. Article 14(3) of the Regulation clarifies that the Member State concerned should 'effect recovery without delay and in accordance with the procedures under national law, provided that they allow the immediate and effective execution of the Commission's decision'.

Since the entry into force of the Procedural Regulation in 1999, the number of recovery decisions adopted by the Commission increased significantly. At the same time, the Commission noted that the execution of these decisions by the Member States did not proceed in a satisfactory manner. As a result, the number of recovery decisions that were still awaiting execution at national level (hereinafter referred to as 'pending recovery cases') started to rise rapidly.

As recovery is the ultimate sanction for breaking State aid rules, the non-execution of recovery decisions threatened to undermine the credibility of the Community's State aid policy. Commissioner Monti recognised this problem and decided in 2003 to set up an Enforcement Unit that was given as one of its main objectives to improve the implementation of recovery decisions by Member States.

This article presents some statistical data on State aid recovery decisions and on the progress made towards their execution since the establishment of the Enforcement Unit.

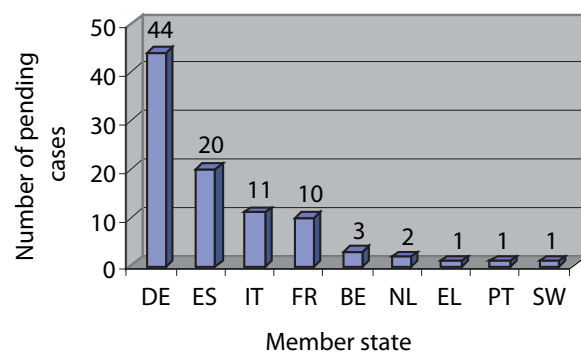
Development of the stock of pending recovery cases ⁽¹⁾

Since the entry into force of the Procedural Regulation in 1999, the number of 'pending recovery cases' has increased considerably, from 55 at the end of 2000 to 90 at the end of 2003. In 2004, the number of pending cases continued to rise to 93, a modest increase due mainly to the 'inflow' of an unusually high number of new recovery decisions adopted in 2004 (22 new recovery decisions, compared to 19 pending cases that could be closed). Preliminary data for the first months of 2005 sug-

gests that the stock of pending recovery cases has now finally started to fall (2 new recovery decisions adopted; 15 pending cases that could be closed between 1 January and 30 April 2005).

More than nine out of ten pending recovery cases concern only four Member States (Germany, Spain, Italy and France). At the same time, there are no pending cases for six of the fifteen old Member States, nor any for the ten new Member States.

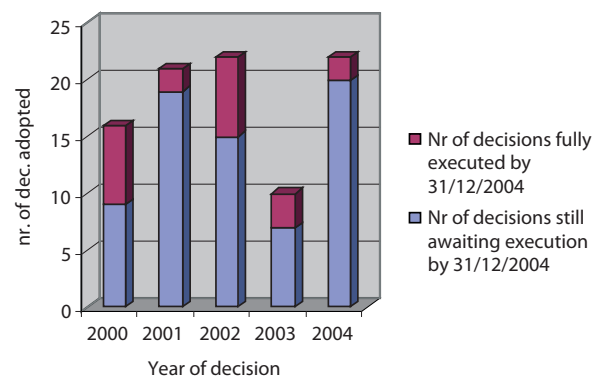
Figure 1 – Number of pending recovery cases by Member State (31/12/2004)



Source: DG Competition.

The execution of recovery decisions at national level tends to be a lengthy process. Almost one quarter of the 93 recovery decisions that were pending on 31/12/2004, had been adopted more than five years earlier (i.e. before 1/1/2000). Of the 91 decisions adopted between 2000 and 2004, Member States had executed only 21 by the end of 2004.

Figure 2 – Number of recovery cases executed/pending by year of decision (situation on 31/12/2004)



Source: DG Competition.

⁽¹⁾ The statistical data in this article refer to recovery decisions that fall within the remit of DG Competition only.

Aid amounts involved

The information available confirms that the total amount of unlawful and incompatible aid concerned by the Commission's recent recovery decisions is very important: at least € 9.2 billion of aid to be recovered under decisions adopted between 2000 and 2004 ⁽¹⁾.

In spite of the delays in the execution of many recovery decisions, significant amounts of incompatible aid have been effectively recovered by Member States in recent years, and especially in 2004/2005. By the end of April 2005, € 5,998 million of unlawful and incompatible aid had been reimbursed or declared lost in bankruptcy proceedings (i.e. 65.1% of the total amount of aid to be recovered) and a further € 1,998 million in recovery interests. The table below gives an overview of the amounts recovered related to Decisions adopted since year 2000 till 2004.

pending cases has even declined in the first months of 2005. In spite of these positive developments, the situation regarding the execution of recovery decisions is still unsatisfactory. The information available shows that there are still unacceptably long delays in the execution of recovery decisions at national level in far too many cases.

The experience gained by the Enforcement Unit confirms that these delays are due to three main factors:

Failure by the Member State to take adequate action

In many cases, the delays are caused by the Member State's failure to take effective action to implement the decision. In this context, one should keep in mind that the authority charged with the execution of the recovery order is often the very same authority that originally granted the incompatible

Table 1 — Aid amounts to be recovered and recovered by 30/04/2005

	Date of Decision					
	2000	2001	2002	2003	2004	Total
Number of recovery decisions adopted	16	21	21	10	22	90
Number of recovery decisions for which the aid amount is known	15	12	16	8	17	68
Total aid ⁽¹⁾ to be recovered (in million €)	361.6	1 827.5	1 089.3	1 115.3	4 822.2	9 215.9
Aid already recovered by 30/04/2005 (million €)						
Of which:	121.4	811.3	1 440.0	1 228.1	4 396.2	7 997.0
(a) Principal reimbursed/in blocked account	17.1	797.8	1 036.4	892.4	3 134.9	5 878.6
(b) Aid lost in bankruptcy	104.3	13.5	1.2	0.7		119.7
(c) Recovery interest paid			402.4	335	1 261.3	1 998.7
Amount outstanding on 30/04/2005 (excluding interest)	240.2	1 016.2	51.7	222.2	1 687.3	3 217.6
% still pending to be recovered	66.4%	55.6%	4.7%	19.9%	35.0%	47.8%

Source: DG Competition.

⁽¹⁾ Only for Decisions for which the aid amount is known.

Main obstacles to the immediate and effective execution of recovery decisions

The data presented above suggests that, since 2003, some progress was made towards an improved execution of recovery decisions. Significant amounts of incompatible aid have already been recovered (especially since 2004) and the stock of pending recovery cases appears to have stabilised in 2004. More recent data confirms that the number of

aid (and presumably, at the time of the granting, the authority responsible was convinced that the granting of that aid was fully justified). On this point, though, the Procedural Regulation is very clear: Article 14(3) provides that the Member State concerned is to effect recovery 'without delay' and that it should take 'all necessary measures available under national law to recover the aid from the beneficiary'. It is of course true that, in some cases, the Member State might be faced with a number of practical difficulties to execute recovery decisions (e.g. in cases in which the incompatible aid was granted through fiscal schemes with many thousands of beneficiaries). In such cases, the ECJ has confirmed on several occasions that only the absolute impossibility can be accepted in order not to

⁽¹⁾ It should be noted that the information available on amounts to be recovered is not complete. DG Competition received reliable information on aid amounts to be recovered in only 68 out of the 90 recovery decisions adopted between 2000 and 2004.

comply with a recovery decisions⁽¹⁾. Therefore, it is not sufficient for the Member State to inform the Commission of some legal and practical difficulties preventing the implementation of a particular recovery decision, without taking any step whatsoever to recover the aid from the undertaking in question and without proposing to the Commission any alternative arrangement for implementing the decision. In such a case, the Commission and the Member State must, in accordance with Article 10 ECT, work together in order to overcome the difficulties whilst fully observing the EC treaty provisions.

Whenever the Commission considers that the Member State does not take all measures available under national law to execute a particular recovery decision, it can refer the matter directly to the ECJ. In a first step it can file an Article 88(2) ECT action against the Member State concerned for its failure to comply with the recovery decision within the prescribed time. If the Member State has been condemned by the ECJ for failing to execute the recovery decision and if it still does not take all measures available under national law, the Commission can bring a further action under Article 228(2) ECT action, this time for the Member State's failure to comply with the ECJ's judgment.

Since 2003, the Commission decided to initiate an Article 88(2) ECT action for failure to execute recovery decisions against four Member States, namely Spain (Basque fiscal schemes⁽²⁾), France (Kimberley Clark/Scott Paper)⁽³⁾, Italy (Municipalizzate)⁽⁴⁾ and Germany (Thuringen Porzellan (Kahla))⁽⁵⁾. In addition, the Commission also decided to send a letter of formal notice (the first step in the Article 228(2) ECT procedure) to Spain for its failure to execute the recovery decision regarding Spanish Shipyards⁽⁶⁾. More details on these cases can be found in the box.

Lack of precision in the recovery decision

A second factor that has sometimes complicated the execution of recovery decisions is the lack of precision of the recovery provisions in the final negative decisions (e.g. lack of precision regarding the identity of the undertaking that has to reimburse the aid or regarding the precise amount to be reimbursed). To avoid this problem in the future, the Enforcement Unit is now closely involved in

the drafting of the final decision to ensure that the operative part of the decision includes all the necessary elements to allow a smooth execution of the recovery.

Length of national recovery procedures

In the majority of cases, however, the main cause of the delay in the execution of recovery decisions lies in the long duration of national recovery procedures. On several occasions, the ECJ has enounced that the recovery of unlawfully paid aid must take place in accordance with the relevant procedural provisions of the national law, subject however to the proviso that those provisions should be applied in such a way that the recovery required by Community law is not rendered practically impossible. The Procedural Regulation has reinforced this principle in article 14(3), which says that '*recovery shall be effected without delay and in accordance with the procedures under the national law of the Member State concerned, provided that they allow the immediate and effective execution of the Commission's decision*'. The experience gained in recent years by the Enforcement Unit shows that national procedures tend to be complicated and that national courts responsible for their application are often overburdened. As a result, even in cases in which the recovery decision is crystal clear and in which the Member State acts in a diligent and efficient manner, beneficiaries are still able to delay effective recovery for a very long time. Moreover, the complexity of national procedures makes it sometimes difficult for the Commission services to establish clearly whether or not the measures taken by the Member State concerned are the most effective measures available under national law.

Conclusion

In spite of the progress made since 2003, the execution of recovery decisions by Member States remains unsatisfactory: the number of 'pending recovery cases' remains high and the 'turn-around' of cases remains too slow. This situation is clearly unacceptable. Ineffective enforcement of recovery decisions does not only undermine the credibility of the Commission's state aid control, it also results in inequality of treatment between Member States. In this respect, it is also relevant to keep in mind that more than 90% of all pending recovery decisions concern only four Member States. Acceptance of long delays in the execution of these decisions therefore amounts to a de facto discrimination against Member States that enforce recovery decisions in a more effective manner, and even more so against Member States that play by the rules and do not grant illegal aid at all.

The Commission will therefore need to continue its efforts to improve the execution of recovery

⁽¹⁾ See Case C-57/97 Belgium/Commission [1999] ECR-I 3671.

⁽²⁾ Cases 48/99-50/99 Decisions of 11.7.2001 and Cases 52/99-54/99, Decision of 17.10.2002.

⁽³⁾ Decision of 6.10.2004.

⁽⁴⁾ Case CR 27/99, OJ L 77, 24.3.2003, pages 21-40.

⁽⁵⁾ Case CR 62/00, OJ L 227, 11.9.2003, pages 12-44.

⁽⁶⁾ Case C 03/1999, OJ L 37, 12.2.2000, pages 22-30.

decisions by the Member States concerned. To this end, the Commission services will continue to monitor closely the recovery measures taken at national level. Where it appears that a Member State does not take the most effective measures available under national law, the Commission will not hesitate to bring action against that Member State under Articles 88(2), or even 228(2) of the Treaty.

The requirement that recovery should be implemented in accordance with national procedures constitutes undoubtedly the single most important obstacle to effective recovery. The experience gained by the Enforcement Unit during its first full year of operation suggests that, in most cases, national recovery procedures are not very efficient and do not allow Member States to achieve an 'immediate and effective execution of the Commission's decision' (as is also required by article 14(3) of the Procedural Regulation). At some point in the near future, therefore, the Commission will inevitably have to ask itself whether it is sufficient to require Member States to take all measures available under national law to execute recovery decisions ('obligation d'effort'). In order to avoid inequality of treatment, it may perhaps be necessary to move a step further and to impose strict deadlines for the execution of recovery orders by the Member States (an 'obligation de résultat').

Article 88(2) and 228(2) ECT action against Member States for failure to execute recovery decisions

Basque fiscal aid schemes (ES)

On November 2003, Commission filed Art. 88(2) action against Spain before the ECJ on the grounds of the non execution by the Spanish authorities of 6 decisions adopted by the Commission in relation to the Basque fiscal aid schemes ⁽¹⁾. Commission considered that Spain did not act in conformity with its obligation to co-operate with the Commission, as it has not provided any information on the measures adopted for the recovery of the incompatible aid granted through these fiscal schemes.

Kimberley Clark/Scott Paper (FR)

In October 2004, the Commission found that France did not comply with the recovery decision of 12 July 2000 on the aid granted to Scott Paper ⁽²⁾ and therefore decided to refer the matter to the Court of Justice of the European Communities directly in accordance with Article 88(2) EC. ⁽³⁾

The recovery decision of 12 July 2000 is currently being challenged by the beneficiary and by the French local authorities before the Court of First Instance of the European Community. ⁽⁴⁾ At the same time, the beneficiary challenged the national recovery orders in the national courts.

The Commission considered that it was necessary to refer the case to the Court for a number of the reasons. The main reason is that the national authorities and the national judge have agreed to suspend proceedings in the national court until the Court of First Instance of the European Community issue its judgement on the case. This is contrary to Article 242 EC, which provides that an appeal before the European Court does not have any suspensory effect. Furthermore, there are no provisional measures available under French law to ensure that the aid is withdrawn from Scott during the proceedings before national courts. Finally, the Commission considered that France did not act in conformity with its obligation to co-operate with the Commission, as it has not provided any new information on the recovery since July 2003.

Municipalizzate (IT)

On April 2005, the Commission decided to initiate Art. 88(2) action against Italy. The Commission considered that Italy had not respect the Decision of the Commission of 5 June 2002 ⁽⁵⁾, by which the aid granted by Italy to public services company was declared incompatible with the common market, and must to be recovered. More than two years since the decision was adopted, the Commission considered that the measures proposed by the Italians authorities to proceed with the execution of the Commission Decision were not satisfactory, and did not allow for an immediate and effective recovery as requested by art. 14(3) of the Procedural Regulation 659/99.

Thuringen Porzellan (Kahla) (DE)

On 25 February 2005, the Commission adopted the Decision to initiate Art. 88(2) actions against Germany, for failure to comply with a decision of 30 October 2002 ⁽⁶⁾. This decision ruled that aid given to German porcelain manufacturer Kahla Porzellan GmbH and its successor company Kahla/Thüringen Porzellan GmbH by the German Land of Thuringia was incompatible and had to be recovered from the beneficiaries. The Commission noted that more than two years after the decision was issued, Germany had not fully complied with the decision, since an amount of € 3.3 million plus interests remains to be recovered from the still operating successor company Kahla/Thüringen Porzellan GmbH. Kahla Porzellan GmbH is in bankruptcy since 1993.

⁽¹⁾ Cases 48/99-50/99 Decisions of 11.7.2001 and Cases 52/99-54/99, Decisions of 17.10.2002.

⁽²⁾ Case C38/1998, OJ L 12, 15.1.2002, pages 1-32.

⁽³⁾ Decision of 6.10.2004.

⁽⁴⁾ CFI Cases T-366/00 and T-369/00.

⁽⁵⁾ Case CR 27/99, OJ L 77, 24.3.2003, pages 21-40.

⁽⁶⁾ Case CR62/00, OJ L 227, 11.9.2003, pages 12-044.

The German authorities maintain for several reasons that no further recovery action is needed. The Commission disagrees with this view and considers that the reasons brought forward by Germany to refrain from recovery are not acceptable. The Commission therefore insists on a complete and effective enforcement of the decision to restore competition.

Spanish Shipyards (ES)

On 26 June 2003, the Court of Justice of the European Community had condemned Spain for its failure to implement the Commission's recovery

decision of 26 October 1999 ⁽¹⁾ regarding aid granted to the Publicly-owned Shipyards ⁽²⁾. In October 2004 the Commission noted that Spain had still not complied with the recovery decision of 26 October 1999, as it had not taken the most effective measures available in the Spanish legal system to effect the recovery. The Commission therefore considered that Spain did not comply with the judgment of the Court of Justice of 26 June 2003 and decided to pursue the matter in accordance with Article 228(2) of the Treaty. To this effect, the Commission sent a letter of formal notice to Spain on 28 October 2004. The Commission is currently assessing the measures adopted by Spain

⁽¹⁾ Case C03/1999, OJ L 37, 12.2.2000, pages 22-30.

⁽²⁾ ECJ Case C-404/00, ECR 2003, I-6695.

The practical impact of the exercise of the right to be heard: A special focus on the effect of Oral Hearings and the role of the Hearing Officers

Serge DURANDE and Karen WILLIAMS ⁽¹⁾, Hearing Officers attached to the Cabinet of the Commissioner

Executive summary

The purpose of this paper is to give an overview of the effect that the exercise of the right to be heard has in the Commission's decision-making process in competition matters. More particularly, it analyses the influence that oral hearings and also the role the Hearing Officers can have in practical terms. In doing so, the paper is intended to shed some light on an often neglected area of the Commission's antitrust and merger work, the visibility of which is frequently precluded by its mainly internal nature.

Introduction

The right to be heard as a fundamental right

The Commission must comply with general principles of EU law, which include *inter alia* the respect of the rights of defence, during its administrative proceedings ⁽²⁾. More specifically, the European courts have consistently held that the right to be heard, as an essential component of the rights of defence ⁽³⁾, arises in all proceedings initiated against a person which are liable to culminate in an adverse measure against that person ⁽⁴⁾. The right to be heard, as a consequence drawn from its fundamental nature, ⁽⁵⁾ must be guaranteed even in the absence of any specific legislation ⁽⁶⁾.

The need to respect the right to be heard has been recently codified and, arguably, reinforced in the Charter of Fundamental Rights. Article 41 thereof states that '*every person has the right to be heard before any individual measure which would affect him or her adversely is taken*'. It may appear the Charter goes beyond the existing case law, to the extent that it seems to eliminate the requirement for it to apply of '*having a proceeding initiated against a person*'. The only condition in Art. 41, appears to be that '*an individual measure could affect [that person] adversely*'.

What is the content of the right to be heard? In competition proceedings it involves two dimensions: first, an obligation on the Commission to make its case known to the defendants; secondly, an obligation to grant the defendants an opportunity to submit their comments on the Commission's objections ⁽⁷⁾.

The first dimension entails, in turn, that the defendant must have access to the Commission's file ⁽⁸⁾. We know now that such access is not restricted to the documents on which the Commission has based its objections, but covers the entirety of the Commission's file, other than business secrets, other confidential information and internal documents ⁽⁹⁾. This is generally known as the principle of 'equality of arms' which was previously enshrined in the jurisprudence of the ECHR ⁽¹⁰⁾. In the light of this principle, the fullest possible access to the Commission's file may be now seen as a necessary corollary of the right to be heard.

The second dimension of the right to be heard, i.e., the possibility for the defendant to make known its own views on the Commission's objections, does not, in principle, require that comments are submitted in any particular form, whether oral or written. The choice is left to the legislator, although

⁽¹⁾ The authors would like to thank Aitor Montesa Lloreda for his contribution to this article. The views expressed are personal to the authors.

⁽²⁾ Cases 100 – 103/80 *Musique Diffusion Française*, [1983] ECR 1825, point 8 and 9, among many others.

⁽³⁾ The European courts have stated that the rights of defence include, in particular (i) the right to be heard, (ii) the right of access to file and (iii) the principle of good and sound administration. See Cases T-191/98 and T-212 to 214/98 *Atlantic Container Line v. Commission* [2003] ECR II-3275.

⁽⁴⁾ A person against whom proceedings which are liable to culminate in an adverse measure are initiated shall hereinafter be referred to as 'a defendant'.

⁽⁵⁾ Case 17/74, *Transoceanic Marine Paint Association* [1974] ECR 1063.

⁽⁶⁾ Case 301/87 *France v. Commission* [1990] ECR I-307, point 29, Cases 234/84 and 40/85 *Belgium v Commission* [1986] ECR 2263 and 2321, Case 259/85 *France v Commission* [1987] ECR 4393.

⁽⁷⁾ This is constant since Cases 56 and 58/64 *Consten and Grundig* [1966] ECR 429 at para. 5. It is the basis for Articles 27(1) of Regulation 1/2003 and 11(2) of Regulation 773/2004.

⁽⁸⁾ Case T-10 to 12 and 15 /92 *Cimenteries* [1992] ECR-II 2667

⁽⁹⁾ CFI judgments in Cases T-30/91, *Solvay v Commission*, T-36/91, *ICI v Commission*, and T-37/91, *ICI v Commission* [1995] ECR II-1775, II-1847 and II-1901.

⁽¹⁰⁾ See *Bendenoun v. France*, 3/1993/398/476 (1994)

for practical reasons a written contribution would appear inevitable. The law has, in this sense imposed on the Commission a formal duty to hear the defendants first in writing and then orally, if they so request.

Lastly, it seems clear that the right to be heard is just an opportunity and cannot become an obligation upon the defendants. They are entitled to waive this right if they consider this to be in their interest.

The right to be heard as a creation of the (secondary) law

The right to be heard, as a fundamental right, only concerns those natural or legal persons against whom a possible adverse measure is envisaged. However, the law has also recognized the existence of a right to be heard to other parties with a particular interest in a case. In antitrust matters, Articles 6 and 13 of Regulation 773/2004, respectively confer on complainants and interested third parties a right to be heard in writing. The latter have been also recognised a right to have certain access to the information available in a case. But the intensity of this right is very different from that of the defendants themselves. Complainants are simply entitled to a non confidential version of the Statement of Objections ⁽¹⁾, whereas interested third parties only enjoy an even more diluted right to be informed of the nature and subject matter of the procedure ⁽²⁾.

As mentioned above, this 'softer' version of the right to be heard is not the expression of a fundamental right. It is merely drawn from the legislator's conviction that antitrust enforcement is strengthened through a close involvement of complainants and interested third parties in the proceedings ⁽³⁾. It is in this context that the law provides the Commission with discretion to invite complainants and interested third parties upon request to express their view orally at the oral hearing of the defendants ⁽⁴⁾. In other words, this right seems to be designed, to a large extent, to primarily serve the purpose of the procedure and not only the interests of the third parties concerned.

In merger proceedings, the law has reproduced the differentiation of the rights of defendants and other parties, along lines analogous to those already mentioned ⁽⁵⁾. The Merger Regulation has

however created a third and novel category, that of the 'other involved parties' that is, parties to the proposed concentration other than the notifying parties, such as the seller and the undertaking which is the target of the concentration ⁽⁶⁾. Whereas other involved parties do not have the same right to access to the file than the notifying parties, access to the file is open to them in so far as this is necessary for the purposes of preparing their comments ⁽⁷⁾. In addition, they have the right to be informed of the Commission objections ⁽⁸⁾ and to be present at the oral hearing ⁽⁹⁾. Their position is therefore much closer to that of a defendant, in terms of procedural guarantees, than to that of a complainant in antitrust matters. This view is reinforced by the Implementing Merger Regulation's recognition that, in their writing comments on the Commission objections, '*They may set out all facts and matters known to them which are relevant to their defence*' ⁽¹⁰⁾. By referring to the term 'defence', the Implementing Regulation seems to suggest that other involved parties may, in fact, be entitled to rights of defence and not simply procedural rights derived from the legislator's will, at least in some instances.

How is the right to be heard exercised in practice in competition proceedings?

In 2003 Statements of Objections were sent to the notifying parties in 8 merger cases. All parties replied in writing, but in two cases the parties waived their right to an oral hearing. This proportion was higher in 2004, when there were three waivers out of 7 cases in which a Statement of Objections was issued.

In Antitrust matters, 2003 was a busier year. Investigations conducted resulted in the Statements of Objections being issued in 32 cases. Only a very limited number of defendants preferred not to make use of their right to be heard in writing and this was always in the context of Statements of Objections addressed to several defendants. Nonetheless, in 10 of those cases, all the defendants waived their right to an oral hearing. In 2004 the situation was similar as to the exercise of the right to be heard in writing, but in terms of oral hearings waivers were 11, out of 28 cases in which a Statement of Objections was sent.

It can be seen therefore that defendants are surprisingly often reluctant to make use of their right to express their views at an oral hearing. There may

⁽¹⁾ Art. 6(1) Regulation 773/2004.

⁽²⁾ Art. 13(1) Regulation 773/2004.

⁽³⁾ See recitals 5, 8 and 11 of Regulation 773/2004.

⁽⁴⁾ Arts. 6(2) and 13(2) Regulation 773/2004.

⁽⁵⁾ See Articles 18 of Regulation 139/2004 (The Merger Regulation) and 14 to 16 of Regulation 802/2004 (The Implementing Merger Regulation).

⁽⁶⁾ Article 11(b) of the Implementing Merger Regulation.

⁽⁷⁾ Article 17(2) of the Implementing Merger Regulation.

⁽⁸⁾ Article 13(2) of the Implementing Merger Regulation.

⁽⁹⁾ Article 14(2) of the Implementing Merger Regulation.

⁽¹⁰⁾ Article 13(3) of the Implementing Merger Regulation.

be a number of different reasons for this behaviour, but two of them appear more important than others.

First, some defendants may fear that an oral hearing would be an opportunity for complainants and/or opposing third parties to present their arguments and reinforce the Commission's views as to the objections raised. Secondly, the defendants may consider that the Commission's position is already fixed at the time of sending the Statement of Objections and that only in exceptional circumstances that position could be modified. In that context, defendants may believe that the investment required for a good preparation of an oral hearing is not compensated by the low probability of obtaining a decision which would suit their interests better.

The second reason may seem most important if one pays attention to the answers that private practitioners, and, in general, the business community, gave to questions posed in the framework of the House of Lords enquiry of 2000 for its report named 'Strengthening the Role of the Hearing Officer in EC Competition Cases' ⁽¹⁾. An analysis of those answers shows that a number of practitioners expressed great doubts as to the value of oral hearings and the possibility to reconcile evidence and put questions to the Commission ⁽²⁾.

Nevertheless, since then, new Terms of reference of the Hearing Officers have been adopted ⁽³⁾, which indirectly give more importance to the oral hearing by strengthening the role of the Hearing Officers. It should be also noted that the new implementing regulations, subsequently adopted in both the antitrust and merger fields, explicitly provide for the possibility for any participant at the hearing to ask questions to any other participant ⁽⁴⁾.

The value of the oral hearing in the Commission's procedure

An adversarial part of the procedure

It has been long said that the Commission's procedure in competition matters has an inquisitorial character. The Commission has even been termed as being at the same time prosecutor, judge and jury. The proceedings are, to a substantial extent, carried out in writing and with little opportunity

for the defendants to shape the debate in a specific direction. However, this description is nowadays too simplistic. One can today legitimately argue that there are some adversarial aspects to the Commission's procedure.

The Commission's procedure is divided in three stages ⁽⁵⁾. In stage I, the Commission obtains all the information available in order to set up the most accurate facts of the case. To this end, it has very wide powers of investigation ⁽⁶⁾. Stage I ends with the notification of the Commission's competition concerns to the defendants by means of a Statement of Objections. A Statement of Objections is a procedural document, preparatory in relation to the final decision, which delimits the scope of the objections of the Commission. The Commission cannot rely in its final decision on any other objections, but can withdraw them in part or in full. The assessments set out in that document are just provisional ⁽⁷⁾.

In stage II, the Commission must give the defendants an opportunity to comment in writing on the objections raised. The defendants also have the occasion to express their views at an oral hearing. For that purpose, as explained before, complete access to file must be conducted.

In stage III the Commission may adopt a final decision, once it has fulfilled some procedural obligations that may increase the quality of such decision, such as the consultation of the Advisory Committee.

Stages I and III are directed by the Commission and the defendant has a very restricted margin of manoeuvre. It is obliged to answer when required and cannot readdress the Commission's attention to any specific point of its interest. Stage II, however, confers a substantial role on the defendant and is shaped in a more adversarial manner. The Commission is no longer the sole master of the procedure. It should take account of the factors emerging from the defendant's answer in order either to abandon its objections, if they are proved unfounded, or to amend and supplement its arguments, both in fact and in law, in support of the objections which it maintains ⁽⁸⁾. The Commission's objections are thus reviewed in the light of the explanations provided. The defendant may also bring external opinions and experts in its support. Even though the Commission is not forced

⁽¹⁾ Nineteenth report of 21 November 2000 of the House of Lords.

⁽²⁾ See part 3 point 29 of the Report.

⁽³⁾ Commission Decision of 23 May 2001 on the terms of reference of hearing officers in certain competition proceedings. *Official Journal L* 162, 19.06.2001, p. 21–24. Hereinafter 'the Mandate'.

⁽⁴⁾ Article 15(7) of the Implementing Merger Regulation and 14(7) of Regulation 773/2004.

⁽⁵⁾ These three stages, under different denominations, take place both in antitrust and merger cases.

⁽⁶⁾ Articles 17 to 22 of Regulation 1/2003, Articles 11 to 13 of Regulation 139/2004.

⁽⁷⁾ Order of the Court in Joined cases 142 and 56/84, BAT & Reynolds [1986] ECR 01899. Paras. 13 and 14.

⁽⁸⁾ Order of the Court in Joined cases 142 and 156/84, BAT & Reynolds [1986] ECR 01899. Paras. 14.

to address all the arguments put forward by the defendants in its final decision, it should be receptive to those arguments and open to persuasion ⁽¹⁾. Arguably, this openness should be showed by the inclusion in the final decision of, at least, the main arguments raised by the defendants. Finally, as it has been pointed out above, during the oral hearing the defendant may be entitled to ask questions to the Commission, when allowed by the Hearing Officers ⁽²⁾. The Commission's ability to answer these questions satisfactorily may be mentioned in the Interim Report of the Hearing Officers that will be referred to below. Besides, the defendants may also put questions to the complainants and other parties present at the oral hearing and the Hearing Officers take good account of such interaction in the Interim Report.

In fact, oral hearings reinforce the quasi adversarial nature of the second stage of the procedure. It is true that there is no judge presiding over such a stage, but there are a number of persons with a special responsibility in the subsequent stage, whether consultative (such as the Member States or the Hearing Officers in some instances), or decisive (such as the influence of other involved Commission services and their Commissioners in the College), that may take good account of the result of the hearing and the interaction produced therein.

In some cases, the oral hearing may also serve to complete the Commission's investigation

A Statement of Objections is, as already said, a preliminary assessment that can be radically changed or substantially adjusted. Sound administrative practice seems to require that the Commission carries out the most complete work of investigation before issuing a Statement of Objections. In this sense it would not appear appropriate that the Commission sends a Statement of Objections and organizes an oral hearing just to clarify some obscure points relating to a case under investigation. In addition, the Commission must have had substantiated sufficiently its objections against the defendant in the first place and make them understandable so that the defendant can enter a valid defence. However, should obscure points arise in the framework of a thorough investigation; the defendants' reply may have a very important role in their clarification.

⁽¹⁾ As suggested by AG Slynn in Case 86/82 Hasselblad, [1984] ECR 883.

⁽²⁾ Articles 14(7) of Regulation 773/2004 and 15(7) of Regulation 802/2004. The Hearing Officer does not oppose to these questions in any oral hearing, provided they are not unduly put in an aggressive fashion.

Accordingly, the Commission may use the oral hearing to shed light on some points of law or fact on which it has not yet reached a clear understanding. In this context, the possibility for the Hearing Officers to accept fresh documents from the defendants at the hearing, which takes place from time to time, is of particular importance ⁽³⁾. Also interventions by third parties are often helpful, whether they confront or support the defendants' position.

As a result, whilst oral hearings are normally hallmarked by their purpose to ensure the respect of the rights of defence, they may also involve investigative aspects, at least up to a point. There are sometimes delicate balances to achieve in this respect.

In view of the potentially high value of oral hearings for the Commission's correct understanding of the case, the Commission may be willing to hold such a hearing even when the defendants have waived this right. It is clear that defendants cannot be forced to attend, but nothing in the law or the courts' judgments seems to prevent the Commission from organizing a meeting with complainants, interested third parties, other involved parties in merger proceedings, representatives from the Member States and other involved Commission services, to which the parties would be invited. This meeting may have a restricted value in relation to that of an oral hearing of the parties, but could provide the Commission with fresh arguments and some interaction. Third parties may have, for instance, opposing views to those expressed by the defendants in writing. They can also contradict each other or the Commission. The strength of their arguments may be a good test for the Commission's objections. Persons involved in the decision making process may find it useful to take strong arguments as a reference. Finally, these opinions may enhance the correct understanding of the issues raised by the case.

Oral hearings may sensitize participants on the main issues of dispute

Oral hearings provide defendants with the widest possible audience they can reach in the Commission's proceedings. An oral hearing, run by a Hearing Officer, is usually held in the presence of the case team, the responsible Director, a member (at least) of the Commission's Legal Service, members of other associated Commission services and a number of representatives of National Competition Authorities ⁽⁴⁾. All these persons have a

⁽³⁾ Article 12(3) of the Mandate.

⁽⁴⁾ Member States representatives are also present at the Advisory Committee.

particular role in the subsequent stage. They are consulted at the time of adopting a final decision. Their views and, eventually, criticisms, may be taken into account by the Commission.

In this context, the importance that oral hearings may have cannot be underestimated. Well shaped questions to the Commission raise quite often a number of points of interest which receive careful reflection during the decision-making stage. The strength of the Commission's case is tested and the really significant issues are more easily identified than in the written comments. It is not too bold to argue that oral hearings circumscribe the genuine object of the debate.

Practical effect of oral Hearings in the Commission's decision making

As one might expect, oral hearings only rarely reverse completely the orientation of the case. Should this be normal practice, one could legitimately criticise the weakness of the Commission's reasoning in its Statement of Objections. However, experience shows that, in a number of instances, the orientations of cases have been altered quite dramatically subsequent to the explanations given in oral hearings, even leading the Commission to drop entirely its objections, i.e. to abandon the case.

Oral hearings more often adjust some particular points of importance to the defendants. Following oral hearings, the objections addressed to a number of defendants have been dropped in several cases in the last years, while objections against other defendants in the same proceedings have been retained. Oral hearings have also helped to establish correctly the duration of the infringement in antitrust cases, to modify the scope of the infringements found, or to appreciate in a more correct manner the role that aggravating or mitigating circumstances should play in the subsequent stage in determining the level of fines. They have also had an important impact on the Commission perception as to the sufficiency of commitments proposed by the notifying parties in merger proceedings.

The practical impact of the role of the Hearing Officers in the Commission's decision making

A number of dispositions of their mandate give the Hearing Officers a real ability to influence the decision making process

Whilst the Hearing Officers have decisive power in some purely procedural matters (time limits to reply to a Statement of Objections, access to file,

protection of legitimate confidentiality claims and admission of third parties ⁽¹⁾), where their assessment is only subject to the review of the European Courts ⁽²⁾, they cannot impose any view on the Commission as to the other procedural guarantees of the defendants or the substance of any given case. Nevertheless, there is a significant distinction to be made here. Concerning procedure, the Hearing Officers must submit a report to the College, on the basis of the draft decision to be presented to the Advisory Committee, on the respect of the right to be heard. This report will consider, in particular, whether the draft decision deals only with objections in respect of which the parties have been afforded the opportunity of making known their views, including all questions relating to access to file. Where appropriate, it will also deal with the objectivity of any enquiry conducted in order to assess the competition impact of commitments proposed in relation to any proceeding initiated by the Commission. The report is sent to the competent member of the Commission, the Director-General for Competition and the Director responsible, and also to the NCAs ⁽³⁾. As an additional guarantee, that report is communicated, together with the decision, to the addressees. It is, finally, published in the Official Journal ⁽⁴⁾.

In this context, it is of course difficult to see how the Commission could attach to one of its decisions a negative final report of a Hearing Officer stating that the procedure followed was not correct and had led to a violation of the right to be heard. As a result, procedural shortcomings have to be corrected in the course of the investigations, before the final report of the Hearing Officer is attached to the draft decision of the College.

In matters other than the right to be heard, the Hearing Officers have a more complex role to play. Under their terms of reference, they are allowed

⁽¹⁾ Inter alia, Articles 8 to 10 of the Mandate.

⁽²⁾ In general, the decisions of the Hearing Officers have a preparatory character in relation to the Commission's final decision. The European Courts have clarified in a number of instances that 'only measures immediately and irreversibly affecting the legal situation of the undertakings concerned would be of such a nature as to justify, before completion of the administrative procedure, the admissibility of an action for annulment' (See Cases T-10,11,12 & 15/ 92 *Cimenteries* [1992] ECR II-2667). Accordingly the decisions of the Hearing Officers can only be challenged together with the final decision. As the only exception to this rule, the ECJ has stated that decisions concerning the disclosure of information which has been claimed to be confidential are definitive in nature and can be the object of an independent appeal (See Case 53/85 *Akzo* [1986] ECR 1965).

⁽³⁾ Articles 14 and 15 of the Mandate. When appropriate, it is also sent to the EFTA Surveillance Authority.

⁽⁴⁾ Article 16 of the Mandate. Hereinafter that formal report will be referred to as the 'final report'.

to present observations on any matter arising out of any Commission competition proceeding to the competent member of the Commission ⁽¹⁾. In addition, they are obliged to seek to ensure that in the preparation of draft Commission decisions, due account is taken of all the relevant facts, whether favourable or unfavourable to the parties concerned, including the factual elements related to the gravity of any infringement and to contribute to the objectivity of this decision ⁽²⁾. They are finally authorized to make observations on the progress of the proceedings further to the oral hearing, relating, among other things, to the need for further information, the withdrawal of certain objections, or the formulation of further objections.

From the wide numbers of 'musts' and 'mays' above, it can be inferred that the Hearing Officers have an obligation to use their best efforts to ensure that the best possible decision is taken. The fulfilment of this duty is especially important where an alternative decision could cause any prejudice to the defendants. However the Hearing Officers are not an Advocate General. Their opinions are not compulsory and are not published. This may be seen as a shortcoming of the Hearing Officers' role, but conversely, one may also argue that the absence of publicity enhances their freedom to express internally their views and the fact that their opinions on these grounds are not required, reinforces their moral authority in the cases where they decide to take position.

What is beyond any doubt is that the Hearing Officers have no more ammunition than the strength of their arguments when it comes to the substance of the case. Neither the Commissioner nor the Directorate General are, by any means, bound to follow those arguments. However, the Hearing Officers' opinion is likely to be carefully taken into consideration for a number of reasons, particularly in the framework of the current reinforcement of the Commission's checks and balances through the appointment of a Chief Economist and the introduction of scrutiny panels.

First, the Hearing Officers have no responsibility for the investigation of the case. They are, therefore, a fresh pair of eyes in the proceeding which may alleviate its otherwise mainly inquisitorial nature. Second, the Hearing Officers have access to and frequent contact with all the parties involved in each case: the case team, defendants, complainants and other persons concerned. Such wide and frequent access confers upon them a privileged central and impartial position with full knowledge

of the positions of the parties. Third, the Hearing Officers preside over the oral hearing, where they can test the strength of all parties' arguments and may also address questions in order to clarify certain points, which they normally do. And fourth, the Hearing Officers may select the issues, other than those related to the right to be heard, that they wish to rise. They can therefore focus on the matters which, for their gravity or novelty, have retained their attention and require in their view more direct action.

Both the Hearing Officers and the case team prepare their own report on the hearing. These reports are sent to the Commissioner and constitute the working basis of the meeting where the further orientation of the case is decided. This report of the Hearing Officers ⁽³⁾, is usually divided in two main parts. The first part deals extensively with issues related to due process. The second one starts by a summary of the main arguments of the different parties at the hearing. In some cases the Hearing Officers may also proceed to analyse their strength, with a special focus on how those arguments stood up to attack, if there was any, at the hearing. Finally, the interim report may include the Hearing Officers' conclusions as to the substance of the case.

Often, the Hearing Officers' conclusions are very succinct and limit themselves to confirm the Commission's view, although it is not rare that, even in this case, they propose to investigate further some issues or include arguments or counterarguments expressed at the hearing. Nonetheless, in a number of cases, the Hearing Officers suggest important precisions. They propose adjustments in the aggravating and attenuating circumstances concerning an infringement. These adjustments may have major consequences for the final level of fine, as it has been the case in a number of instances. Finally, the Hearing Officers may even recommend radical changes in the orientation of the case.

Both the report of the case team and that of the Hearing Officers' are presented to the Commissioner. In some cases, where no important questions have been raised, the case team's proposal as to the orientation of the case will be smoothly adopted. However, should there be any controversial point, the Commissioner would listen to the different arguments exposed and decide on the course of action.

The value that a Commissioner gives to the Hearing Officers' opinion depends to a great extent on the nature of the issues discussed. As explained above, concerns related to due process questions,

⁽¹⁾ Article 3(3) of the Mandate.

⁽²⁾ Article 5 of the Mandate.

⁽³⁾ Hereinafter 'Interim Report'.

in the large sense of the term, are always taken into very careful consideration and almost in every case followed. Other kinds of arguments may or not be endorsed, but they are accorded the attention that deserves the opinion of a fresh pair of eyes, with special responsibility over the defendants' rights of defence and direct knowledge of the case.

The Hearing Officers may also propose that the case is reviewed by an internal scrutiny panel. This has recently happened in a number of cases at or with the advice of the Hearing Officers. Possibility of panel revisions is a further guarantee of impartiality and thorough work in disputed cases. They prove that the checks and balances recently set up by the Commission can be very effective.

After the new orientations of the case are adopted or the old ones, with due adjustments, are confirmed, the Hearing Officers are called on to certify that due process was respected by means of their Final Report, which was referred to above.

Conclusion

When oral hearings are held, they are an important part of the Commission's decision-making process

Oral hearings often confirm the orientation of the case, but they may also change, as has been previously described. But above all, they are an important reference for the several services and persons which are involved in the Commission's decision making process, in order to decide on the merits of a given case.

In view of the importance of oral hearings, the Commission may be tempted to organise a succedaneum of them should the defendants waive their right to be heard orally. Even having a lower signification, these 'quasi hearings' could be a useful tool for the sake of a correct investigation and decision.

Finally, the fears that defendants may have about hearings becoming arenas for parties having views opposed to their own, is unfounded. Those parties may have equal access to the Commission by other means and the fact that such confrontation is avoided, may not help the solidness of the defendants' position.

Oral Hearings are always an opportunity to defend the positions of the parties and, at the same time, improve the quality of the final decision.

The Hearing Officers play a complex role, although difficult to circumscribe in the Commission's decision making process

The Hearing Officers' natural role is to protect the requirements of due process within the Commission's procedure. But in addition to this, they have a mandate to use their best efforts to ensure that the decision adopted is objective, built on solid proof, sound and proportional.

This second task, is only carried out where it is perceived that there is a genuine need for it. Such part of the Hearing Officer's work can only use persuasion as a tool of influence and remains outside public scrutiny ⁽¹⁾.

⁽¹⁾ Interim reports of the Hearing Officers are internal documents, like the Legal Service's opinions or the case teams reflections.

Reforming state aid policy to best contribute to the Lisbon Strategy for growth and jobs

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Since she took up the mandate of Commissioner in charge of Competition, Neelie Kroes has made no secret that she plans to reform state aid policy. To some extent, reforming state aid is a logical step following the other comprehensive reforms undertaken under Commissioner Mario Monti's tenure in the field of antitrust and merger control. In addition, with the re-launch of the Lisbon Strategy after five years of disappointing results, state aid policy has gained a specific relevance. There is today a unique opportunity to improve both the rules and the procedures of state aid policy. With the objective of less and better targeted state aid, state aid policy can be used pro-actively to contribute to revamp European economies, and to promote a more efficient use of public money. On the 7th of June 2005, the Commission launched a consultation document, the *State Aid Action Plan*, to get views about how to best conduct this reform.

State aid can be justified for a series of legitimate political reasons, and notably for equity reasons (ex: social and regional cohesion, cultural diversity) or to increase economic efficiency. This paper focuses on the latter aspect and elaborates on the key concepts that could shape the reform of state aid policy, so that it best contributes to economic efficiency, thus supporting growth and employment.

1. The Lisbon Strategy: less and better targeted state aid

The revived Lisbon Strategy refers to a broad range of objectives and policy tools initially defined in the European Council conclusions of Lisbon in 2000, ultimately with the ambitious strategic goal 'to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion'. It covers a package of reforms mutually reinforcing one another: product and capital market reforms; investment in the knowledge-based economy; labour market reforms; social policy reforms; and environmental reforms.

The Lisbon Strategy has recently been re-launched, at mid-term, by the Commission and the March 2005 European Council, with a clearer focus on

growth and employment. The new Lisbon Action Programme, designed by the Commission, focuses on ten priority areas: 1) effective internal market; 2) free and fair trade; 3) better regulation; 4) improving European infrastructure; 5) investing in Research and Development; 6) boosting innovation; 7) creating a strong industrial base; 8) more and better jobs; 9) adaptable workforce; 10) better education and skills.

As regards state aid policy, successive European Councils have translated the objectives of the Lisbon Strategy into a generic formula: 'less and better targeted state aid'. The abstract objective of less and better targeted state aid should not be understood as a mere rhetoric against state intervention in markets. It reflects in fact the basic experience that state aid (i.e. any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain firms or the production of certain goods) can be very detrimental for the economy.

State aid distorts competition and may prevent it from creating the right incentives for business to become more efficient and to innovate. To that extent state aid ought in principle to be kept to a minimum. This should not, however, be misunderstood as a request that state intervention in all its forms has to be reduced. Most state interventions (e.g. education, defence, security, taxation, public services) do not come under the legal definition of state aid, because they are not selective or do not distort competition and trade. State intervention can therefore promote competitiveness and avoid losing the benefits of competitive markets. To that extent, less state intervention in the form of state aid that distorts competition follows the objectives of the Lisbon Strategy.

Better targeted state aid reflects the idea that the choice of state aid as the right policy instrument should be made with great care. Governments do not always have all necessary information to make the right decisions when using tax-payers' money for state aid. They may be subject to political pressure, to lobbying, and fail to see the problems with giving state aid. It is in the governments' own interest, however, and in the interest of European citizens, to target state aid well, and make the best

use of taxpayers' money. In particular, the Spring 2005 European Council calls for a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimisation of human capital, as well as the reduction in regional disparities.

The principle of less and better targeted state aid is therefore fully in line with the modern concept of competition policy: not as an end in itself, but as an instrument to improve the benefits from a free market economy. Competition policy rests upon the idea -comforted by experience- that competition creates incentives and sanctions for market participants to improve their efficiency and to innovate, in order to provide consumers with the products they wish to obtain, at low prices. Preserving and promoting competition is therefore the key to obtain economic efficiency, which in turn leads to competitiveness, growth and employment.

State aid policy can contribute to the Lisbon Strategy in a dual way. First, by controlling state aid that distorts competition, it makes sure that the benefits of competitive markets are preserved. Second, by encouraging Member States to target state aid better, it can improve the functioning of markets and therefore improve the competitive dynamics, thereby increasing economic welfare. This is the case when markets do not function optimally, e.g. because market players do not sufficiently take into account some side-effects of their actions. Insufficient investment in environmentally friendly technologies or in R&D is a typical consequence of this. State intervention, either in the form of general measures or in the form of state aid, may be needed to improve a situation where competition is unlikely on its own to produce efficient outcomes. State aid can change the incentives of the market players so that they do take such side-effects into account and an efficient outcome is obtained.

State aid may also be needed when market forces produce undesirable results -for instance social or regional inequality- to correct the action of well-functioning markets, thereby fulfilling the equity objective of state aid.

2. Specificities of state aid policy

In 1998, in a seminal economic analysis of the effects of state aid ⁽¹⁾, Besley and Seabright underlined that state aid policy was probably the least well understood domain of competition policy. To a great extent, unfortunately, this statement has remained valid and the tremendous academic and

professional interest for antitrust and merger control over the last five years has not been matched so far in the case of state aid policy. State aid policy has a number of specificities that are worth reminding.

First of all, state aid policy is about controlling Member States and not undertakings. Article 87 of the EC Treaty prohibits any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain firms or the production of certain goods in so far as it affects trade between Member States. The Treaty has given the Commission the task to monitor proposed and existing state aid measures by Member States to ensure that they do not distort intra-community competition and trade to an extent contrary to the common interest. It falls under its responsibility to make sure that the level playing field would be maintained between Member States, no matter their different levels of resources and their different traditions of state intervention in the markets. This is all the more important e.g. in the context of the liberalisations foreseen in the Lisbon Strategy: by delaying reforms and protecting incumbents through state aid, some governments can not only damage the competitive dynamics in their own market, but also harm competitors from Member States having undertaken reforms, thus reducing the benefits of the reform agenda everywhere.

The State Aid Scoreboard, for instance, shows that there are important variations in the way Member States intervene in the economy. It is clear that European governments have different traditions of economic governance, different levels of overall taxation and different scopes and sizes for their public services. The Treaty does not ask the Commission to judge upon Member States' use of their public funds. Instead, the Commission has been given the exclusive responsibility to assess those state measures which distort competition and trade between Member States. In that process, the Commission has to balance the negative effects of state aid in terms of distortion to competition and trade with its positive effects in terms of common interest for the Union.

Almost 50 years of state aid law have resulted in a fairly broad definition of state aid. Jurisprudence has led to qualify a measure using state resources as state aid almost as soon as it favours some undertakings, the additional criteria of distorting or threatening to distort competition and affecting trade being almost always presumed fulfilled. The efforts of the Commission to limit this concept to those measures having a significant impact on competition and trade have not so far been translated into legal terms.

⁽¹⁾ Besley T. and P Seabright, 1998, *The Effects and Policy Implications of State Aids: An Economic Analysis*, Report to DG-III of the European Commission.

However, the Treaty explicitly allows exceptions to the ban on state aid where the aid has a beneficial impact in overall terms. State aid may be declared compatible with the Treaty provided it fulfils clearly defined objectives of common interest and does not distort intra-community competition and trade to an extent contrary to the common interest. The Commission has a wide discretion for deciding when state aid shall be compatible with the common market. The Treaty has provided a series of areas where state aid shall be authorised; these exceptions relate notably to social distress, natural disasters, social and regional cohesion, public services and transport infrastructures, cultural diversity and economic development. However, nothing prevents the Commission to elaborate on its own interpretation of the common interest, in what regards state aid.

Contrary to notably merger control, where the Commission's guidelines have clearly established that the test for authorising or prohibiting a concentration should use a consumer welfare standard, state aid policy has not so far elaborated a clear welfare standard to judge upon authorising an aid measure. In the short run, state aid generally leads to harm to competitors, and not to consumers who may benefit from e.g. subsidised (and thus lower) prices. In the long run, however, state aid reduces the incentives to increase efficiency and innovate and harms consumers too. There is an additional geographical dimension to these effects, since governments act in a given territory. This adds complexity to measuring the effects of the aid measure, since consumers outside the region where the aid is given could be penalised already in the first stage ⁽¹⁾.

In the context of the Lisbon Strategy, it might be useful to put forward principles as to when state aid best serves the objective of fostering growth and jobs. This way, Member States will be encouraged to partner with the objectives of the Strategy, by clearly understanding which types of aid are most likely to be authorised and by thus favouring these types of aid. More specifically, it can be considered that the common interest in relation to the objective of growth and jobs is best realised when state aid improves the functioning of markets, by correcting situations where markets fail.

3. Market failures as justification for state intervention in favour of growth and jobs

In economic terms, a market is said to work efficiently when it is not economically possible to improve the outcome of the market process for some stakeholders without harming some other stakeholders. A market failure is consequently a situation where the market does not lead to an economically efficient outcome.

Market failures have different origins, and notably: externalities (situations where actors do not take full account of the consequences of their actions on other actors in society); public goods (goods which are beneficial for society but which are not normally provided by the market given that it is difficult or impossible to exclude anyone from using the goods); imperfect information; coordination problems and market power. In such cases, market forces on their own are not capable to produce an efficient outcome. This is the reason why, for instance, fundamental research (which is to a large extent a public good) is typically not sufficiently provided by markets, which tend to focus on development activities that can be rapidly profitable.

Governmental action, which fully exploits the potential of the market economy to create efficiency, is more likely to reach the objectives of the Lisbon Strategy, and to bring growth and employment. To generate growth and jobs, a careful analysis of the performance of markets in the EU ought to be made. In general, less state aid and a sound competition policy shall reduce the market failure linked to market power. But in addition, governments may consider clearly identifying the situations when markets on their own do not deliver economic efficiency, and target state aid to these areas. In case of a market failure, the idea is to only intervene to improve the performance of the markets -in certain cases through state aid- and not to harm the market forces. One may even argue that governments may not want to intervene when there is no need to do so, because their own actions could then do more harm than they bring benefits, and could destroy efficiency.

When it is clear that markets are failing, and that state intervention can improve the functioning of the markets, this could be a justification for state aid relating to the Lisbon priorities ⁽²⁾. However, the existence of a market failure is not a sufficient condition for aid approval.

⁽¹⁾ For instance, competitors to the aid beneficiary could be constrained to increase their prices outside the territory where the aid is given, in order to be able to match the subsidised pricing of the aid beneficiary there.

⁽²⁾ In addition, it is worth reminding that state aid that does not address a market failure, but rather social and regional cohesion or cultural diversity, can also be authorised, provided the advantages in terms of common interest outweigh the harm for competition.

4. Criteria necessary to authorising state aid

The success of the Lisbon Strategy depends inter alia on governments' ability to design the most appropriate state aid measures and the Commission is willing to facilitate this process. In the re-focused Lisbon Strategy, the common interest relates to fostering more efficient markets, leading to growth and jobs. From the Commission's practice, it is possible to develop criteria outlining when state aid serves this common interest and should therefore be authorised.

Correcting market failures

The first element to foster growth and jobs consists in targeting state intervention towards correcting market failures. Demonstrating the presence of a market failure should be done effectively, so that it is fully appreciated whether intervention is justified. Paying lip service to vague market failures without conducting economic analysis is of limited value here. In order to guarantee that a measure adds to the functioning of markets, it has to be targeted on a well-defined market failure. The central question to ask is why markets do not deliver an efficient outcome. Referring to broadly defined policy objectives is unlikely to be sufficient to isolate the reasons for the malfunctioning of the markets and hence, to ensure the effectiveness of the intervention. It is only when the sources of the market failure are identified that an effective policy instrument can be chosen and a sustainable effect on markets can be expected. To that extent, it is generally considered that aid to schemes in favour of R&D, innovation, training, risk capital and environmental activities typically feature market failure issues. Accordingly, well-targeted state aid measures in this field could have a positive impact on the market. By opposition, aid to individual firms in difficulties or without a clear horizontal objective may less clearly or not at all address market failures.

State aid is the right instrument

State intervention to correct market failures can take many forms and state aid is only one of them⁽¹⁾. Member States may deem it necessary to carefully examine what policy instrument is the best response to the market failure, and make sure that their intervention will really improve the matter.

In approving state aid measures, the Commission may want to know whether the Member State concerned has explored other and less competition-distorting policy instruments.

⁽¹⁾ regulation, general taxation measures, direct state intervention are other possible options

Incentive effect

A second important element for designing and authorising state aid for the Lisbon Strategy, is that the aid measure is effective and can bring the expected results. State aid can change the incentives of the aid beneficiaries and therefore induce a change of behaviour, possibly then resolving the market failure and leading to a better outcome.

For instance, it is well accepted that there is a market failure related to the funding of small innovative firms like start-ups, because investors do not have sufficient visibility to precisely assess the risk level and the pay-off potential of these firms. Transaction and agency costs result in making the investment in these firms unprofitable. By giving aid to the investor (e.g. a risk capital fund), it is however possible to compensate these specific costs related to a well-defined market failure, which then makes the investment profitable and induces the investor to approve a funding that would otherwise be turned down.

The success of the aid measures relates to the incentive effect it creates for the beneficiary of the aid in changing behaviour in a desired way. State aid that clearly fails to produce incentive effects will not have beneficial effects while possibly maintaining their distortive impact. The design of the aid measure should aim at maximising the incentive effect. To that extent, guarantees or conditional aid measures may sometimes have a better leverage than direct grants.

Proportionality

A third and related criteria relates to the proportionality of the aid meaning that all its components are necessary for the aid to achieve the desired effect and that it is well targeted to the problem addressed. This criteria is also linked to the choice of state aid as the right policy instrument. For this to be assessed one could for instance analyse the counterfactual: what would be the market outcome without state intervention? Sometimes market failures are temporary; they tend to have different degrees of severity, depending on the type of undertaking concerned. Often, the market itself is able to design the appropriate corrective mechanisms. In order to be acceptable, an aid measure may therefore have to be limited in time, or to differentiate between, for instance, large and small companies, or between regions. Also, the amount of the aid should be designed as to precisely match the intensity of the market failure. In short, the design of the state aid measure should be thought through, before it can be approved by the Commission.

The positive impact of state aid for the Lisbon Strategy depends therefore on: i) how well a market failure is identified; ii) whether the incentive effect is sufficient and iii) whether it is proportional to the problem addressed. These criteria, taken together, show the ability of the aid to improve the functioning of markets. This positive effect has to be balanced against the negative impact of state aid on competition and trade.

Minimising distortions to competition

The fourth criteria that the Commission considers before approving state aid is to ensure that the distortion of competition is kept at a minimum. Even if a measure targets a well-defined market failure it could result in excessive market power, barrier to entry, foreclosure in the market at stake or in other markets, sometimes to the point that its overall impact is negative. National governments may not take into account European wide negative spill-over effects. Before authorising state aid, the Commission will have to make sure that the distortion to competition is kept to its minimum and that it does not contravene to the common interest.

It makes sense to evaluate and measure the distortive effects of an aid. Not all forms of state aid are likely to distort competition or to affect trade in an appreciable way. The level of distortion of an aid depends on: i) procedural aspects of the granting process, ii) market characteristics and iii) the amount and type of aid instrument. The design of an aid measure should therefore not only take into account the effectiveness of the aid in terms of incentive effect and necessity; it should also take into account the possible harm to competition. The criteria for choosing the beneficiaries of a given aid measure should preferably follow an open, transparent and non-discriminatory procedure, in order to limit distortions of competition by unduly favouring some undertakings. In general, this means that a non-discriminatory scheme is preferable to aid granted to a single undertaking.

The level of distortion of competition depends on the nature of the recipients and on the market structures where they operate. Subsidising an already dominant company — in addition to questioning the existence of a significant market failure — seriously runs the risk of encouraging predatory and anti-competitive behaviours, and thus be very detrimental for competition. State aid in an oligopolistic market may also increase the risks of collusion between market players, e.g. by allowing the recipient to retaliate and discipline maverick players. Therefore, aid to large firms should, in particular, be critically assessed on an individual basis, due to their potential influence on the market. In

addition, aid measures that facilitate market entry should be preferred over those that favour incumbents with market power. For instance, state aid in recently liberalised sectors, like in the telecommunications sector or postal sector may prevent the benefit of liberalisation to materialise if it targets incumbents to the detriment of newcomers.

The amount and intensity of aid is also clearly a factor in the degree of harm to competition. If the aid amount is small or the aid intensity is low, the distortion of competition is likely to be limited. State aid support to activities far away from the market will be less detrimental than support to activities closer to the market or to competitive activities. Depending on the form of the aid (e.g. direct subsidy, tax reduction or guarantee) the measure of the aid amount and intensity may differ. In addition, some forms of aid may be less prone to damage competition (ex: refundable loans may be entitled to higher intensity levels than direct grants). Investments in infrastructures can often remedy market failures better than subsidies to firms, without distorting competition.

Finally, state aid should not result in crowding out of private initiative. Public bodies may act as commercial entities in a number of markets. State aid to them may be justified, e.g. in case of a given market failure preventing the optimal provision of products or services. However, the amount of aid should be well tailored and should not have as a result that private entities operating on the same market are consequently unable to compete with public entities, with the result that the market does not develop and/or is not competitive.

Balancing the positive and the negative elements

The final act relates to the Commission's decision making in balancing the positive and negative impacts of the aid measure. Only if these four criteria are fulfilled — i) targeting of market failure, ii) creating the right incentives, iii) necessity of the aid and iv) distortion of competition to the least possible extent — can a lasting contribution of the aid measure be expected. A measure targeting the Lisbon objectives of growth and jobs shall be declared compatible only if the overall balance is positive, indicating a better functioning of the markets without significant negative effects on the functioning of markets and hence, an increase in European welfare is induced by the measure.

5. Putting the principles into practice

As announced in the State Aid Action Plan, the Commission is looking for comments on the right principles that should guide its reform. Some

principles have been put forward in the precedent paragraphs, with a specific focus on the objective of increasing economic efficiency. However, such principles will only have an impact if they are implemented in the rules and practice of state aid policy.

State aid control operates at two levels. First, the Commission may receive notifications for individual aid or for aid schemes, so that it can decide if the measure is state aid and shall nevertheless be authorised. In the process, the Commission has explained that it intends to consistently follow the general principles and criteria to balance the positive and negative impacts of a state aid measure, in line with the jurisprudence of the Courts. Second, the Commission establishes *ex ante* rules, which set out when some measure may qualify as state aid, and under which conditions the Commission may authorise the aid. Such rules may also specify which measures do not have to be notified, using Block Exemption Regulations. It makes sense that the assessment of state aid measures is in line with their likely degrees of distortion to competition.

The criteria developed above are to some extent already reflected in the present rules, however without always being explicit — since they are rather based on practical experience. The reform of state aid policy could be an opportunity to clarify the rules and to simplify them as well. In addition, the Commission could work at improving the practice and procedures of state aid, to make them more efficient and to reduce the administrative burden. There are, however, limitations to the degree of sophistication that the Commission's assessment can reach in practice.

First, most of the aid measures are awarded within aid schemes. In these cases the beneficiary is not known at the time of notification, limiting the potential for the Commission to analyse in-depth the effect of the aid scheme on individual markets. Ex-post monitoring and obligations to notify individually for some groups of beneficiaries are possible elements of an improved assessment by the Commission.

Second, there are limitations to the possibility of quantifying the effects, both positive and negative, of an aid measure. Balancing the benefits and the distortions of competition will always incorporate some form of qualitative judgement. The reform of state aid policy should advance the economic thinking underlying the Commission's decision-making process and could try to develop a more rigorous approach towards the design of aid measures, in partnership with Member States. In any case, the simple attempt to try and justify state aid

through economic analysis has the potential to improve the clarity and transparency of state aid policy.

Third, the concept of market failure has to be made tangible before it can be applied. The sources of the market failure have first to be identified clearly and to be put into context. Not all problems identified in the market are automatically market failures. Before advocating for state intervention, it should be clarified what a normal result of the market is and what a real market failure is. Then, not all market participants may be affected by the market failure in the same way. Typically, large established multinationals are generally less affected than start-ups. This implies that diversity among beneficiaries have to be taken in consideration. In the future, the Commission may want to develop methodologies and guidelines in that respect, if Member States have not done it already. In any case, experience and past practice already provide useful examples of well-targeted measures.

Finally, the reform offers the opportunity to improve the design of state aid instruments, notably by making more explicit and understandable the various rules. Current state aid guidelines are built on years of experience and they have developed conditions (intensity levels, types of recipients, bonuses etc...) to optimise the efficiency of the aid, and to limit its detrimental effects on competition. In revising the rules, state aid reform could attempt to be more specific about such provisions as aid intensity bonuses, differentiation according to the recipient, intensity levels to obtain the expected results, demonstration of an incentive effect, etc.

Conclusion

It is an on-going challenge to develop economic principles into state aid policy and to gear it towards supporting the Lisbon Strategy for growth and jobs. There is today a unique opportunity to make state aid policy as coherent and understandable as the rest of competition policy. In its reform of state aid policy, the Commission has to further develop principles and criteria to support an effective design and authorisation of state aid measures. The *State Aid Action Plan*, in that respect, could mark the beginning of a new development in state aid policy. The success of such a process will however require a partnership with Member States and their full support, because they are ultimately in charge of designing the state aid measures that could contribute to growth and employment. In addition, a successful contribution of state aid policy to the Lisbon Strategy will require improving the procedures of state aid to make it more efficient and less cumbersome.

Conglomerate and vertical mergers in the light of the Tetra Judgement

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Conglomerate and vertical mergers call for particular attention today because of the recent developments with the judgement given by the Court of Justice in the Tetra Laval case. This judgement was rendered following an appeal by the Commission against the decision of the Court of First Instance three years ago. It was considered at the time that there were some important questions of law that had to be clarified by the Highest Court. Most importantly, clarifications were sought as regards the applicable standard of proof in merger control, in particular with respect to conglomerate effects. Clarifications were also sought as to the implications of the CFI's judgement on the relationship of the ECMR with article 82 and the approach to be taken towards behavioural commitments.

In the first part of this presentation I will develop some reflections on the analytical framework for non-horizontal mergers in view of some of the statements contained in the Court's judgement. The second part will be dedicated to specific considerations relevant to leveraging theories, i.e. the link with article 82 and the Commission's assessment of behavioural remedies.

I. Some Considerations relevant to the analytical framework for non-horizontal mergers

A) Standard of proof in merger control

Returning to the recent Tetra judgement, one of the main questions raised by the Commission in its appeal concerned the standard of proof in EU merger control. Essentially, the Commission considered that, as in other EU jurisdictions, the standard of proof for prohibiting but also for allowing mergers should be one of 'balance of probabilities'. In other words, for reaching a final decision (whether positive or negative), it should be required from the Commission to assess, on the basis of the various elements at its disposal, which effects are *the most likely*.

This reasoning relies, first, on the fact that the test contained in Article 2 is a symmetric test in which the Commission must adopt reasoned decisions to *approve* as well as to *prohibit* mergers. The high standard of proof required from the Commission therefore works in both ways as illustrated, for instance, by the judgement of the CFI in the Seb/Moulinex case, in which the Court had essentially considered that there were indications of a dominant position in some markets where the Commission had reached a different conclusion. Interestingly, one of the most important factors mentioned by the CFI at the time was the 'product-range effect' resulting from the operation, that is, one well-known type of conglomerate effect.

Second, the Commission's position also relied on the consideration that merger control is about conducting a prospective analysis and that it would be unworkable to require an excessively high standard. Merger control (and accordingly consumer protection) would indeed be ineffective if negative decisions were to be taken only if anticompetitive effects are shown 'beyond any reasonable doubt'.

The recent Tetra judgement positively confirms, in our view, that our standard should indeed be one of 'balance of probabilities'.

In particular, the Court of Justice explicitly stated that, in a prospective analysis such as the one conducted in merger control, '*it is necessary to envisage various chains of cause and effect with a view to ascertaining which of them is the most likely*' ⁽¹⁾. In other instances, the Court also used similar terminology ⁽²⁾. Let me say that I welcome this development.

B) Standard of proof in conglomerate (and other non-horizontal) mergers

That being said, the question then arises whether, when applied to conglomerate effects — or even more generally to non-horizontal mergers —, the standard of 'balance of probabilities' remains in fact much higher than when applied to horizon-

⁽¹⁾ C-12/03 P, judgement of 15 February 2005, Paragraph 43, emphasis added.

⁽²⁾ Judgement, paragraph 42 '*the prospective analysis ... does not entail the examination of past events...but rather a prediction of events which are more or less likely...*'

tal mergers. The Court's judgement entails two important and undisputable consequences for merger control:

- 1) The Court clearly confirms the Commission's competence to address conglomerate effects resulting from mergers;
- 2) More generally, the Court also confirms that the Commission should not only examine 'direct and immediate' effects resulting from concentrations but also indirect effects occurring in the foreseeable future (provided that there is — of course — sufficient evidence).

In summary, the Court's message is that the Commission should not be 'short-sighted' in its assessments.

In its judgement, the Court also found that, with respect to 'conglomerate-type mergers' in which harm to competition may occur after a '*lengthy period of time*' and through '*leveraging*', '*the chains of cause and effect are dimly discernible, uncertain and difficult to establish*' ⁽¹⁾. The quality of evidence is therefore particularly important in order to support the Commission's conclusion that '*the economic development envisaged by it would be plausible*' ⁽²⁾. The Court also distinguished the situation in Tetra with the situation examined in the Gencor case — i.e a horizontal merger case in which collective dominance was the concern — by stating that, in the former, the '*structure of the market would not have been immediately and directly affected by the notified operation*' ⁽³⁾.

Some commentators have considered that, as a result of these statements, it would therefore become very difficult for the Commission to challenge 'conglomerate-type' mergers and, more generally, non-horizontal mergers. These comments also suggest a systematic opposition between the analytical frameworks of horizontal and non-horizontal mergers.

Such statements appear to be excessive: they go well beyond the specificities of the Tetra case and ignore that various types of anticompetitive effects can result from conglomerate and vertical mergers.

There are several elements which suggest that a systemic opposition that is sometimes made between horizontal mergers and conglomerate (and more generally non-horizontal) mergers is somewhat 'over emphatic'. The purpose here is not to deny the specifics of non-horizontal effects, whether they are vertical or conglomerate, but on the contrary

to insist on the need to have a practical approach, which takes account of the specificities of each case (whether it is horizontal or not), and to keep in mind the basic principles of merger control.

- *Unilateral / Coordinated effects*

The first element that should be recalled is that the purpose of merger control, in economic terms, is always to assess whether a merger will result in the creation or the enhancement of market power, irrespective of whether it is a horizontal or a non-horizontal merger. Just as in a horizontal merger, a non-horizontal merger can result in an increase in market power either because of a unilateral effect or because of a coordinated effect.

For example, a unilateral effect can occur in a non-horizontal merger when products of rivals would no longer be considered as attractive as they were pre-merger, or when competitors would be prevented from entry, thereby enhancing or creating market power for the benefit of the merged entity. As you know, when assessing horizontal mergers, the Commission's analysis also aims at identifying the existence of such effects.

Besides, as for non-horizontal mergers, the Commission's practice and the recent Horizontal Merger Guidelines also show that our assessments of horizontal mergers are more and more refined and based on dynamic and complex assessments, rather than on a mere 'static approach' relying on overlaps.

Thus, in that perspective, there is not so much difference in the type of exercise that the Commission pursues as an agency. Whatever the type of merger, the Commission is looking at whether the merger would change *the ability and the incentives* of the merged entity in a sense that it would end up with significant market power, which would be detrimental to competition i.e. to consumers.

- *In practice, most problematic non-horizontal mergers are 'multidimensional'*

The second important element to keep in mind is that in practice, the distinction between horizontal and non-horizontal mergers is somewhat artificial because many problematic mergers can have horizontal effects, as well as vertical and conglomerate effects, and each of these effects may have an influence on the other. Therefore, the fact that a merger is mainly perceived as being of a conglomerate nature does not necessarily provide useful information as to the type of anticompetitive effects that it would cause. Such mergers can entail a variety of complex effects and each of them has to be addressed.

⁽¹⁾ See judgement, paragraph 44.

⁽²⁾ See judgement, paragraph 44.

⁽³⁾ See judgement, paragraph 83.

- *Structural / behavioural effects*

Finally, the Tetra judgement has to be read in the very specific context of the operation that was put under the Court's scrutiny. It would be wrong to assume, on the basis of the Tetra judgement, that the distinction between horizontal and non-horizontal mergers is essentially one between structural and behavioural effects. In other words, it is wrong to assume that non-horizontal mergers only produce anticompetitive effects if the merged entity adopts a certain conduct — which may be more difficult to predict —, and that horizontal effects tend to be more 'structural', that is, more immediate and direct.

Such distinction is not verified in practice and the Tetra judgement, when referring to the indirect 'chain of cause and effect', was focusing on the specificities of the case and on the wording of the decision itself, which refers to the conduct that the merged entity would adopt.

For example, in a vertical merger, the Commission may have serious concerns when the operation allows a company to acquire the whole quantities available of its main input, thereby restricting access to this essential source of supply for its potential competitors. In such a case, there is very direct causal link between the operation and its anticompetitive effects.

In the same vein, a recent example of a vertical merger involving energy players shows that the Commission can have equally strong concerns when, thanks to the merger, a dominant supplier upstream would have full access to proprietary information on the costs of its competitors downstream. That is also one example of a concern that may occur in some cases, and it is hard for me to consider that such an anticompetitive effect arises from a specific conduct. This is clearly an immediate and direct effect arising from a non-horizontal merger.

Similarly, there are various types of conglomerate effects that may arise from mergers, and it is clear that some of them may directly affect the market structure.

For example, the Seb/Moulinex case in which the Court of First Instance insisted upon the competitive advantages arising from the capacity to propose a range of products. Such 'portfolio effects' obviously do not fit in the specific type of scenario that was considered in Tetra, involving products that are in fact imperfect substitutes.

There is also take the example of conglomerate mergers involving (as in GE/Honeywell) the sale

of complementary goods to a single group of customers, which are clearly different from the type of mergers considered in Tetra.

All these elements show that the Tetra judgement does not lay down the principle that the standard of proof should systematically be higher for conglomerate effects or that non-horizontal effects are systematically 'behavioural' rather than 'structural'. The Tetra judgement rather shows that each case should be examined on its own merits and that the assessment of the consequences of a merger should be made on the basis of solid and cogent evidence.

II. Leveraging and its relationship with Art. 82 and behavioural commitments

A) *The role of Art. 82 in the assessment of leveraging practices*

What is the role of Art. 82, when assessing non-horizontal mergers? If the theory of harm in such a case is based on leveraging a dominant position on one market into another related market, the potentially leveraging undertaking is subject to control under Art. 82 and the relevant practices may qualify as unlawful under this provision. This applies typically to the practices addressed in the Tetra case, namely tying and predatory pricing. At this point it seems important to mention that there are also leveraging practices that may not necessarily be considered as abusive. Mixed bundling is an example here, which by the way was one of the concerns considered by the Commission in the GE/Honeywell case.

As regards practices caught by Art. 82, the CFI in the Tetra judgement took the view that when assessing the incentives to engage in the leveraging practice, *'the Commission must also consider the extent to which those incentives would be reduced or even eliminated owing to the illegality of the conduct, the likelihood of its detection, action taken by the competent authorities both at Community and national level, and the final penalties which could ensue.'*⁽¹⁾ The Commission fully agrees that an assessment of the incentives to leverage is an important element in the analysis. However, it had a major problem with this far reaching obligation that the CFI was about to impose on the Commission, and this is the reason why it was one of the core elements in its appeal to the ECJ.

⁽¹⁾ Case T-5/02 Tetra Laval v Commission [2002] ECR II-4381, para. 159.

These concerns were twofold: The first is a systematic one. In our view the very reason for the merger regulation was that an ex-post control under Art. 82 was not considered sufficient for the prevention of such abuses. On the basis of this concept it seems inconsistent to disregard potential leveraging practices merely because of their conflict with Art. 82. And this reasoning applies to abuses resulting from dominance established by the merger, as well as to abuses to gain dominance in a neighbouring market as long as this leveraging is possible and profitable as a result of the merger.

The second concern was a practical one. How can it be reasonably possible for the Commission to assess the likelihood of detection and the potential reaction by probably several competition authorities, and all that in the tight timeframe of a merger investigation? Any such assessment would have been inevitably purely speculative, and thus in conflict with the high standard of proof and evidence set by the CFI itself.

Due to these concerns, we noted with satisfaction that the ECJ shared these concerns and followed the Commission's arguments in that respect. Some commentators feel that the ECJ judgement remained somewhat unclear in that point. We do not share this view. According to the Court, *'it would run counter to the regulation's purpose of prevention to require the Commission, as was held in [...] the judgement under appeal, to examine, for each proposed merger, the extent to which the incentives to adopt anti-competitive conduct would be reduced, or even eliminated, as a result of the unlawfulness of the conduct in question.'*⁽¹⁾ In our view this clearly means that an Art. 82 assessment does not have to be integrated into a merger assessment.

To avoid a misunderstanding here: This does not mean that the Commission considers Art. 82 to be a weak or obsolete instrument — on the contrary. Some very recent headline cases reflect its importance, and the reform projects launched recently with regard to Art. 82 show that the Commission considers it as one of its core enforcement instruments.

The view has been expressed that the whole issue about Art. 82 in practice may be of limited relevance, as the parties to the merger could introduce the assurance to respect Art. 82, i.e. not to engage in abusive leveraging, in the form of a commitment that the Commission would have to take into account. This brings us to the next aspect, the role of behavioural remedies in leveraging cases.

B) Behavioural remedies in leveraging cases

The issue of behavioural remedies is not exclusively relevant in non-horizontal cases, it can come up in all types of merger cases. But in scenarios where the theory of harm is based on leveraging behaviour, the question seems obvious to what extent a behavioural remedy is acceptable to eliminate the competition concern. As a starting point, the distinction between structural and behavioural remedies is useful for general presentation purposes, but one has to be careful not to get caught by a too simplistic categorisation. Practitioners know from case experience that the term 'behavioural remedy' covers a wide range, and that some commitments in that category can have structural features. Examples include granting access to an essential facility, not using an IPR, or making production capacity in a plant available to third parties. However, these are not the type of remedies that were at stake in the Tetra case. The point at issue there was about a promise not to abuse a dominant position, not to engage in practices forbidden by Art. 82.

• Tetra judgement: No rejection of behavioural remedies without assessment

In its decision, the Commission had rejected such commitments in a rather categorical way. And that's where the ECJ followed the CFI's reasoning, and concluded that the Commission could not on mere grounds of principle reject a behavioural remedy of that kind, based on the mere reasoning that a behavioural commitment cannot remedy a structural change brought about by a merger.

But it is also important to stress at this point that there is nothing in the judgment that establishes a presumption to the contrary. The judgement does not suggest that the Commission has to be in principle satisfied with such promises in leveraging scenarios to eliminate competition concerns. Such an approach would be contrary to the Court's conclusions on Art. 82 mentioned earlier. If the Court concludes that illegality and fines under Art. 82 are not sufficient to reliably stop undertakings from engaging in leveraging practices, why should a mere promise to respect Art. 82 make such a substantial difference? The additional risk of a revocation of the merger clearance decision does not appear to add much.

What the ECJ requires the Commission to do is to undertake a thorough assessment of any remedy proposal, be it structural or behavioural, and to reflect this analysis in the decision. This is in line with the general standard of proof set by the Community Courts, and the Commission will reinforce its efforts to meet this standard also in the remedies field.

⁽¹⁾ Judgement, para. 75.

- *Criteria to assess behavioural remedies*

What does this mean in operational terms? The Commission will submit every remedy proposal regardless of its nature to an assessment of efficiency and effectiveness to eliminate the competition concern. And it may have to market test the remedy proposal, because the market normally knows fairly well what remedy will work in practice, and what not. In the assessment of behavioural remedies, as for any remedy, the Commission will, *inter alia*, take the following considerations into account:

First, assuming the remedy works properly, does it fully address the competition problem in its entirety? It must be sufficiently complete in scope and not leave room for doubt or 'exceptions'. *Second*, can non-compliance be detected easily and is the remedy 'self-policing' without the need for continued monitoring by the Commission? This is a crucial element with regard to behavioural remedies, which typically translate into many individual commercial interactions on the market that cannot — and indeed should not — be followed by the Commission in detail. And third, assuming non-compliance is detected, would Commission intervention still be timely? If a violation of the commitment can only be detected when it has taken place, this speaks against the suitability of the remedy.

It seems unlikely that mere promises not to abuse a dominant position will, in the future, play an important role as a suitable remedy in leveraging cases. Not because this is a behavioural remedy.

But because from the practice one can see that the criteria set out above are difficult to meet by such a commitment proposal. As usual, there must be a case-by-case assessment where all merits of a case are taken into account.

A final remark in this context: without entering into discussions about the comparability of the Tetra case and the scenario assessed in the Gencor/Lonrho case. It seems justified, based on the emphasis put on the distinction between the two cases by the ECJ, to consider that in horizontal scenarios where a dominant position is formed directly by the merger, the principal rejection of a remedy that promises not to abuse as formulated by the Court in Gencor still stands.

III. Conclusion

The category of 'non-horizontal mergers' comprises a wide variety of scenarios, and it raises a variety of interesting and relevant questions that have to be taken into account in their assessment. Does the Commission intend to develop guidance on these scenarios as it did for horizontal mergers? On some of the questions we already have guidance and clarification from the Community Courts, but the Tetra case only addressed one scenario from this wide variety. On some questions such clarification by the Courts is still to come. At that stage the Commission will then have to draw its conclusions as to its future policy in this area and in what way further guidance could be provided for the legal and business communities.

In the context of the Luxembourg Presidency of the Council of the European Union was organised in the 'Centre Culturel Neumünster' in Luxembourg a:

1) Conference on Consumer Policy Perspectives — May 2, 2005

The Ministry of the Economy and of Foreign Trade and the Directorate for Competition and consumer Protection organised the event. Product labelling as a consumer information mode was the subject of the conference and underlined the work currently carried out by the European Commission within the consumer policy strategy. The interventions on the surveys initiated by the Health and Consumer Protection Directorate General show high interest by the audience of national delegates of the Member States, representatives of the European consumer consultative group and other stakeholders.

We would like to bring to your attention a few quotations in order to give a better vision of Consumer Policy Perspectives for labelling.

Mr. Pierre Rauchs, Head of Consumer Affairs Department at the Ministry of Economic Affairs and Foreign Trade



«Pour que le consommateur puisse pleinement profiter des avantages du marché intérieur, il est crucial non seulement que le socle de règles communes soit consolidé, mais encore que le consommateur soit informé de ses droits et pleinement éclairé sur les caractéristiques des produits qu'il est tenté d'acheter. L'étiquetage, vecteur d'information par excellence pour le consommateur, favorise la transparence des marchés et, par voie de conséquence, le jeu concurrentiel libre et sans entraves. Un étiquetage clair, concis et fiable contribue à la responsabilisation du consommateur et appelle des choix éclairés et autonomes.»

«Protéiforme et abondante, l'information qui est offerte au consommateur dans le secteur alimentaire risque parfois de semer la confusion au lieu de guider le particulier au moment de ses achats. Dans cette optique, les participants à la conférence ont exploré ensemble les possibilités pour améliorer la qualité des informations communiquées au travers de l'étiquetage. Le consommateur «moyen» se retrouve-t-il devant la masse des informations communiquées? Faut-il réglementer la matière ou simplifier et harmoniser les règles d'étiquetage? Le petit artisanat de proximité doit-il obéir aux mêmes règles que les grandes multinationales de l'agro-alimentaire?»

2) European Competition Day — May 3, 2005

The Ministry of the Economy and of Foreign Trade and the Competition Council organised the event. The objective was to promote competition law in the Member States under the topic of liberal professions. Mrs Neelie Kroes, Member of the European Commission in charge of competition, made a speech during the opening dinner. Mr. Philip Lowe, Director General for Competition and Mr. Gabriel Bleser made presentations during the Day.

We would like to bring to your attention a few of their key quotations in order to give a better vision of the challenges ahead for Competition Policy.

Mrs Neelie Kroes, Member of the European Commission in charge of competition

'I would like to remind all of us of the importance of actively promoting and advertising what we are doing for consumers... There is, however, an urgent need for all of us to better explain why we do what we are doing. Indeed, some may take it for granted, but most European consumers are not really aware of the beneficial effects competition policy enforcement has on their day-to-day life.'

'I therefore feel encouraged to call upon you, colleagues of the national competition authorities, to join the Commission in its pro-active enforcement strategy within the ECN. And ...gather sufficient resources to enthusiastically contribute to our concerted use of competition enforcement tools to the benefit of all European consumers.'

Mr. Philip Lowe, Director General for Competition

'The Commission's work in the area of professional services was triggered by the receipt of a number of informal complaints and market information, as well as greater interest from national judges which resulted in a series of preliminary rulings from the European Court of Justice. This led the Commission to undertake a general stocktaking exercise of existing regulation affecting the professions in Member States.'

'I also fear that the government and public authorities of the Member States will not always be able or willing to prevent any abuse of regulatory powers in self-regulated sectors. In some cases they will be unable to prevent such abuses because they have effectively abandoned their regulatory powers to the economic actors in the sector. In other cases they will be unwilling to do so, because of the well-known economic phenomenon of regulatory capture. The Commission is therefore still considering taking appropriate enforcement action using the EC competition rules.'



From left to right: M^{me} Christiane Weidenhaupt, Conseiller Conseil de la Concurrence; M^{me} Octavie Modert, Secrétaire d'Etat; M. Gabriel Bleser, Rapporteur Général de l'Inspection de la concurrence; M. Giuseppe Tesauro, ancien avocat général à la CJCE; M^{me} Nellie Kroes, Commissaire Européen chargé de la Concurrence; M. Thierry Hoscheit, Président du Conseil de la Concurrence; M^{me} Elisabeth Mannes-Kieffer, Chargée de la DG Marché intérieur du Ministère de l'Economie.

M. Gabriel Bleser, Rapporteur Général de l'Inspection de la Concurrence. Ministère de l'économie et du commerce extérieur. G.D. Luxembourg.

«Des études démontrent que les entreprises européennes paient trop chers pour les services délivrés en Europe. L'exercice auquel se livrent la DG Concurrence et les autorités nationales de concurrence doit être vu faisant partie des objectifs de Lisbonne. J'ai pu suivre ce dossier depuis le début et ce qui me dérange un peu dans les discussions est le fait que l'on dispose rarement d'études de satisfaction du consommateur entendu au sens large du terme, (c'est-à-dire entreprises et consommateur final privé) suite à l'introduction de plus de concurrence dans certains secteurs. La majorité des études se concentre sur le seul facteur prix. Or, même si nous savons que le consommateur moyen est d'abord intéressé par les prix et pas nécessairement par la qualité du service presté, je pense que l'on devrait davantage analyser le taux de satisfaction des consommateurs.»

«Il est souvent affirmé que les professions libérales figurent parmi les professions qui sont le plus réglementées et le moins ouvert à la concurrence. Il est vrai que ces professions sont fortement réglementées. Mais, les ordres, syndicats ou chambres se dotent souvent de règles qui ont pour effet d'entraver le libre exercice de la profession et qui vont au-delà des prescriptions législatives et réglementaires... Le Conseil et l'Inspection de la concurrence vont continuer les consultations et surveiller le développement de changements législatifs et réglementaires dans le domaine des professions libérales.»

***Next European Competition and Consumer Day
will be in London 15 September 2005 under
the United Kingdom Presidency of the European Union.***

Reorganisation of cartel work in DG Competition

Anna SAARELA and Paul MALRIC-SMITH, Directorate-General Competition, directorate F

In recent years greater priority has been given to anti-cartel work. The fight against cartels has been identified by Commissioner Neelie Kroes as one of the key areas where DG Competition will concentrate its efforts in the future. In order to support this key activity, a new Directorate, devoted exclusively to cartel enforcement has been established. The Directorate will implement the European Commission's 'zero tolerance policy' in relation to this most damaging type of anti-competitive practice. The work of this Directorate will put the spotlight on the costs of cartels to consumers and their adverse effects on competitiveness and growth in Europe.

The Cartel Directorate has prime responsibility for the handling of cartels and deals with immunity application under the Commission's leniency notice. That being said, the Cartel Directorate will not have a monopoly on handling cartel cases and some flexibility will remain. It is expected that it will handle the majority of cartel cases.

Cartel work has a strong legal focus, both in the investigation and development of a case, and in the need to apply correct procedures and ensure that rights of defence are respected. Given these aspects, a certain degree of specialisation is needed for effective action against cartels. DG Competition's aim is to develop a body of specialized case-handlers to deal with cartel cases. The Directorate will be a point of focus for the outside world.

Together with the Directorate for Policy and Strategic Support, the Cartel Directorate will formulate policy in this area and coordinate the Commission's contributions to the work on international fora, such as the ICN and the OECD. The new directorate will take the lead in developing policy in the area of cartel enforcement and leniency.

The Commission's leniency programme has been very successful, and today many cartel investigations begin with an application for immunity from fines in return for providing evidence about a cartel. Furthermore, it encourages other participants to try and obtain reduced fines as a result of providing information to the Commission on volun-

tary basis. In 2004, the Commission dealt with 49 applications for immunity and leniency in 25 different cases.

The first months of the current year have seen a sharp rise in applications for immunity giving rise to new cases. On the other hand major new investigations have also been launched as a result of information received in other ways, and notably through good cooperation with national competition authorities within the European Competition Network (ECN).

Whilst being very successful, the Commission's programme can be improved and like all sets of rules, needs to be adapted to changing circumstances. Particularly important in this regard is the interplay between the Commission's leniency programme and the existence of leniency programmes in many Member States (17 today). Also the application of personal sanctions on individuals involved in cartels in certain Member States raises legal and policy issues. These developments, and the very success of the leniency programme in uncovering cartels, will give rise to new challenges to address the burden of multiple leniency applications in different jurisdictions and to streamline and accelerate the handling of cartel cases, so that the incentives to cooperate with the Commission are maximised.

In the light of the priority given to the fight against cartels, additional staff are being allocated to these duties in the context of the creation of the Directorate, and the resource needs will be kept under review.

In close cooperation with the national competition authorities of the Member States, the Commission aims to act effectively and efficiently against cartels, and to uncover many more of them. It will also continue to make clear that such behaviour not only attracts high fines and potential personal liability under Member States' law. The combined efforts of all involved will guarantee that cartels are effectively and severely sanctioned for the benefit for consumers and the competitiveness of European industry.

Joint selling of Bundesliga media rights — first Commission decision pursuant to Article 9 of Regulation 1/2003

Stefan WILBERT, Directorate-General Competition, unit C-2

Introduction

On 19 January 2005 the Commission adopted the first commitment decision pursuant to Article 9 of Regulation (EC) No 1/2003. In case COMP/C-2/37.214 — *Joint selling of the media rights to the German Bundesliga* the Commission declared the commitments on the German football league binding and ended the proceeding. ⁽¹⁾

Media, sports and joint selling — previous EU competition policy

The media and the sports sectors are closely related. Premium content, such as first division football, is a key driver for the roll-out of new and innovative media services in the EU. Joint selling, i.e. the pooling of media related club rights and marketing by a single entity, typically the league association, constitutes a recurrent pattern used by UEFA and most national football leagues.

In its exemption decision *Joint selling of the commercial rights of the UEFA Champion League* of 23 July 2003 ⁽²⁾ under Regulation No 62/17, the Commission followed a balanced approach and exempted UEFA's liberalised joint selling policy:

It found the joint selling scheme to restrict competition within the meaning of Article 81(1) of the Treaty and highlighted the negative effects on prices, innovation and media concentration to the detriment of the consumers. Joint selling hinders competition between the clubs in terms of prices, innovation and fan services and products. It additionally leads to the league selling the rights in a single bundle or very few packages on an exclusive basis, typically to the incumbent broadcasters that have little or no incentive to innovate and put their traditional TV business at risk.

The Commission identified efficiencies within the meaning of Article 81(3) of the Treaty related to a liberalised and appropriately tuned joint selling scheme, in particular the reduction of transaction costs due to a one-stop-shop for media operators and clubs and advantages for the branding of a uniform league product.

UEFA liberalised its joint selling mechanism to take into account the Commission's concerns and introduced modifications such as a transparent tender, the sale of smaller packages, additional marketing by the clubs and a prohibition to hold back rights through joint selling.

Commitment decisions — a new tool

Article 9 of Regulation 1/2003 creates a new type of decisions: decisions accepting commitments. This tool gives the Commission the power to make the commitments given by the companies under investigation binding on them and subsequently end the proceeding pursuant to Article 9(1) of Regulation 1/2003 if, in light of the commitments, there are no longer grounds for action.

The tool can be applied in all antitrust cases where it is justified by reasons of procedural efficiency and unless a fine would be appropriate (Recital 13 of Regulation 1/2003). The instrument requires the co-operation of the company under investigation which can at any time opt for the formal prohibition procedure. The Commission is also free to use the formal prohibition procedure.

In a first step, the Commission notifies its preliminary assessment in which the Commission specifies its competition concerns. Subsequently, the company offers commitments aimed at removing the Commission's concerns. If the Commission considers that the commitments are sufficient to terminate the proceeding it publishes the commitments in a notice pursuant to Article 27(4) of Regulation 1/2003 giving all interested third parties the opportunity to comment and to point to weaknesses and insufficiencies of the commitments. The advisory committee is consulted on the draft decision (Article 14 of Regulation 1/2003).

The company to whom the decision is addressed must respect the conditions of the settlement. Otherwise the Commission can impose a fine of up to 10% of their turnover (Article 23(2) of Regulation 1/2003), and also periodic penalty payments are possible until it complies with the commitments (Article 24 of Regulation 1/2003). Moreover, national courts must enforce the commitments by any means provided for by national law, including the adoption of interim measures.

⁽¹⁾ Full text published in German, English and French on the DG COMP website http://europa.eu.int/comm/competition/antitrust/cases/index/by_nr_74.htm#i37_214.

⁽²⁾ OJ L 291, 8.11.2003, p. 25.

If there is a material change in any of the facts on which the decision is based, the Commission may, upon request or on its own initiative, reopen proceedings (Article 9(2) of Regulation 1/2003).

Transition from the old to the new legal framework

The *Bundesliga* case started as a notification procedure under Regulation 17/62 and was carried over into the new legal framework.

The German Football Federation (Deutsche Fußball-Bund) and later the League Association (Ligaverband) applied for negative clearance or, failing this, an individual exemption under Article 81(3) of the EC Treaty in respect of the joint selling of television and radio broadcasting rights and rights to other technical forms of exploitation for matches in the first and second national football divisions (Bundesliga and 2. Bundesliga respectively) ⁽¹⁾. The Commission started investigations and entered into negotiations with the German league leading to a preliminary settlement.

On 30 October 2003, pursuant to Article 19(3) of Council Regulation No 17, the Commission announced in a notice in the Official Journal of the European Union its intention to take a favourable view of an amended joint selling system ⁽²⁾. It subsequently received numerous comments from interested third parties which made it necessary to re-open the discussions.

With the entry into force of Regulation 1/2003 on 1 May 2004, the application made by the league lapsed in accordance with Article 34(1) of that Regulation. Accordingly, the Commission acting on its own initiative, continued with the proceedings with a view to adopting a decision under Chapter III of Regulation 1/2003.

Competition concerns in respect of joint selling by the German football league

The Commission informed the League Association by letter dated 18 June 2004 of its preliminary assessment within the meaning of Article 9(1) of Regulation 1/2003. According to the Commission's preliminary assessment, the problems lie in the transfer of the media rights to the Bundesliga and 2. Bundesliga from the clubs to the German League Association and the subsequent central selling. In the selling agreements, the League Association determines the price and the nature and scope of exploitation. Through the agreement on central marketing and the subsequent joint selling, the Bundesliga clubs are prevented from dealing

independently with television and radio operators and/or sport rights agencies. Competition in the sale of rights is excluded. The clubs are prevented in particular from taking independent commercial decisions about the price or structuring the nature and scope of the rights sale differently from the joint selling system.

In addition, according to the preliminary assessment, joint selling has an adverse effect on the downstream relevant television markets and markets in the new media, since the possibility of supplying football content plays an important role in competition between programme suppliers for advertising revenues and subscribers or pay-per-view customers.

The Commission's market definitions and competition concerns related to joint selling by the German league are in line with the competition policy set out in the UEFA Champions League decision for the international football competition.

Commitments given by the German football league

The league offered commitments which significantly change its joint selling policy: ⁽³⁾

- The league rights are offered in several packages in a transparent, non-discriminatory procedure. Agreements concluded with the agents and sub-license holders will not exceed three seasons.
- Live broadcasts of the Bundesliga and the 2. Bundesliga are offered by the League in particular in two packages, available to both for free TV and for pay TV programme suppliers. A third package entitles the buyer to broadcast deferred highlights on free TV, and also to live broadcasts of at least two Bundesliga matches.
- One package contains the League right to broadcast Bundesliga and 2. Bundesliga matches live and/or near-live on the Internet. From 1 July 2006, the package contains the right to broadcast the matches live and near-live. The League Association will, on every day on which games are held, offer a total of at least 90 minutes live coverage of the matches on the Internet, e.g. in the form of a conference channel. Coverage per game will not be less than five minutes and will contain all important match events, e.g. goals and penalty kicks.
- A different package contains the League right to broadcast Bundesliga and/or 2. Bundesliga matches live and/or near-live and/or after the event on mobile phones.

⁽¹⁾ Carlsberg notice, OJ C 6, 9.1.1999, p. 10.

⁽²⁾ OJ C 261, 30.10.2003, p. 13.

⁽³⁾ MEMO 05/16 contains a comprehensive summary of the commitments and different packages.

- Every club can sell its home games to a free-TV broadcaster 24 hours after the match for one-off free-TV broadcasting of up to the full match within the EEA. One and a half hours after the end of a match, every club can exploit a summary of its home and away games of up to 30 minutes on the Internet. From 1 July 2006, immediately after the end of the match every club can cover its home and away games on its homepage or that of a third party without restriction as to length. Every club can sell the coverage of its home games on mobile phone networks within the EEA to the operators of those networks.
- The above-mentioned club rights may not be sold in such a way that a product can be devised by a buyer which clashes with the interests of the League or the acquirers of league packages in having a uniform product and jeopardises the advantages of branding and the one-stop shop.
- Unused rights may be exploited by the clubs following a defined procedure. However, the League Association remains entitled to parallel, non-exclusive marketing of the corresponding package. This applies when the Association has failed to sell certain rights covered by the joint selling procedure. Clubs are also entitled to sell rights where the holder of those rights, for no objective reason, fails to use them.
- The changes relating to television and, as set out, partly relating to the Internet, will enter into force on 1 July 2006. All other changes apply

from 1 July 2004. The transitional stage ensures that the arrangements are brought into line with the competition rules without jeopardising the operation of the Bundesliga and the 2. Bundesliga.

Scope of the decision and conclusion

The decision solely deals with the marketing policy of the central marketing body and excludes the competition implications of future licence agreements. The decision contains the explicit reservation that a separate examination under Community law cannot be ruled out, in particular if more than one jointly sold package with exclusive exploitation rights is acquired by one purchaser. The decision is binding until 30 June 2009.

The decision highlights the improvements in respect of competition in the marketing of Bundesliga and 2. Bundesliga rights between the league and the clubs which allow for new, in particular club branded products. The commitments improve the accessibility of content for TV, radio and new media operators, make sure that all rights are being made available to the market and thereby contribute to innovation and dampen the concentration tendencies in the media markets.

The decision reconfirms the EU competition policy vis-à-vis joint selling of media rights for national leagues. It applies the new tool of commitment decisions for the first time and marks one additional step towards full implementation of the modernisation of antitrust rules.

First collective dominance cases under the European consultation mechanism on electronic communications

Inge BERNAERTS and Stefan KRAMER, Directorate-General Competition, unit C-1

In the first semester of 2005, the Commission dealt with two collective dominance cases in the electronic communications sector. Both cases were notified to it under the so-called electronic communications consultation mechanism⁽¹⁾. The first case related to the market for broadcasting transmission services in the UK. The second case related to the market for wholesale mobile access and call origination in Ireland.

Introduction — the consultation mechanism

The EU regulatory framework on electronic communications that was adopted in 2002, generated a new symbiosis between the EU competition rules and sector specific *ex ante* regulation in the telecommunications industry. Pursuant to the Framework Directive on electronic communications⁽²⁾, national regulatory authorities ('NRAs') must analyse a series of 18 product markets that are predefined by the Commission, on the basis of competition law and economics, as relevant markets susceptible to *ex ante* regulation⁽³⁾.

If a market is found to be effectively competitive, i.e. if no undertaking is found to have significant market power ('SMP') on that market, no sector specific *ex ante* regulation can be imposed or maintained. The behaviour of the players on that market will then be governed solely by the general competition rules. By contrast, undertakings that are found to have SMP on one of the 18 markets must be made subject to appropriate *ex ante* regulation (such as transparency, non-discrimination, accounting separation or access obligations or price control), which will apply in addition to the general competition rules. The concept of SMP is

equivalent to 'dominance' as defined by the European Court of Justice in competition law cases. An undertaking is deemed to have SMP if, either individually or jointly with others, it enjoys a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers⁽⁴⁾.

NRAs must notify the results of their market analyses and the regulatory obligations that they intend to impose (if any) to the Commission. In the context of the so-called electronic communications consultation mechanism, the Commission verifies the draft measures' compatibility with Community law and their contribution to the single market.⁽⁵⁾ Upon receipt of a notification, the Commission has one month to make comments on the notified draft measure, to make no comments or, if it has serious doubts concerning the proposed market definition or SMP analysis, to open a second phase investigation. At the end of the second phase investigation, the Commission can prohibit the NRA to adopt the notified draft measure (so-called veto decision). The Commission has received more than 185 notifications so far, from NRAs in 15 Member States. At the time of writing it had adopted 4 veto decisions⁽⁶⁾, 67 comments letters and 32 no comments letters⁽⁷⁾.

Broadcasting transmission services in the UK

On 11 November 2004, the UK regulator, Ofcom, filed a notification concerning broadcasting transmission services (market nr. 18 in the Recommendation). Broadcasting transmission services consist of carrying broadcast content over electronic

⁽¹⁾ A third collective dominance case is at the time of writing under investigation and will not be the subject of this article. The case concerns the market for mobile access and call origination in France (case FR/2005/0179).

⁽²⁾ Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (the 'Framework Directive'), OJ L 108, 24.4.2002, p. 33.

⁽³⁾ Commission Recommendation 2003/311/EC of 11 February 2003 on relevant product and service market within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European parliament and of the Council on a common regulatory framework for electronic communication networks and services, OJ L 114, 8.5.2003, p. 45 (the 'Recommendation').

⁽⁴⁾ Pursuant to Article 14(2) of the Framework Directive.

⁽⁵⁾ For a detailed description of the consultation mechanism on electronic communications see 'The Article 7 consultation mechanism: managing the consolidation of the internal market for electronic communications' by Reinald Krüger and Luca Di Mauro in the Competition Policy Newsletter, 2003, number 3, p. 33.

⁽⁶⁾ Two against Finland (Commission decision of 20 February 2004 in cases FI/2003/0024 and FI/2003/0027 and Commission decision of 5 October 2004 in case FI/2004/0082), one against Austria (Commission decision of 20 October 2004 in case AT/2004/0090) and one against Germany (Commission decision of 17 May 2005 in case DE/2005/0144).

⁽⁷⁾ Some comments letters and no comments letters deal with several notifications at the same time.

communications networks (cable, satellite, or terrestrial networks) to end users. Broadcasting transmission services are generally supplied to broadcasters (TV and radio content providers), who on their turn provide a full package service, including content and transmission, to the consumers.

Market definition

Ofcom's notification focussed on broadcasting transmission services over terrestrial networks, which in Ofcom's view constitute a different market from transmission services over cable and satellite networks. The UK market for TV and radio viewers and listeners has an overall reach of 24.5 millions households corresponding to 59 millions inhabitants. All households have access to terrestrial TV and radio; 44% of households have only access to terrestrial platforms. There are essentially two companies operating terrestrial networks in the UK: ntl and Crown Castle.

As regards terrestrial broadcasting transmission, Ofcom identified 2 layers of markets, one being upstream of the other. At the upstream level, it identified one market for the access to the masts and sites of Crown Castle and another market for the access to the masts and sites of ntl. Ofcom considered that access to Crown Castle's mast and sites and access to ntl's masts and sites are complementary products, not substitutable products, as both are needed together to broadcast throughout the UK (the Crown Castle masts and the ntl masts indeed cover distinct regions dotted all over the country). Ofcom concluded that Crown Castle and ntl are individually dominant on the market for access to their respective masts and sites. The Commission did not object to that conclusion ⁽¹⁾, and the relevant part of the notification will not be dealt with further in this article.

The more controversial part of the notification concerned the market for managed transmission services (MTS) over terrestrial networks in the UK, which is a market downstream of the markets for access to masts and sites ⁽²⁾. Both Crown Castle and ntl are active on the MTS market. The companies grant each other access to their masts and sites, so that they are both able to provide managed transmission services covering the entire territory of the UK. But will these companies effectively compete with each other? That was the relevant question in this case.

⁽¹⁾ See the Commission's no comments letter of 28 January 2005 in case UK/2005/0111.

⁽²⁾ In addition to access to masts and sites, significant investments in transmission equipment installed on these masts and sites, in engineering and customer services are required in order to be able to provide managed transmission services.

Collective dominance?

In its notification, Ofcom argued that Crown Castle and ntl held a joint dominant position on the MTS market in the UK, as both companies were in Ofcom's view unlikely to compete effectively. Ofcom based this view essentially on a 'check list' review of the market characteristics that are enumerated in Annex II to the Framework Directive. The Commission services recognized that certain market characteristics indeed point towards the MTS market being conducive to collective dominance, in particular the high market concentration, barriers to entry, symmetric market shares, similar cost structures, structural links between the parties, low elasticity of demand and moderate growth on the demand side. However, other market features seemed to suggest a different conclusion, in particular the absence of transparency in the market (no transparent pricing).

More importantly, however, the Commission services considered in their preliminary analysis that if one were to look beyond isolated market characteristics at how the MTS market functions in practice, the finding of collective dominance was questionable. They considered that Ofcom in its notification had not provided sufficient evidence that Crown Castle and ntl were likely to collude (i.e. that they had the possibility and incentive not to compete amongst each other), nor that such collusion would be sustainable (i.e. that there was an effective retaliation mechanism in case one of them were to deviate from the collusion ⁽³⁾).

Ofcom had not established, it seemed, a focal point on which Crown Castle and ntl could and would be likely to collude. As contracts in the MTS market are generally awarded through single round bidding procedures, prices and other contract conditions are intransparent, which make them difficult to collude on. There also seemed to be no indication of customer sharing, as both operators had competed in biddings for past contracts, even though few customers had actually switched supplier ⁽⁴⁾.

⁽³⁾ As required by the CFI in *Airtours*.

⁽⁴⁾ The Commission found that the absence of switching in the past could have been caused, at least partially, by legacy investments by the supplier which were customer specific. For future contracts it seemed however that these would not play such a major role as the switch over from analogue to digital transmission services that both suppliers are in the process of implementing, would require Greenfield investments anyway. In addition, as the main contracts would be concluded for a long period of time (10 years or more) and well in advance of implementation (up to 7 years ahead) customer specific investments did not seem to form an obstacle.

Moreover, the Commission services discussed with Ofcom that market players met each other infrequently: only 3 biddings for TV broadcasting contracts (with a duration of 10 years and more) and 3 biddings for much smaller radio broadcasting contracts were likely to be organised in the next 5 years. Under those circumstances, it was not clear how effective retaliation could occur. The 3 TV broadcasting contracts (with Digital 3 and 4, SDN and the BBC) were expected to be negotiated within a relatively short timeframe (between April 2005 and the end of 2005). The next foreseeable negotiations for major contracts would take place only 10 to 12 years later. Of the 3 contracts to be reallocated in 2005, 2 are currently held by ntl (the Digital 3 and 4 contract and the SDN contract) and 1 by Crown Castle (the BBC contract). As the BBC contract would most likely be negotiated first, once the bidding for this contract would be over, there seemed to be no incentive for Crown Castle not to compete effectively for the 2 remaining contracts as ntl would have no means of retaliation. This situation, known in economic theory as a 'finite game', seemed to undermine effective retaliation, which is an essential element to find collective dominance under EU competition law.

Withdrawal of notification

During the first phase of the consultation procedure, the Commission services discussed their preliminary concerns about the collective dominance finding with Ofcom. On the basis of these discussions, Ofcom withdrew its notification with regard to MTS. Throughout the entire consultation mechanism (first phase and second phase), an NRA has the possibility to withdraw a notification. Such a withdrawal terminates the consultation procedure, without the Commission adopting a decision. The withdrawal of a notification is publicised on the Commission's dedicated website for the electronic communications consultation mechanism ⁽¹⁾.

The market for mobile access and call origination in Ireland

On 10 December 2004, the Commission received a notification by the Commission for Communications Regulation ('ComReg') concerning the wholesale market for access and call origination on public mobile telephone networks in Ireland

(market nr. 15 in the Recommendation). Access and call origination services are provided by mobile network operators to independent service providers (resellers which do not issue their own SIM cards) or so called mobile virtual network operators (MVNOs — which issue their own SIM cards). Hence, independent services providers or MVNOs use the network of mobile network operators to offer mobile telephony services at the retail level in direct competition to the retail arm of the host network.

There are three mobile network operators active in Ireland, namely Vodafone (since 1985), O2 (since 1997), Meteor (since 2001). The 3G operator '3' has not yet launched services in Ireland. Currently none of these MNOs offers wholesale access and call origination to third parties. Since there are no transactions on the merchant market ComReg considered all sales to be captive and used market shares in the retail market as a proxy for market shares in the relevant wholesale market. The market shares of the operators in terms of subscribers in September 2004 were 54% (Vodafone), 40% (O2), and 6% (Meteor). In terms of revenue the distribution of market shares was 58% (Vodafone), 39% (O2), and 3% (Meteor).

Collective Dominance — structural characteristics of the market

ComReg identified a number of structural characteristics of the Irish market which it found to be conducive to coordinated behaviour between Vodafone and O2, most notably the structure of the market, the incentive to coordinate, the ability to coordinate, the ability to detect cheating, the enforceability of compliance and actual and/or potential market constraints.

As far as *market concentration* is concerned ComReg stated that Vodafone and O2 together held in September 2004 94% of the market in terms of subscribers and considered the third operator Meteor unlikely to alter the high degree of concentration in the market over the period of the review. The *incentive to coordinate* is in ComReg's view strong since there are only two firms to share the proceeds from coordination and while the two market shares are not identical (symmetric) their absolute size gives a strong enough incentive to coordinate. Further to that, frequent interactions between the two players common to a network industry, steadily increasing demand, lack of drastic innovation favouring one of the two network operators, in ComReg's view all positively impact on the incentive to coordinate.

The *ability to coordinate* depends in ComReg's view on the existence of a simple and transparent

⁽¹⁾ <http://forum.europa.eu.int/Public/irc/infso/ecctf/home>. Up to the date of writing, 3 notifications have been withdrawn: the notification by Ofcom concerning MTS services (case UK/2004/0111), the notification by the Swedish NRA, PTS, concerning the fixed calls markets (cases SE/2005/0146-0149) and the notification by the Danish NRA, NITA, concerning fixed termination services (case DK/2005/0171).

focal point. ComReg identified a focal point with two dimensions, one being price, the other being the denial of access to independent service providers or MVNOs. ComReg believes that Vodafone and O2 offer broadly the same portfolio of services whose complex tariffs can be made transparent by the method of Minimum Monthly Bills (MMBs), a measure used by operators to monitor rivals' tariffs. The analysis of pricing data revealed relatively stable mobile prices particularly for post pay high volume users. The other dimension of the focal point, denial of access to independent entities, has the potential to lessen competition in the retail market and is both simple (access is either granted or denied) and transparent. The fact that there are currently no independent service providers in Ireland must be, in ComReg's view, due to such denial of access⁽¹⁾. ComReg indicated that there is 'pent-up demand' (i.e. unfulfilled demand) of service providers seeking access to MNOs' networks.

The *ability to detect cheating* means that members of the oligopoly can quickly find out about a deviation from the common policy either in terms of price or access granted to third parties. As outlined above, ComReg stated that price movements are easily detectable through MMBs. Similarly, the denial of access to third parties (the second dimension of the focal point) would, according to ComReg, be immediately visible through the appearance of a service provider or MVNO on the Irish market.

Enforceability of compliance means that deviation can be effectively punished and hence coordination between undertakings more easily upheld. In the Irish context if one firm tried to acquire a significant increase in the number of customers through a price decrease then this would result in the other firm also lowering its prices and a new market equilibrium featuring lower prices overall. Similarly, if Vodafone or O2 were to grant access at the wholesale level, which would allow a service provider to acquire a significant number of customers, the other firm could retaliate by also granting access.

ComReg stated that neither Vodafone nor O2 are subject to *actual and/or potential market constraints*. The fringe competitor in the Irish market is Meteor whose past record in attracting subscribers does not seem to pose a serious threat to Vodafone and O2. Despite its lower prices Meteor has until November 2004 not made an

impact on Vodafone's and O2's prices particularly in the post paid segment of the market. In this segment Meteor has only been able to gain a market share in terms of subscribers of 1% since its launch in 2001 while it has a share of 8% in the pre paid segment.

SMP finding and regulatory obligations

ComReg concluded that on the basis of the market characteristics there is evidence of a jointly held position of dominance between Vodafone and that this position is sustained by the refusal to grant access to wholesale airtime or access to an MVNO. As a consequence, ComReg designated Vodafone and O2 as being jointly dominant on the wholesale market for mobile access and call origination. ComReg plans to impose an obligation to provide network access following a reasonable request, a non-discrimination obligation, an obligation of price control by way of cost orientation, an obligation to prepare separated accounts, and an obligation to implement appropriate cost accounting systems. ComReg will allow SMP operators a period of time to meet their obligations regarding access and non-discrimination during commercial negotiations. Only if these are unsuccessful ComReg will direct SMP operators to implement those obligations relating to price control and cost orientation.

The Commission's comments

The Commission did not object to this finding of joint dominance. It considered that ComReg had demonstrated that the characteristics of the market make it conducive to collective dominance and that such form of coordination is sustainable; the oligopolists apparently have no incentive to deviate from the coordinated outcome (considering the ability of the non-deviators to retaliate), and fringe competitors do not (currently) appear to have the ability to challenge the coordinated outcome.

However, ComReg's analysis focused to a large extent on transactions occurring at the retail level of the market because all supply on the relevant market is captive, i.e. provided internally by vertically integrated mobile network operators. In such a case the structure of supply at the wholesale level — at least market shares of the undertakings active on the relevant market — can be derived from supply at the retail level. Other characteristics of the market and competitive conditions at the retail level can also be relevant to assess whether the corresponding wholesale market is conducive to tacit collusion. However, the Commission has in its decision commented that a company's performance on the retail market does not automatically mirror its position and conduct on the upstream

⁽¹⁾ A national roaming agreement was signed between O2 and Meteor in August 2004. A national roaming agreement is, however, not the same as an MVNO agreement because it only concerns occasional roamers in those areas of the country where Meteor has not yet rolled out its own network.

wholesale market, even if there are currently no market transactions taking place. In principle the smallest operator can offer wholesale access (and has the strongest incentive to do so) and can become the most important player on the merchant market. The retail market conditions may inform an NRA of the structure of the wholesale market, they may and need not in themselves be conclusive as regards the finding of SMP at the wholesale level.

The letter sent to ComReg also includes a comment on the degree of uncertainty as far as the performance of fringe competitors on the Irish market is concerned. Especially in the fourth quarter of 2004 Meteor appears to have been able to benefit from its national roaming agreement with O2 and could now be in a position to attract a larger proportion of customers than anticipated in ComReg's analysis. This may also indicate the possible emergence of a constraint on Vodafone and O2's ability to behave independently of their competitors. Hence the Commission requested ComReg to monitor the developments of the emergent competitors Meteor and '3' very closely. In case these competitors prove capable of gaining retail market share (including in the post-paid segment) rapidly and at the expense of Vodafone and O2, one of the criteria which currently imply collusive behaviour by these two operators may no longer be met.

Even if fringe competitors were not able to exert a competitive constraint at the retail level, they may be able to do so at the wholesale level. As far as Meteor is concerned, as a result of the national roaming agreement concluded with O2, one of the fundamental conditions to be able to offer national coverage to an MVNO may now have been fulfilled. Indeed, in order for tacit collusion to be sustainable, it must be shown that fringe competitors do not have the ability to challenge any anti-competitive coordinated outcome. In this context it must also be stressed that for a competitor to be able to disrupt tacit collusion, it is not necessary to be a strong competitor of the tacitly colluding parties. ⁽¹⁾ It is sufficient if customers can foster the emergence of other leading players by contracting with the existing smaller competitors.

The Commission has therefore asked ComReg to closely monitor the behaviour of fringe competitors on the wholesale market for mobile access and call origination. Any concrete evidence that

these companies act as credible access provider alternative to Vodafone and O2 would cast doubt on the sustainability of the collectively dominant position.

Conclusion: how high is the standard for proving collective dominance in the electronic communications sector?

The Court of Justice has set the standard for proving collective dominance cases high in any sector, not just electronic communications. Under the electronic communications consultation mechanism, the Commission aims to ensure (i) that the NRA's market analysis is compatible with the EU competition rules, (ii) a coherent and harmonized approach throughout the EU and (iii) that ex ante regulation is only imposed on undertakings for which it has been duly demonstrated that they have significant market power.

This implies that the Commission, while recognising that NRAs enjoy certain discretionary powers, which reflect the complexity of all relevant factors that must be assessed when determining the existence of undertakings with significant market power, will continue to scrutinise carefully under the electronic communications consultation mechanism whether an NRA's finding of collective dominance is supported by sufficient evidence. To support a finding of collective dominance, NRAs must prove to the requisite legal standard set out by the case law of the Community Courts and in line with the Commission's SMP Guidelines ⁽²⁾ that the characteristics of the market make it conducive to collective dominance and that such form of coordination is sustainable. For the coordination to be sustainable, regulators must show on the basis of a cogent and consistent body of evidence that (i) none of the oligopolists have the ability and incentive to deviate from the coordinated outcome, because in case of such deviation the non-deviators would have the ability and incentive to retaliate and (ii) that no buyer, fringe competitor or potential entrant has the ability and incentive to challenge any anti-competitive coordinated outcome within the timeframe of the review.

In the Irish case covered by this article the Commission found that ComReg has not exceeded its margin of discretion by concluding that at the

⁽¹⁾ Case T-342/99 *Airtours* [2002] ECR II-2585, para. 213.

⁽²⁾ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165, 11.7.2002, p. 6.

stage of market analysis, even in a forward looking review, developments of emergent competitors to Vodafone and O2 were too uncertain to affect its collective dominance findings. In the UK case, the Commission services preliminarily concluded

that the requisite legal standard of proof had not been met, although the Commission did not formally express its views, as Ofcom withdrew its notification concerning MTS in the UK in the course of the first phase of the investigation.

The Maxmobil Judgment ⁽¹⁾: the Court of Justice clarifies the role of complainants in Article 86 procedures

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On 22 February 2005 the Court of Justice rendered a judgment in case C-141/02 P, Commission against T-Mobile Austria GmbH. The Court sets aside the judgment of the Court of First Instance (CFI) in Case T-54/99 max.mobil v. Commission ⁽²⁾. In this judgment the CFI had acknowledged an obligation for the Commission to carry out a diligent examination of complaints which it receives under Article 86(3) of the Treaty and, in the relevant case, to inform the complainants of the reasons not to initiate proceedings against the Member State concerned. The CFI moreover considered that the Commission had complied with this obligation and therefore dismissed the action brought by the Austrian mobile operator against the Commission. The Commission decided however to appeal the judgment because it considered that actions of complainants against a letter of the Commission informing them that it would not initiate proceedings under Article 86(3) were not admissible and that the CFI had erred when acknowledging complainants a kind of right of judicial review ⁽³⁾ in this area. The judgment of 22 February 2005 clarifies a question which had been debated since nearly 15 years.

1. Background of the Court proceeding

On 14 October 1997 max.mobil (the second GSM operator in Austria — now T-mobile) lodged a complaint seeking among other things a finding that the Republic of Austria had infringed Article 82 EC in combination with Article 86(1) EC. The complaint covered three different issues:

- the fact that Mobilkom, the incumbent Austrian operator, did pay the same fee for its licence as max.mobil, although it had been granted additional 1800 MHz frequencies;
- the fact that no 1800 MHz frequencies were granted to max.mobil, at the same time;
- the pricing conditions fixed by the Government as regards the leased lines provided by Telekom Austria to max.mobil, which did not apply to Mobilkom.

⁽¹⁾ Judgment of 22 February 2005 in case C-141/02 P, Commission against T-Mobile Austria GmbH. The opinion of the Advocate General Poiares Maduro, favourable neither for the Commission nor for the CFI, was delivered on 21 October 2004.

⁽²⁾ [2002] ECR II-313.

⁽³⁾ Case T 54/99, cited above, paragraph 58.

DG Competition sought the position of the Austrian authorities on the allegations of the complainant and held further discussions with both the complainant and the Austrian authorities. After these discussions, the Commission decided to continue investigating the last two objections — which seemed more convincing — and not to pursue the case regarding the first objection. The complainant was informed of that decision by letter of 11 December 1998. The letter explained that:

‘concerning the amount of the concession fee, the Commission considers, on the other hand, that you have not produced sufficient evidence of the existence of a State measure which induced Mobilkom to abuse its dominant position. In accordance with the policy which it has followed to date, the Commission has not commenced Treaty-infringement proceedings in such cases unless a Member State has imposed a higher fee on a new entrant to the market than on an undertaking already active there (see the Commission Decision of 4 October 1995 concerning the conditions imposed on the second operator of GSM radiotelephony services in Italy (OJ L 280 of 23 November 1995)).’

As regards the other two objections, the Commission eventually achieved, without having to adopt a formal decision, that the Austrian Government would end the discriminations.

On 22 February 1999, max.mobil appealed the Commission's closure decision to the CFI.

2. Article 86(3) of the Treaty

Article 86 of the EU Treaty entrusts the Commission with a specific surveillance duty “in the case of public undertakings and undertakings to which Member States grant special or exclusive rights”. The Commission must “where necessary, address appropriate directives or decisions to Member States” which enact or “maintain in force any measure contrary to the rules contained in the Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89” and favour their State owned undertakings or undertakings to which they granted exclusive or special rights. However, Article 86 does not specify procedural steps, contrary to Article 226 for infringement procedures or Article 88(2) of the Treaty as regards State aid procedures. In addition, the EC Treaty does not provide as regards the application of Article 86 for the adoption of implementing regulations as

it does in Article 83 as regards the application of the anti-trust rules or in Article 89 as regards the application of the State aid rules.

Since the first Article 86(3) Decisions were adopted in the eighties, a major question was therefore which procedure to follow, and in particular what rights to give to complainants and companies involved. Given that the Article 86(3) procedure has, in its area, precisely the same aim as the Article 226 procedure, the procedural steps of the latter were *mutatis mutandis* applied to the procedure. It is opened via a letter of formal notice specifying the legal objections of the Commission and is pursued bilaterally with the relevant Member State, the objective being ending the breach — if possible in a negotiated way — or by adopting formal decisions.

This approach was mainly developed in the framework of postal and telecommunications cases which make out proportionally the majority of Article 86 procedures dealt with until now. Out of the 15 Article 86 decisions adopted by the Commission, 7 relate to the telecommunications and postal sectors. The last decision was adopted on 20 October 2004 and liberalises mail consolidation in Germany ⁽¹⁾.

In 1992, the Court acknowledged the right of the undertakings which are the beneficiaries from the State measure challenged to be informed and their right to challenge Article 86(3) decisions ⁽²⁾. In 1997, the Court acknowledged that *'the possibility cannot be ruled out that exceptional situations might exist where an individual or, possibly, an association constituted for the defence of the collective interests of a class of individuals has standing to bring proceedings against a refusal by the Commission to adopt a decision pursuant to its supervisory functions'* under Article 86(1) and (3) ⁽³⁾. In its max.mobil judgment of 30 January 2002 ⁽⁴⁾, the CFI went as mentioned a step further: stating that the Commission was under a general duty to investigate Article 86(3) diligently and impartially and that complainants were thus entitled to a kind of judicial review of closure decisions under which the CFI checks, first, that the information provided to the complainant includes a statement of reasons which is *prima facie* consistent and reflects due consideration of the relevant aspects of the case,

second, that the facts relied on are materially accurate and, third, that the *prima facie* assessment of those facts is not vitiated by any manifest error ⁽⁵⁾. By doing this, the CFI introduced a clear distinction between complaints under Article 86 and under Article 226. Regarding the latter the Courts have consistently ruled that the Commission has a discretion under Article 226 which excludes the right for individuals either to require that institution to adopt a specific position or to seek the annulment of a refusal to commence proceedings against a Member State. This position was maintained irrespective of whether the State measure complained of is general or individualised in character. ⁽⁶⁾

3. Main arguments advanced by the Commission

In its judgment the CFI dismissed the inadmissibility exception raised by the Commission for the following grounds:

- in the absence of an act addressed to a Member State, as in State aid cases, the Commission's refusal to take action under Article 86(3) EC constitutes a decision addressed to the complainant, by analogy with decisions to take no further action on a complaint concerning infringements of Articles 81 EC and 82 EC ⁽⁷⁾;
- Article 86(3) always applies in conjunction with other provisions; where it is invoked in conjunction with Article 82 EC, the complainant is in a position comparable to that of a complainant pursuant to Article 3 of Regulation No 17 ⁽⁸⁾ and, in any case, the obligation to undertake a diligent and impartial examination is also justified by the Commission's general duty of supervision, as set out in Article 85(1) EC as regards competition, and more generally in Article 211 EC ⁽⁹⁾ and Article 41 of the Union Charter of Fundamental Rights;
- the parallel, made by the Commission, with Article 226 EC does not go up because Article 86(3) EC states that the Commission shall adopt appropriate measures *where necessary*, which implies that the power to apply the latter provision is not entirely discretionary ⁽¹⁰⁾.

⁽¹⁾ Its wording can be found on <http://europa.eu.int/comm/competition/antitrust/cases/decisions/38745/en.pdf>.

⁽²⁾ Judgment of 12 February 1992 'courier services' (Joined Cases C-48/90 and C-66/90, *Netherlands et al.* [1992] ECR I-565).

⁽³⁾ Judgment of 20 February 1997, 'Bundesverband der Bilanzbuchhalter/Commission', C 107/95, ECR I-947, paragraph 25.

⁽⁴⁾ Case T 54/99, paragraphs 47-59.

⁽⁵⁾ Case T 54/99, cited above, paragraph 58.

⁽⁶⁾ E.g. Case 247/97 *Star Fruit v Commission* [1989] ECR 291, paragraph 11 and order of 14 January 2004 in Case T-202/02 *Makedoniko Metro v Commission*, paragraphs 43 and 46.

⁽⁷⁾ Case T 54/99, cited above, paragraphs 64 to 67.

⁽⁸⁾ Case T 54/99, cited above, paragraphs 48 to 51.

⁽⁹⁾ Case T 54/99, cited above, paragraph 52.

⁽¹⁰⁾ Case T 54/99, cited above, paragraph 54.

For these reasons, the CFI distinguished between, on the one hand, the obligation to examine complaints diligently and impartially and, on the other hand, the obligation to adopt a final decision addressed to a Member State. As regards the latter, the CFI acknowledged that an enforceable obligation, permitting an action for failure to act, does no more exist under Article 86(3) than under Article 226.

The Commission appealed the CFI-judgment on 15 April 1999 on the grounds that:

- Article 41 of the Union Charter of Fundamental Rights does not support the Court's conclusion that there is a general right to examination of complaints, and if it did, it would not permit the restriction of that right to competition cases. ⁽¹⁾ Article 41(1) refers to every person's 'right to have his or her affairs handled impartially, fairly and within a reasonable time'. However, when exercising its discretion under Article 86(3) EC, the Commission does not deal with the affairs of individuals, but rather acts in the general interest; ⁽²⁾
- a truly general obligation to examine complaints, based on general principles of law and enforceable by individuals, is incompatible with the consistent case law regarding both Article 86 EC (with the exception of the TF1 judgment ⁽³⁾) and (without any exception) Article 226 EC;
- there is no basis in the Treaty or in logic to confine the application of general principles of law to a restricted, privileged aspect of Community activity, namely competition law and Community Courts have always resisted attempts to invoke the express procedural rules applicable to certain complaints regarding infringements of the competition rules in circumstances that

fall outside their scope of application, including the application of Article 86(3) EC to competition matters ⁽⁴⁾ even in the *Bilanzbuchhalter* judgment of the Court of Justice. In that judgment the Court of Justice acknowledged that the possibility could not be ruled out that exceptional situations might exist where an individual would have standing to bring proceedings against a refusal by the Commission to adopt a decision pursuant to its supervisory functions under Article 86(1) and (3). However, it expressly excluded that this might be the case where an individual sought action under Article 86 EC against a State measure of a general character. ⁽⁵⁾

4. The Court's findings

The judgment of the Court sets aside the CFI judgment of 30 January 2002 for the reason that although *'It follows from paragraph 24 of the judgment in Bundesverband der Bilanzbuchhalter v Commission that individuals may, in certain circumstances, be entitled to bring an action for annulment against a decision which the Commission addresses to a Member State on the basis of Article 90(3) of the Treaty if the conditions laid down in the fourth paragraph of Article 230 EC (i.e. 'of direct and individual concern' to the applicant) are satisfied' it follows 'from the wording of Article 90(3) of the Treaty and from the scheme of that article as a whole that the Commission is not obliged to bring proceedings within the terms of those provisions, as individuals cannot require the Commission to take a position in a specific sense' ⁽⁶⁾ and that 'The fact that max.mobil has a direct and individual interest in annulment of the Commission's decision to refuse to act on its complaint is not such as to confer on it a right to challenge that decision. The letter by which the Commission informed max.mobil that it was not intending to bring proceedings against the Republic of Austria cannot be regarded as producing binding legal effects, with the result that it is not a challengeable measure that is capable of being the subject of an action for annulment' ⁽⁷⁾.*

In summary, the reasoning of the Court is the following:

- max.mobil fulfils the criterion set out in Article 230 to bring a case to the Court since it has 'a direct and individual interest';

⁽¹⁾ Case T 54/99, cited above, paragraph 48.

⁽²⁾ Case T 266/9, *VTM v. Commission*, [1999] ECR II-2329, paragraph 75.

⁽³⁾ Judgment of 3 June 1999 [1999] ECR II-1757, paragraph 49, in which the CFI acknowledged on the basis of the *Bilanzbuchhalter* judgment of the Court of Justice that complainants in Article 86 procedures are entitled to send a letter of formal notice to the Commission asking it to take a position on their complaint. The CFI stated that, unlike the complainant in the matter which led to the judgment in *Bundesverband der Bilanzbuchhalter*, which intended, by means of its action directed against the Commission's refusal to adopt a decision with regard to the Federal Republic of Germany, indirectly to force that Member State to adopt legislation having general application, TF1 only sought to have the Commission define its position, pursuant to Article 86 of the Treaty, on the various State measures complained of, which it alleges favour two particular economic operators who are clearly identified and with whom it is in direct competition.

⁽⁴⁾ See e.g. Case T32/94 *Ladbroke v Commission* [1994] ECR II-1015., paragraph 43; Case C-422/97 P *Sateba v Commission* [1998] ECR I-4913, paragraph 42; Case C-59/96 P, *Koelman v Commission* [1996] ECR II-1, paragraph 58.

⁽⁵⁾ Case C-107/95 P [1997] ECR I-947, paragraphs 25 and 26.

⁽⁶⁾ Paragraphs 68 and 69.

⁽⁷⁾ Paragraph 70.

— however, since a letter of the Commission informing a complainant that it will close a case ‘cannot be regarded as producing binding legal effects’ the relevant act was not challengeable.

Given that the 1999 Bilanzbuchhalter judgment also concerned an appeal against a Commission decision to close a complaint, it seems that the Court of Justice wanted to correct its previous case-law and now decided, in line with the position of the Commission at the Court, to assimilate the handling of Article 86(3) cases in the Article 226 procedure, as regards the absence of *locus standi* of complainants to challenge Commission’s decisions to file their complaints.

In this regard, the Court also rejected the distinction made by the CFI between the obligation of the Commission to examine complaints diligently and impartially and the obligation to adopt a final decision addressed to a Member State.

5. Conclusions from the judgment

The above-mentioned conclusion is of considerable importance from the point of view of the Commission’s handling of complaints invoking Article 86. Most complaints based on Article 86 are closed ⁽¹⁾, either because the alleged objections do not appear to be substantiated or because, as in the max.mobil procedure, positive results can be reached during the discussions with the concerned Member State. The judgment brings an end to the uncertainty which resulted from previous judgments and in particular from the vague ‘exceptional circumstances’ concept introduced by the 1999 Bilanzbuchhalter judgment. The max.mobil

judgment provides now a clear criterion. Only Article 86(3) *decisions producing binding legal effects* can be challenged. Procedural decisions not to pursue the investigation of a complaint can thus not be challenged given that they have no binding effects.

On the other hand, the judgment does not affect the legitimate interest of complainants to be informed by the Commission of its decision not to take up complaints and its grounds to do so. Both under Article 226 or Article 86(3), the Commission’s practice is to examine complaints with diligence and, in the relevant case, to inform the complainants timely of its intention and the reasons not to take up complaints. In this regard, the Court of justice took note in the max.mobil judgment ‘that the Commission acknowledges that it is under an obligation to carry out a diligent examination of complaints which it receives in the area’ ⁽²⁾. Given that complaints are a major source of information to monitor the implementation of EU law in the Member States, the Commission has obviously an interest in handling complaints seriously. Otherwise aggrieved parties would be dissuaded to lodge complaints to the Commission, and the latter would be deprived of this source of information ⁽³⁾.

The judgment therefore strikes a good balance between the rights of complainants to be informed and the necessary margin of discretion of the Commission to seek solutions with Member States instead of adopting formal decisions or to file complaints which it does not consider sufficiently substantiated, margin of discretion which is also necessary to prioritize the allocation of its resources.

⁽¹⁾ For example, in 2004, while only one formal decision finding an infringement was taken by the Commission, 12 complaints were closed because considered unfounded or such as not to justify the opening of formal proceedings against the Member State in question.

⁽²⁾ Paragraph 53.

⁽³⁾ In the application of the anti-trust rules the Commission also attaches great importance to ‘useful market information’ as defined in Commission Regulation 773/2004 — see Commission Notice on the handling of complaints by the Commission under Article 81 and 82 of the EC Treaty, published in the Official Journal C 101, 27.4.2002, pages 65-77 and the Commission’s webpage: <http://europa.eu.int/dgcomp/info-on-anti-competitive-practices>.

MasterCard and VISA modify network rules and increase transparency of cross-border interchange fees

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I. Introduction

MasterCard and VISA recently repealed some of their network rules and published their cross-border interchange fees on the internet. This article sets out the most important changes and briefly reflects on their importance for competition.

II. Background

The network rules and pricing mechanisms of VISA and MasterCard's payment card systems have been subject to several Commission investigations. The European Commission granted an exemption for VISA's multilateral intra-European cross border interchange fees ('MIF') for consumer cards until 2007 ⁽¹⁾ and cleared some network rules ⁽²⁾, but recently opened proceedings on VISA's rule excluding membership for any applicant deemed by the Board to be a competitor of VISA. ⁽³⁾ The Commission also opened proceedings with regard to MasterCard's cross-border interchange fees for consumer and commercial cards. ⁽⁴⁾ Both investigations are pending. Moreover, a number of national competition authorities and financial regulators across the European Union are investigating the pricing of domestic and international payment systems due to the increasing economic importance of cards for over the counter payments.

Interchange fees paid by the merchant ('acquiring') bank to the cardholder ('issuing') bank largely determine the prices paid by merchants for accepting VISA and MasterCard branded payment cards. To the extent that these fees are multilaterally fixed by a group of banks, the setting of these fees and consequently the distribution of costs and revenues within the system is no longer subject to the immediate competitive pressure of market forces. In order to reduce the ensuing distortive effects of interchange fees on competition in the market

for merchant acceptance services, VISA capped the level of its intra-European cross-border interchange fees at the cost of services which its cardholder banks provide to the benefit of merchants. In addition, VISA undertook to reduce the overall level of intra-European cross-border interchange fees, by capping the fee for debit card payments at €0.28 until 2007 and by reducing the ad valorem fee for credit and charge card payments to 0.7% by 2007. ⁽⁵⁾ Moreover, VISA allowed its banks to disclose the level of the interchange fee and the cost components used for calculating the cap. ⁽⁶⁾

III. More transparency of cross-border interchange fees

However, it appears that even though VISA's member banks were no longer prohibited from disclosing the interchange fee, merchants had difficulties in obtaining this information from their acquiring bank. After the Commission addressed the issue of transparency with VISA and MasterCard, both networks respectively agreed to publish their intra-European cross-border interchange fees on the web. As can be derived from the websites of both networks ⁽⁷⁾, the interchange fee rates for consumer credit and charge cards are currently set at 0,80% – 1,30% (MasterCard) and 0,70% – 1,05% (VISA). The rates for debit cards are 0,50% – 1,15% (Maestro) and € 0,27 – 0,30 (VISA electron). VISA and MasterCard also disclosed to which extent their respective Boards take different categories of cost into account for setting their respective interchange fees. ⁽⁸⁾

Merchants have welcomed the networks' move to publish the cross-border interchange fees on the internet as a step in the right direction. However, it would appear that most payment card transactions in Europe are domestic and therefore subject to a separate set of domestic interchange fees. In

⁽¹⁾ Commission decision of 24.7.2002, OJ L 318, 22.11.2002, p. 17-36; see also *Stephen Ryan*, Clarifying the application of competition rules to card payment systems, Competition Policy Newsletter, No. 3/2002, p. 33.

⁽²⁾ Commission decision of 9.8.2001, OJ L 293, 10.11.2001, p. 24-41.

⁽³⁾ Statement of Objections of 30.7.2004, Commission Press Release IP/04/1016 of 3.8.2004 (<http://europa.eu.int/rapid>).

⁽⁴⁾ Statement of Objections of 24.9.2003 in cases Comp 34.324, 34.579, 35.578, 36.518, 38.580.

⁽⁵⁾ Both caps are calculated on the basis of the yearly weighted average of the different interchange fee levels applicable to the relevant transactions.

⁽⁶⁾ Commission decision of 24.7.2002, OJ L 318, 22.11.2002, p. 21 at pt. 25.

⁽⁷⁾ MasterCard: http://www.mastercardintl.com/corporate/mif_information.html; VISA: <http://www.visaeurope.com/acceptingvisa/interchange.html>.

⁽⁸⁾ 50% p. guarantee (MC + VISA), 25% (MC) / 26% (VISA) free funding, 25% (MC) / 24% (VISA) processing.

contrast to the cross-border interchange fees, these domestic fees still remain undisclosed in both networks.

IV. Abolition of network rules and new license

Both MasterCard and VISA also repealed the so-called ‘No Acquiring Without Issuing’ (‘NAWI’) Rule, which obliged their acquiring banks to issue a substantial number of payment cards before starting to acquire merchants for card acceptance. Merchant acquirers are therefore no longer obliged to issue cards in the Visa or MasterCard systems.

MasterCard also abolished the ‘No Discrimination’ Rule ⁽¹⁾ (‘NDR’) in the European Economic Area as of 1.1.2005. ⁽²⁾ This Rule prohibited merchants from charging a fee on top of the final retail price if MasterCard/Maestro is used for payment. Merchants, however, appear to have refrained from surcharging even in countries where the Rule was not enacted. Based on investigations in Sweden and the Netherlands ⁽³⁾, the Commission cleared a similar rule in VISA’s network in 2001 as not appreciably restricting competition between acquiring banks. ⁽⁴⁾

Finally, following a request of the Commission, MasterCard also introduced a new cross border acquiring license for its debit card ‘Maestro’. Maestro debit cards are gaining increasing significance across the European Union. Maestro recently replaced Switch and Solo as domestic debit cards in the UK and has become the dominant debit card in several other EU Member States. It is hoped that this new cross-border acquiring license will invigorate competition between MasterCard acquirers to the benefit of retailers and their customers in these countries.

V. Conclusions

It remains to be seen to what extent the increased transparency of cross-border interchange fees — although not of domestic interchange fees — and the modification of VISA’s and MasterCard’s network rules contributes to increasing competition. Several issues remain to be addressed. Investigations into MasterCard’s interchange fees are ongoing. The intransparency of domestic interchange fees and the question as to whether these fees are acceptable under European and national competition law are issues to be addressed within the European Competition Network.

⁽¹⁾ Also referred to as ‘No Surcharge Rule’.

⁽²⁾ VISA so far did not follow this move.

⁽³⁾ <http://europa.eu.int/comm/competition/antitrust/cases/29373/studies/>.

⁽⁴⁾ See FN 2.

Merger control: Main developments 1 January to 30 April 2005

Mary LOUGHRAN and John GATTI, Directorate-General Competition, Merger Network

Recent cases — Introductory remarks

In the first four months of 2005 the number of notifications received by the Commission increased by over 40% to 101 as opposed to 72 in the previous period.

The Commission adopted a total of 88 final decisions, an increase of nearly 35%, compared to the previous four month period and over 50% in the comparable 2004 period. Of these, 84 transactions were cleared unconditionally pursuant to Art. 6 (1) (b) and 4 transactions were cleared subject to conditions imposed pursuant to Art. 6 (2). Of the 84 unconditional clearances 46 decisions (55%) were taken in accordance with the simplified procedure. No decisions were adopted pursuant to Article 8. However two proposed transactions were withdrawn after the Commission had decided to open in-depth investigations. In addition, four Article 6(1)c decisions initiating second phase investigations were adopted. Finally the Commission took two referral decisions pursuant to Article 9 during the period. The most important decisions adopted during the period are summarised below.

A – Summaries of decisions taken under Article 6

Summaries of decisions taken under Article 6(2) where undertakings have been given by the firms involved

Alcatel / Finmeccanica / Alcatel Alenia Space & Telespazio

The European Commission cleared the creation of two joint ventures resulting from the French electronics company Alcatel merging its space activities with those of Alenia Spazio and Telespazio, part of the Italian Defence and engineering company Finmeccanica. The Commission's review highlighted serious concerns in certain satellite subsystems (Telemetry Tracking & Control or 'TTC' and radar altimeters), but Alcatel and Alenia addressed these concerns by offering a license for both subsystems, in addition to agreeing to price monitoring for TTCs.

Alcatel is a French industrial company that produces telecommunication equipment, satellites and space subsystems and provides space-related

services. Finmeccanica is an Italian state controlled diversified engineering company that produces satellites and subsystems and provides satellite-based services such as space mission management. The two groups will merge their space-related activities into two joint ventures. One, Alcatel Alenia Space will concentrate on the manufacturing of satellite systems and payload for commercial satellites (e.g. telecommunications) and institutional satellites (e.g. scientific missions, military). The other, Telespazio, will provide space-related services such as the control of satellite systems.

Satellite systems and subsystems are either sourced globally by commercial telecommunication operators or sourced at the European level by the European Space Agency (ESA). The Commission verified whether the combination of Alcatel Space and Alenia Spazio as two prime contractors of satellite systems and suppliers of a number of satellite subsystems, could exclude competing satellite prime contractors and integrators from the market or negatively affect satellite users. The Commission's market investigation did not confirm these concerns, as Space and Alenia Spazio face credible competitors for satellite systems and related equipment. Specifically for satellites for institutional buyers, the buyer power and the extensive monitoring of the European Space Agency (ESA) and the application of geographical return rules (work sharing between ESA's member states) would keep the merged entities from acting independently of their customers and competitors.

The Commission's investigation however showed that the combination of the merging parties' activities would result in a virtually uncontested market position for TTCs and radar altimeters, which are essential components of satellites.

In order to address these competitive concerns, Alcatel Space and Alenia Spazio committed themselves to license TTCs and radar altimeter technology and to supply TTC equipment at prices not exceeding those charged for comparable equipment and as documented in price lists that will function as a benchmark. The Commission was satisfied that the proposed commitments would remove the competition concerns and ensure effective competition in the EU markets and therefore cleared the operation.

Apollo / Bakelite

In March, the European Commission cleared the proposed acquisition of the German chemical company, Bakelite AG, by the investment group Apollo, subject to conditions. The Commission found that the proposed transaction could give rise to competition concerns in the markets for phenolic resins for refractory materials and for reactive diluents for epoxy systems. Phenolic and epoxy resins are chemical products used in a variety of end-applications, such as insulation, laminates, friction material, coatings and flooring.

The Apollo Group controls two companies active in the sectors concerned by the transaction, namely Borden and Resolution which manufacture respectively formaldehyde resins and epoxy resin products for sale throughout the world.

Bakelite is a producer of formaldehyde resins, moulding compounds and epoxy resins. Based in Germany, it is mainly active in Europe. Prior to the transaction, Bakelite was controlled by the Rütgers group, which is part of the RAG group.

The activities of Bakelite and Borden overlap in the sector of phenolic resins (a type of formaldehyde resins), and the activities of Bakelite and Resolution overlap with respect to epoxy resins.

The market investigation carried out by the Commission into phenolic resins confirmed that Bakelite and Borden were complementary businesses in terms of both geographic sales and end-applications. The Commission found however that the proposed operation would significantly impede effective competition in the markets of phenolic resins for refractory bricks, shapes, and taphole clay (refractory materials) in the EEA. In order to remove these competition concerns, the parties offered to license a 'Technology package' to their customers, who could then sublicense it to an alternative supplier. The proposed remedy will therefore help alternative suppliers to meet customer demands for these specialised products. The Commission did not consider that the proposed operation would significantly impede effective competition in other end-applications for phenolic resins due to the parties' complementarities and the presence of strong alternative suppliers, such as Dynea and Sumitomo.

In the field of epoxy resins, the Commission's market investigation identified concerns regarding mono-functional aliphatic glycidyl esters (CarduraTM), a specific type of diluents, where the parties have strong market positions. This raw material is an essential component of epoxy formulated systems, which are tailor made epoxy product packages for specific end-uses, such as composites,

surface protection and electrical laminates, where Bakelite is already a major market player. Hence, the new entity could have leveraged its market power in this market to strengthen its overall position over the whole epoxy product value chain and to foreclose Bakelite's downstream competitors. However, the parties offered to enter into long-term supply agreements with any direct customer of CarduraTM using it in epoxy formulated systems to secure supply and pricing conditions.

Honeywell / Novar

The European Commission cleared the proposed acquisition of Novar by Honeywell after Honeywell had proposed to divest Novar's fire alarm business in Italy.

Honeywell, a US corporation, is an advanced technology manufacturing company supplying customers world-wide with aerospace products and services, automotive products, electronic materials, specialty materials, performance polymers, transportation and power systems, home and building controls, and industrial controls.

Novar is an international group based in the UK focusing on Intelligent Building Systems (IBS), Indalex Aluminum Solutions (IAS) and Security Printing Services (SPS). This acquisition will allow Honeywell and Novar to combine their activities in the sectors of fire alarm systems, intrusion and other security systems and in building control systems.

The Commission's investigation showed that the merger would significantly impede effective competition on the market for fire alarm systems in Italy where the merged entity would have held a very strong position, leading to likely price increases for customers.

To remove these serious doubts, Honeywell proposed the divestiture of Novar's entire fire alarm business in Italy (known in Italy under the brand Esser Italia). The Commission considered this undertaking to be sufficient to eliminate its competition concerns and therefore cleared the case.

Orkla / Chips

The Commission's investigation into the proposed acquisition of Chips by Orkla highlighted concerns in certain sectors of the Finnish convenience foods market. In January the Norwegian group Orkla, which is active in branded consumer goods, announced a public tender offer for all shares in Chips Abp, a Finnish snacks and food company operating mainly in the Nordic and Baltic countries.

The investigation identified serious competition concerns resulting from the combination of the merging parties' activities in the Finnish market for the sale of frozen pizzas to the retail sector. In order to eliminate the Commission's regulatory concerns, Orkla offered to terminate the existing distribution agreement for Billy's pizza between Chips and a Swedish company, Gunnar Dafgard, which accounts for all of Chips' sales of frozen pizza in Finland. The Commission considered that this commitment is sufficient to maintain effective competition, as it ensures that the Billy's pizza brand will be managed and distributed independently from the merged businesses. The Commission therefore cleared the operation subject to conditions.

B – Summaries of referral decisions taken under Article 9 of the ECMR

Blackstone (TBG Careco) / NHP

In February, following the request of the UK Office of Fair Trading ('OFT'), the European Commission decided to refer the acquisition of NHP plc by the US Blackstone Group to the UK competition authority for examination. Both parties are active in the UK private care home market for the elderly.

Blackstone is an international merchant-banking firm, which had acquired Southern Cross Healthcare Limited (Southern Cross), a UK company which operates care homes for the elderly. NHP is a UK-listed company which is also active in the care home sector in the UK. The OFT argued that the care home market in the UK is very local and that the proposed transaction would affect competition especially in three UK local authorities areas (Arbroath, Nottingham and Port Talbot), where the parties would have a high combined market share in nursing and residential care homes.

The Commission's investigation indicated that the UK care home market is local in scope. Furthermore, following the results of the investigation, it could exclude the possibility that there are separate product markets for nursing and residential care homes in the UK. The parties would become the biggest service provider in some local areas. Therefore the merger would affect competition in some local markets. The local markets do not represent a substantial part of the common market.

On this basis the Commission decided to refer the case pursuant to Article 9(2) of the Merger regulation as the concentration affects competition in a distinct market within the territory of the UK that does not form a substantial part of the common market.

Iesy Repository /Ish

In February, the European Commission referred, pursuant to Article 9.2 of the Merger Regulation, the examination of the proposed acquisition of the North Rhine-Westphalian network cable operator 'Ish' by the Hessian cable operator 'Iesy' to the German competition authority (the Bundeskartellamt) mainly because both undertakings are exclusively active in Germany.

Both Iesy and Ish operate cable networks, bought from Deutsche Telekom AG, in their respective regions of Hesse (Iesy) and North Rhine-Westphalia (Ish). They deliver radio and television signals to households and other network operators through these networks. They are not active outside Germany.

The Bundeskartellamt requested that the case be referred to it, as the effects of the merger were limited to Germany and the Bundeskartellamt believed that the merger might affect competition in the German market for cable television. As there are distinct markets for cable television within the European Community, the Commission agreed with the Bundeskartellamt's view that the planned merger could affect competition on parts of the German market for cable television. The Commission concluded that the conditions for a referral were met, and that a national investigation was appropriate given the experience the Bundeskartellamt gained in previous cable TV cases.

C – Summaries of cases abandoned during Phase II investigation

Microsoft / Time Warner / ContentGuard

Microsoft and Time Warner had notified the Commission of their intention to acquire joint control of ContentGuard. ContentGuard is one of the main Digital Rights Management (DRM) patent-holders. The Commission launched an in-depth investigation on 25 August 2004, examining, in particular, the possibility for Microsoft to block competitors' access to ContentGuard's patents.

ContentGuard is a US company active in the development and licensing of intellectual property rights (IPR) relating to DRM. ContentGuard holds a key patent portfolio, as an inventor of fundamental DRM technology. DRM technology consists of software solutions that enable digital content of any type (e.g. audio, films, documents) to be transmitted securely over an open network e.g. to end users or exchanged between devices. DRM is set to become pervasive throughout the entire IT indus-

try, and is already the standard for online delivery of media content such as music and video. Microsoft is currently the leading, and possibly dominant, supplier of DRM solutions.

The Commission opened an in-depth investigation on 25 August 2004 and sent a statement of objections on 29 November 2004. One of the main Commission concerns was that the operation could have buttressed Microsoft's monopoly in the market for PC operating systems. Microsoft would have the ability to use DRM as a gatekeeper technology, because Microsoft controls the PC operating systems on which DRM software can be used.

The parties informed the European Commission that Thomson was acquiring a 33% stake in ContentGuard. Although this acquisition by Thomson was announced in November 2004, it only took place on 14 March 2005. As the original operation, whereby Microsoft and Time Warner acquired joint control of ContentGuard, was abandoned, the companies withdrew their notification under the Merger Regulation.

The Commission services carefully reviewed whether the transaction involving Thomson would fall under the Merger Regulation and concluded that the conjunction of Thomson's acquisition of an equity stake, and of changes in ContentGuard's governance structure, no shareholder will have control over ContentGuard. Thus, the new transaction was not subject to EU Merger rules.

The shareholding structure and governing rules of ContentGuard have been significantly modified. Microsoft, Time Warner and Thomson each hold a one third stake and none of them has control over ContentGuard. Consequently, Microsoft will no longer be in a position to shape ContentGuard's licensing policy to the detriment of Microsoft's competitors.

Total/Sasol

Sasol Wax International (Sasol) and Total SA abandoned their proposed joint venture in the field of

petroleum-based waxes following the Commission's decision to open an in-depth investigation under the EU Merger Regulation.

Sasol Wax International AG ('Sasol'), a German company belonging to the South-African Sasol Group, specialises in the production and sale of petroleum-based waxes, in particular in paraffin and micro waxes. Total France S.A. ('Total') is part of the Total group, one of the largest oil and gas companies world-wide. In addition to the production of paraffin and micro waxes, Total produces their raw materials: slack wax and bright stock slack wax.

The proposed operation was the creation of joint venture active that would have been active in the production, marketing and sale of petroleum-based wax products and bitumen additives combining Sasol's and Total's activities in these areas.

Slack wax and bright stock slack wax are produced in refineries as by-products of the oil refining process. They can be used captively, sold directly or further refined into paraffin waxes or micro waxes, to be used in a variety of end applications such as candle, rubber, packaging, cable, chewing gum or adhesives.

The first-phase investigation carried out by the Commission raised serious doubts as to the compatibility of the transaction with the common market and the EEA agreement. In particular, the investigation showed that the combination of Total's and Sasol's commercial activities, the supply of raw material from Total to the joint venture and the increase of the capacity constraints resulting from the transaction would significantly strengthen Sasol's leading position in the markets for paraffin and micro waxes.

In the light of the competitive concerns identified and the unsatisfactory nature of the remedies proposed by Total and Sasol, the Commission decided on 12 April 2005 to open a second-phase in depth investigation. However, on 20 April 2005, Sasol and Total communicated to the Commission the termination of the joint venture agreement and the withdrawal of the notification.

Honeywell / Novar : When it comes to fire, vertical has a taste of horizontal

François-Xavier ROUXEL, Directorate-General Competition, Merger Network ⁽¹⁾

On 7 January 2005, Honeywell International Inc. ('Honeywell') notified the contemplated acquisition of the British company Novar plc ('Novar').

In the markets for fire alarm systems, the Commission investigated whether this transaction would raise vertical and horizontal issues, respectively, in the Nordic countries and in some countries such as Italy. Whereas it came to the conclusion that vertical issues should be dismissed, the Commission considered, however, that the transaction, as notified, raised serious doubts as it may have significantly impeded effective competition in Italy, as a result of the creation of a dominant position. The Commission finally cleared the operation, subject to the divestiture of Novar's activities in this country.

This article analyses further, through simulations, the potential vertical competition issues that were raised in the Nordic countries. It illustrates the fact that the merger of two companies active in vertically related markets can lead to unilateral effects very similar to those caused by purely horizontal mergers, from both a qualitative and quantitative standpoint. ⁽²⁾

I. The markets for fire alarms

The purpose of a fire alarm system is to detect a fire and report it to a central location or bring it to the direct attention of those within the vicinity directly through the emission of a loud signal.

The main components of a fire alarm system are the fire detectors and the fire panel. The former are dispatched to cover the area at stake and aim to detect fires and report them to the fire panel. They come along other peripheral components such as call points or sounders. These components are also connected to the fire panel. The latter receives the signals emitted by the fire detectors or other peripheral components and is programmed to trigger specific action accordingly (triggers sound-

ers, closes doors, calls fire department, etc.). The panel typically accounts for a mere 10%-20% of the overall cost of the fire alarm system. In most of them sold nowadays, the fire detectors and the other peripheral components communicates with the panel using a proprietary protocol. The protocol is defined by each manufacturer of fire detectors.

At least, three vertically-related markets can be identified with respect to fire alarms:

- (i) the supply of components for fire alarm systems to system integrators (supply of fire detectors, call points, sounders, etc.)
- (ii) the supply of fire alarm systems to installers: it consists of adding the fire panel to the peripheral components (in order to make them communicate together and fulfil the expected functions)
- (iii) the installation and servicing of fire alarm systems in the premises of the end-customer.

The latter market did not lead to any significant vertical or horizontal competition issues and will not be further detailed hereunder.

The Commission found that most of these markets are still national in scope. It left the question open as to whether the market for fire detectors could be wider in scope.

II. The situation in Nordic countries

In the Nordic countries (Norway, Finland, Denmark and Sweden), Honeywell is active only on the market for fire components to system integrators. It sells its components — in particular its fire detectors — to ESMI. This company manufactures panels which can communicate with Honeywell's components using Honeywell's protocol. In turn, ESMI markets the complete fire alarm systems.

Novar manufactures fire detectors but do not market them. They are used internally to be sold along with the fire panels manufactured by Novar, as fire alarm systems. The only market on which Novar is actually active is thus the market for fire alarm systems. This market is described in figure 1.

⁽¹⁾ The author thanks the head of unit in charge of this case, Claude Rakovsky, the other members of the Honeywell / Novar case team, Tiina Pitkanen and Guillaume Lorient, as well as Miguel de la Mano and Benoît Durand, members of the Chief Economist Team, for many fruitful discussions.

⁽²⁾ It is emphasised that this article does not summarise the analysis already contained in the Commission's final decision but rather elaborates on the market setting of the case as a basis for a simulation.

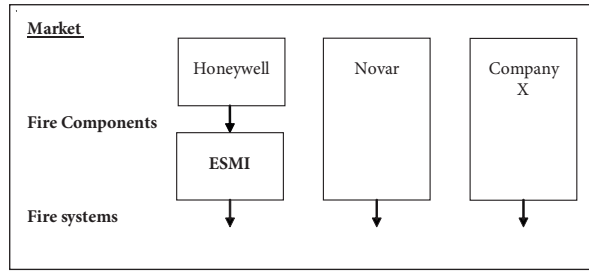


Figure 1: Novar's and Honeywell's positions in Nordic countries

As a result, the merger brings together companies which are not primarily active on the same market, but on vertically-related markets. It is also worth noting that there is no supplier-customer relationship between Honeywell and Novar pre-merger. The question arises as to which economic mechanisms may be at stake in this setting and how to evaluate whether (and to what extent) such merger may be detrimental to competition. To this end, we developed a economic model which is described below.

III. The economic model

a. Model reflecting the settings of the case

The following economic model aims to capture the change of incentives of the merging parties further to the merger, in the environment in which they compete. Indeed, after the merger, it is rational for the merged entity to set the prices of its different products (fire detectors to ESMI, for Honeywell and fire alarm system for Novar downstream) so that it maximises its overall profit (and not only the profit of each firm separately).

To this end, we consider a setting composed of a total of n firms competing on the downstream market (fire alarm system). Each firm i manufactures fire alarm systems at a cost c_i and sells them at a price p_i and in quantities q_i .

Honeywell is firm 1' ⁽¹⁾. It manufactures fire detectors (and other peripheral components) at cost c_1' and sell them to Firm 1 (representing ESMI) at a price p_1' and in quantities q_1' ⁽²⁾. Firm 1' and firm 1 are thus the two companies which are not vertically integrated. Firm 2 is Novar. We aim to simulate the merger of Firm 1' and Firm 2. These settings are described in figure 2.

(1) All parameters relating to the upstream market are referred using a prime.

(2) We consider a fixed ratio between intermediate and final goods, here equal to 1 for the sake of simplicity. This means that the price p_1' is that of the average number of fire detectors in a fire alarm system.

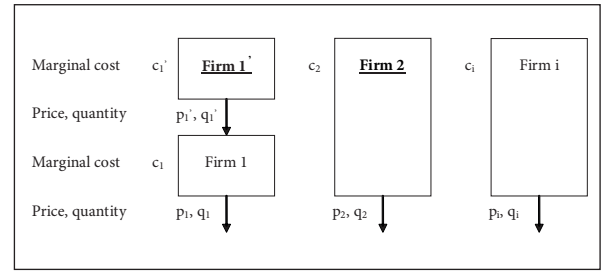


Figure 2: Settings of the model. The merging firms are underlined

The market for fire alarm systems is characterised by competition on prices (Bertrand) and demand can be approximated as a linear function of the prices:

$$\text{For each product } i: q_i = \alpha_i + \sum_{j=1}^n \gamma_{ij} \cdot p_j$$

The profit of the firms is as follows:

$$\text{Firm 1': } \pi_1' = (p_1' - c_1') \cdot q_1'$$

$$\text{Firm 1: } \pi_1 = (p_1 - c_1 - p_1') \cdot q_1$$

$$\text{Any other firm } i: \pi_i = (p_i - c_i) \cdot q_i$$

Pre-merger scenario

Pre-merger, by taking account of the demand function, the optimisation of each firm's profit

($\frac{\delta \pi_i}{\delta p_i} = 0$), leads to a linear system whose solution

is the series of pre-merger prices. This system can be written using matrices with $(n + 1)$ rows and columns, as described in equation 1, and solved by inverting the square matrix. This model thus provides a way to easily compute the prices and quantities at the equilibrium.

Post-merger scenario

Further to the merger, the merged entities incentives have changed since it can set the prices p_1' (of the upstream goods sold to Firm 1) and p_2 (of the final goods sold by Firm 2) so as to optimise its overall profit $\pi_1' + \pi_2$. This implies replacing the separate pre-merger profit optimisation

$$\frac{\delta \pi_1'}{\delta p_1'} = 0 \quad \text{and} \quad \frac{\delta \pi_2}{\delta p_2} = 0 \quad \text{with the optimisation of the}$$

$$\text{combined profit of the merged entity: } \frac{\delta(\pi_1' + \pi_2)}{\delta p_1'} = 0$$

$$\text{and } \frac{\delta(\pi_1' + \pi_2)}{\delta p_2} = 0. \text{ This leads to a linear system,}$$

described in equation 2, whose solution is obtained by inverting the square matrix and provides the prices of the post-merger equilibrium.

As result, one can derive the price increases and the quantity reductions due to the merger, for each firm.

b. Model reflecting a horizontal merger

In order to have a point of comparison to assess the outcome of the above-described model, it is interesting to compare it with a classic horizontal merger, such as the merger of firms 1 and 2, where firm 1 would be already vertically integrated and manufacture the final goods at a cost equal to $c_1' + c_1$.

The same methodology can be used as above to derive the linear systems which provide the equilibrium prices. Pre-merger, profit optimisation

leads to equations of the type: $\frac{\delta \pi_i'}{\delta p_1} = 0$ for each

firm i . Post merger, the profit optimisation equations of the merging firms (firm 1 and firm 2)

must be replaced with: $\frac{\delta(\pi_1 + \pi_2)}{\delta p_1} = 0$ and

$\frac{\delta(\pi_1 + \pi_2)}{\delta p_2} = 0$. The pre-merger and post-merger

solutions are described in equations 3 and 4.

IV. Simulations

The above-described models require that the parameters of the demand function be defined (i.e. the α_i and γ_{ij}) as well as the marginal costs of the firms (c_i). In the simulations below, we considered that all firms had the same marginal cost, equal to 1. This marginal cost is split into two for firms 1' and firm 1: 0.8 and 0.2, respectively. This corresponds to the typical breakdown in the fire alarm systems between peripheral components and the fire panel.

As for the demand, we relied on a set of parameter values for α_i and γ_{ij} ⁽¹⁾ corresponding to elasticities of about -3 and 1, respectively for each player's own-price-elasticity and the cross-price-elasticities. Such elasticities are reasonable for markets such as fire alarm systems. In the framework of an in-depth investigation, real elasticities could be estimated on the basis of market data.

a. Simulation with the case settings

In a setting where 3 firms are competing on the downstream market (i.e. $n=3$), the results of the simulation are the following:

	Firm 1'	Firm 1	Firm 2	Firm 3
<i>Pre-merger</i>				
Price	1.33	1.78	1.55	1.55
<i>Post-merger</i>				
Price	1.49	1.88	1.69	1.59
Δ Price	+ 12%	+ 6%	+ 9%	+ 3%
Δ quant.	- 20%		- 16%	- 7%
Δ profit	+ 4%	- 36%	+ 5%	+ 18%

Model 1: Impact of the vertical merger.

These results confirm that, further to the merger, the merging parties have strong incentives to raise the price of the intermediate good (here by 12%). Indeed, as result, the firm 1' passes through only a part of the price increase (prices of Firm 1' increase only by 6%): the loss of volume is limited for Firm 1 while it sells at a higher price. In addition, part of the sales lost by Firm 1 will be captured by Firm 2, thus increasing further the merged entity's profit. The higher prices offered by firm 1 (because of firm 1') and firm 2 reduce in turn the constraints on the remaining competitor which not only gain customers lost by Firm 1 but can also afford to slightly increase its prices.

As a result, Firm 1 faces a price increase of 12% of its input. The customers of fire alarm systems experience price increases ranging from 3% to 9%. The overall quantities available on the market are reduced by 7%.

Firm 1, which is dependent on one of the merging parties, loses the most by far, its profit plummeting by 36% because of two combined effects: faced a price increase of its input, it is forced to increase its prices in turn. This reduces the quantity of goods it sells. Secondly, the competitive constraints on the market do not allow him to wholly pass on the price increase of its input. For each good sold, its margin is hence also reduced. Interestingly enough, the remaining competitors are those who benefit the most from the merger. These results give a hint about who may or may not complain about the transaction.

b. Comparison with a purely horizontal merger

It is interesting to compare the above-described impacts of the merger with those of a purely horizontal merger, occurring in the same conditions. To this end, we applied the parameters of

⁽¹⁾ All α_i are equal to 1. γ_{ii} are equal to -1 and all other γ_{ij} to 0.33 when n equals 3.

the previous simulation to the horizontal-merger model described in section III.b. The outcome is provided in the table below.

	Firm 1	Firm 2	Firm 3
<i>Pre-merger</i>			
Price	1.49	1.49	1.49
<i>Post-merger</i>			
Price	1.62	1.62	1.54
Δ Price	+ 9%	+ 9%	+ 3%
Δ quant.	– 15%	– 15%	+ 9%
Δ profit	+ 8%	8%	18%

Model 2: Impact of the horizontal merger. ⁽¹⁾

First, this table shows that the pre-merger prices in Model 2 are lower than those predicted by Model 1. This is due to the fact that, in Model 2, Firm 1 is vertically integrated. It illustrates the positive effect of the elimination of the double marginalisation. *A contrario*, it makes it clear that the vertical merger at stake (Model 1) does not cause any elimination of the double margin which could have reduced the negative effects of the merger.

The impacts of the previously-described vertical merger appear to be very similar to those of the horizontal merger: price increases range from 3% to 9% and the quantities overall available on the market are reduced by 7%. The non-merging company benefits the most from the merger, as its profit soars by 18%.

It could be argued that the effects of this merger are very similar to those of a purely-horizontal merger simply because the downstream company, Firm 1, accounts only for 20% in the cost of the final product: its presence is not so significant. However, this explanation is infirmed by the simulations: the price increases in the downstream market remain

unaltered irrespective of the weight of each firm (Firm 1' and Firm 1) in the cost of the final good. The only change is that, the smaller the share of Firm 1' in the cost of the final good, the higher the price increase of the intermediate good sold to Firm 1 further to the merger: firm 1' adjusts its price to Firm 1 so as to mainly optimise the profit derived from the sales of the vertically-integrated party to the merger: Firm 2.

IV. Conclusion

In the case of the acquisition of Novar by Honeywell, it was finally found that the merger was unlikely to raise serious doubts in the Nordic countries. First, Novar's market share turned out to be smaller and those of the main competitors significantly higher, depending on the Nordic country at stake. As a result, the sales lost by ESMI further to a hypothetical price increase by Honeywell would not be captured by the merged entity to a large extent, but by its remaining competitors. Price increases are thus likely to remain limited. More importantly, the Commission came to the conclusion that it is not so difficult for a panel manufacturer to adapt its panels to the protocol of other fire detectors. The threat that ESMI may switch to other suppliers (as they already did in the past) appears credible enough to prevent significant price increases further to the merger.

However, these simulations, along with the analysis of the economic mechanisms at stake, remain interesting examples showing that a merger between companies active in vertically-related markets does not systematically eliminate the double marginalisation and may cause effects on the market similar — both quantitatively and qualitatively — to those of a purely horizontal merger. It can be shown that such negative effects would still materialise — even though to a lesser extent — if Firm 2 (Novar) was not vertically integrated, i.e. was active only downstream.

⁽¹⁾ As for quantities, the model predicts 0.25 for Firms 1' and 1, 0.55 for firms 2 and 3, pre-merger. Post-merger, they become respectively 0.20 for Firms 1' and 1, 0.46 for firm 2 and 0.59 for firm 3.

Equation 1: solution of the pre-merger equilibrium in the settings of the case

$$\begin{pmatrix} \Omega_{1,1}\gamma_{1,1} & \gamma_{1,1} & \gamma_{1,2} & \cdots & \gamma_{1,n} \\ -\gamma_{1,1} & 2\gamma_{1,1} & \gamma_{1,2} & \cdots & \gamma_{1,n} \\ 0 & \gamma_{2,1} & 2\gamma_{2,2} & \ddots & \vdots \\ \vdots & \vdots & \ddots & \ddots & \gamma_{n-1,n} \\ 0 & \gamma_{n,1} & \cdots & \gamma_{n,n-1} & \gamma_{n,n} \end{pmatrix} \cdot \begin{pmatrix} p_1 \\ p_1 \\ p_2 \\ \vdots \\ p_n \end{pmatrix} = \begin{pmatrix} \Omega_{1,1}\gamma_{1,1}c_1' - \alpha_1 \\ \gamma_{1,1}c_1 - \alpha_1 \\ \gamma_{2,2}c_2 - \alpha_2 \\ \vdots \\ \gamma_{n,n}c_n - \alpha_n \end{pmatrix}$$

where the matrices M_{pre} and Ω have n rows and columns and are defined as follows:

$$M_{pre} = \begin{pmatrix} 2\gamma_{1,1} & \gamma_{1,2} & \cdots & \gamma_{1,n} \\ \gamma_{2,1} & 2\gamma_{2,2} & \ddots & \vdots \\ \vdots & \ddots & \ddots & \gamma_{n-1,n} \\ \gamma_{n,1} & \cdots & \gamma_{n,n-1} & 2\gamma_{n,n} \end{pmatrix} \text{ and } \Omega \text{ is the product of the matrices } (\gamma_{i,j}) \text{ and } M_{pre}$$

This implies in particular that $\Omega_{1,1} = \sum_{j=1}^n \gamma_{1,j} \cdot (M_{pre}^{-1})_{j,1}$

Equation 2: solution of the post-merger equilibrium in the settings of the case

$$\begin{pmatrix} \phi_1 & \gamma_{1,1} + \Omega_b\gamma_{2,1} & \gamma_{1,2} + \Omega_b\gamma_{2,2} + \phi_2 & \cdots & \gamma_{1,n} + \Omega_b\gamma_{2,n} \\ -\gamma_{1,1} & 2\gamma_{1,1} & \gamma_{1,2} & \cdots & \gamma_{1,n} \\ \gamma_{1,2} & \gamma_{2,1} & 2\gamma_{2,2} & \ddots & \vdots \\ \vdots & \vdots & \ddots & \ddots & \gamma_{n-1,n} \\ 0 & \gamma_{n,1} & \cdots & \gamma_{n,n-1} & \gamma_{n,n} \end{pmatrix} \cdot \begin{pmatrix} p_1 \\ p_1 \\ p_2 \\ \vdots \\ p_n \end{pmatrix} = \begin{pmatrix} \phi_1c_1' + \phi_2c_2 - \alpha_1 - \Omega_b\alpha_2 \\ \gamma_{1,1}c_1 - \alpha_1 \\ \gamma_{2,2}c_2 - \alpha_2 + \gamma_{1,2}c_1' \\ \gamma_{i,i}c_i - \alpha_i \\ \gamma_{n,n}c_n - \alpha_n \end{pmatrix}$$

where $\phi_1 = \Omega_{1,1}\gamma_{1,1} - \Omega_{1,2}\gamma_{1,2}$ and $\phi_2 = \Omega_{2,1}\gamma_{1,1} - \Omega_{2,2}\gamma_{1,2}$

$$\Omega_b = (M_{pre}^{-1})_{2,1} \cdot \gamma_{1,1} - (M_{pre}^{-1})_{2,2} \cdot \gamma_{1,2}$$

Equation 3: solution of the pre-merger equilibrium in a purely horizontal merger

$$\begin{pmatrix} 2\gamma_{1,1} & \gamma_{1,2} & \cdots & \gamma_{1,n} \\ \gamma_{2,1} & 2\gamma_{2,2} & \ddots & \vdots \\ \vdots & \ddots & \ddots & \gamma_{n-1,n} \\ \gamma_{n,1} & \cdots & \gamma_{n,n-1} & 2\gamma_{n,n} \end{pmatrix} \cdot \begin{pmatrix} p_1 \\ p_2 \\ \vdots \\ p_n \end{pmatrix} = \begin{pmatrix} \gamma_{1,1}(c_1 + c_1') - \alpha_1 \\ \gamma_{2,2}c_2 - \alpha_2 \\ \vdots \\ \gamma_{n,n}c_n - \alpha_n \end{pmatrix}$$

Equation 4: solution of the post-merger equilibrium in a purely horizontal merger

$$\begin{pmatrix} 2\gamma_{1,1} & \gamma_{1,2} + \gamma_{2,1} & \cdots & \gamma_{1,n} \\ \gamma_{2,1} + \gamma_{1,2} & 2\gamma_{2,2} & \ddots & \vdots \\ \vdots & \ddots & \ddots & \gamma_{n-1,n} \\ \gamma_{n,1} & \cdots & \gamma_{n,n-1} & 2\gamma_{n,n} \end{pmatrix} \cdot \begin{pmatrix} p_1 \\ p_2 \\ \vdots \\ p_n \end{pmatrix} = \begin{pmatrix} \gamma_{1,1}(c_1 + c_1') + \gamma_{2,1}c_2 - \alpha_1 \\ \gamma_{2,2}c_2 + \gamma_{1,2}(c_1 + c_1') - \alpha_2 \\ \gamma_{i,i}c_i - \alpha_i \\ \gamma_{n,n}c_n - \alpha_n \end{pmatrix}$$

No export aid to large firms outside the EU

Giorgio PERINI, Directorate-General Competition, unit G-3

Introduction

On May 19, 2004 the Commission adopted a partially negative decision (not yet published), with recovery, in respect of incompatible aid granted to a large firm, in Italy.

The latter was deemed to take advantage of national funding for trade penetration programmes in non-EU countries (mainly South-East Asia).

The Commission's decision, adopted on the grounds that the assessed grants were to be qualified as aid to export-related activities, hence incompatible, has been challenged before the Court both by the beneficiary and the Member State concerned.

Background

The case was raised by a European competitor complaining that a subsidiary of an Italian firm, established in Great Britain, involved in the same market segment he was active in, was able to make an aggressive pricing policy thanks to public subsidization.

It turned out that indeed the mother undertaking benefited twice, in 1995 and in 2000, of financial facilities for trade penetration programmes in non EU countries, in order to establish subsidiaries abroad, such as representative offices, shops and warehouses.

Aid was allowed in the form of soft loan, for 85% of the admissible expenses. The interest rate rebate could attain 60% of the reference rate. The loan had to be repaid in 5 years, on a straight line basis. A two years grace period was envisaged.

Eligible costs were mainly constituted by costs related to the establishment of permanent structures abroad and to trade promotion activities.

Relevant case-law

It has been stressed by the European Court of Justice, in its judgement of 21 March 1990 on case 142/87 (Tubemeuse ruling; ECr 1990 I-00959), that even if the aid aims at exporting outside the EU, nevertheless intra-community exchanges may be affected. Moreover, having regard to the interdependence between the markets on which Community undertakings operate, it is possible that such aid might distort competition within the Community.

In addition, according to the quoted case law of the ECJ, even if the beneficiary exports almost its whole production outside the E.U., the E.E.A. and the acceding countries, subsidization of export activities can affect trade between MS.

It has been ascertained, in the case at hand, that sales abroad represented, from 1995 until 1999, 52 to 57,5% of the overall annual turnover of the beneficiary, and that two-thirds of them took place inside the EU.

Furthermore, as it concerns outward-oriented competition among Community undertakings, it came out that one of the funded programmes was to be carried out in conjunction with a local firm controlled at 100% by the beneficiary.

Aid to forward FDI (Foreign Direct Investments)

The Commission's practice towards these aids has been that only initial productive investments, carried out by SMEs, can be subsidized under EU State aid rules, even if the investment concerned takes place outside the EU.

In its decision of 5 June 1996 on case C50/95 ⁽¹⁾, it approved a scheme subject to aid being granted only for FDI by SMEs, provided all the requirements set down for State aid to SMEs are met, and to aid for large enterprises being notified individually.

Furthermore, the only notification of an individual aid to a large undertaking on the basis of the above mentioned decision resulted in a negative decision ⁽²⁾.

The Commission, in the case at hand, held the view that aid granted towards the above mentioned expenses (see 'background') was to be qualified as aid to export-related activities, thus not falling under the category of outward foreign direct (productive) investments.

In addition, by admission of the Italian authorities themselves, the beneficiary was, at least at the time the second aid was granted, a large undertaking,

⁽¹⁾ Commission decision 97/241/CE of 5.6.1996, published in OJ L 96, 11.4.1997, p. 23.

⁽²⁾ Commission decision of 14.10.1998 on the case LiftgmbH, published in OJ L 142, 5.6.1999, p. 32.

furthermore located in a non assisted area, having subsidiaries all around the world, among others established in almost all EU Member States.

Assessment

As concerns the qualification of the subsidies under examination as State aid, irrespective of the fact whether the aid in question supported exports to other Member States of the EU or outside the EU, they have been considered potentially able to affect trade between Member States, therefore subject to Article 87(1) of the Treaty.

As far as the assessment of their compatibility is concerned, and to the extent that presumed unlawful aid is at stake, the Commission based its assessment upon the rules in force at the moment the aid was granted, according to the Commission notice on the determination of the applicable rules for the assessment of unlawful State aid ⁽¹⁾.

In addition, in the light of the first sub-paragraph of the above mentioned notice, where, at the time of a decision, guidelines have been replaced by a regulation, the Commission considers that the rules set out in the regulation apply to the extent that they are more favourable than those of the guidelines.

This resulted in a double assessment being made, both under the rules in force at the moment the aid was granted and those applicable at the time the decision was adopted. Its outcome is as follows.

As the wording of the 'de minimis' rule of 1992 ⁽²⁾, in force at the time the first aid was granted, did not explicitly exclude export aid, an amount not exceeding 50.000 ECU (now EUR) was considered not to fall under the provision of Article 87(1) of the Treaty, thus not subject to recovery, to the extent that no other 'de minimis' aid had been allowed to the same beneficiary, during the relevant three-year period. Moreover at that time the beneficiary still fell within the category of medium-sized enterprises.

On the contrary the Commission declared the remaining part of the first aid and the second aid to be incompatible, on the grounds they constituted aid to export-related activities.

Accordingly, a negative decision with recovery of the incompatible aid was adopted.

Complying with multiple rules: EU State aid and WTO subsidy rules

The Commission has assessed the aid in question in the light of Articles 87 to 89 of the EC Treaty.

Nevertheless, when assessing certain types of aid, international agreements binding for the EU are also susceptible to come at stake, and, among them, in particular, the WTO 'Agreement on subsidies and countervailing measures' (ASCM) ⁽³⁾.

Export aid is defined, according to ASCM, as: a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I; b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods ⁽⁴⁾.

These subsidies, according to Article 3 thereof, are prohibited, except as provided in the WTO Agreement on Agriculture.

Conclusion

In its decision the Commission confirmed the applicability of Article 87(1) of the Treaty also to aid granted for activities to be carried out by EU firms outside the EU, the EEA and the acceding countries.

Moreover, the Commission's unfavourable attitude towards aid to export-related activities, in particular in favour of large enterprises, was confirmed on the grounds that any kind of public support to commercial penetration, is indeed able to adversely affect trading conditions to an extent contrary to the common interest.

⁽¹⁾ Published in OJ C 119, 22.5.2002, p. 22.

⁽²⁾ See Community guidelines on State aid to SMEs, published in OJ C 213, 19.8.1992, p. 2.

⁽³⁾ Uruguay Round of Multilateral Trade negotiations (1986-1994) — Annex I — Annex IA — 'Agreement on subsidies and countervailing measures' (WTO-GATT 1994), published in OJ L 336, 23.12.1994, p. 156-183.

⁽⁴⁾ In this context it should be noted that a rather wide notion of 'de facto' export contingency has been developed. A first guidance, even if not exhaustive, of what is considered to fall under that notion is provided by the definition laid down at Article 1 (b) and (c) of the 'de minimis' regulation 69/2001 (published in OJ L 10, 13.1.2001, p. 30).

Commission's proposal to phase out tax benefits for exempt companies in Gibraltar: Strict limits on existing as well as new beneficiaries

Radoš HORÁČEK, Directorate-General Competition, unit G-3

Description of the exempt companies scheme

Companies registered with the Gibraltar authorities under the 1967 Gibraltar exempt companies legislation are only subject to a fixed annual tax ranging between £225 and £300 (approximately €350 – €500). They are exempt from any further taxation in Gibraltar. Exempt companies may not conduct any trade or business within Gibraltar and no Gibraltarian or Gibraltar resident may have a beneficial interest in their shares.

The Exempt Companies scheme was classified as State aid as it fulfils the four relevant criteria set by article 87(1) of the EC Treaty. The exemption from tax grants them an advantage compared to companies subject to the generally applicable profit tax rate. This advantage is clearly selective, financed from State resources and is liable to distort trade and competition. The regime satisfies none of the criteria set out in Articles 87(2) and 87(3) of the EC Treaty under which State aid may be considered to be compatible with the common market.

The 'Gibraltar Exempt Companies Scheme' constitutes aid that existed before the United Kingdom's accession to the European Communities in 1973. Therefore the Commission must follow the procedure provided for in Article 88(1) of the EC Treaty which includes proposing appropriate measures to phase it out. After the United Kingdom rejected the Commission's first proposal for appropriate measures in November 2002, and the Commission adopted a final negative decision in March 2004 on the corporate tax reform in Gibraltar, which was supposed to replace the exempt companies scheme, the United Kingdom approached the Commission suggesting new terms of phasing out.

Following intensive negotiations, the Commission proposed a second set of measures in January 2005 that was unconditionally accepted by the United Kingdom on 18 February 2005. Consequently the last offshore regime in Gibraltar will be gradually phased out by the end of 2010.

Procedural aspects

Initially the Commission considered the exempt companies legislation as illegal aid and opened a formal investigation procedure following Article 6

of the Procedural Regulation ⁽¹⁾. However, Gibraltar challenged that decision before the Court of First instance. In its judgement in joint Cases T-195/01 and T-207/01 ⁽²⁾ the Court ruled that the subsequent modifications introduced after the United Kingdom's accession were, contrary to the Commission opinion, clearly separable from the original 1967 Gibraltar exempt companies legislation, which is thus to be treated as existing aid.

In November 2002 the Commission adopted a proposal for appropriate measures in which it suggested closing the scheme to new applicants within one month of acceptance and putting an end to the scheme before the end of 2005. The United Kingdom conditioned its acceptance of this proposal on, amongst other things, a positive Commission decision on the Gibraltar corporation tax reform ⁽³⁾. Since the acceptance was not unconditional, it amounted to a refusal. After the Commission adopted a final negative decision on the Gibraltar corporation tax reform in March 2004, the United Kingdom made new proposals concerning transitional arrangements for abolishing the scheme.

Procedural rules concerning existing aid measures require the Commission to propose appropriate measures to the Member State concerned, inviting it to amend or to abolish the scheme. When the Member State does not accept the proposal, the Commission may open the formal investigation procedure following Article 19(2) of the Procedural Regulation ⁽⁴⁾. The Commission can only order the amendment or abolition of the measure after such a formal investigation.

The Commission faced a choice of opening a formal investigation procedure or proposing new appropriate measures that would be accepted by the UK and enforceable from the day of their acceptance. The main disadvantage of the first approach would be that for more than a year, which is the usual duration of the formal investigation procedure, an unlimited number of new companies

⁽¹⁾ Council regulation (EC) No 695/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27.3.1999, p. 1.

⁽²⁾ ECR II-2309 [2002].

⁽³⁾ CPN 2004/2, p. 97.

⁽⁴⁾ Ibid. footnote 1.

could legally enter the scheme. The Commission therefore chose to negotiate appropriate measures with the United Kingdom that would allow for a restricted number of new entrants but would at the same time immediately significantly limit the distortion of competition.

After intensive negotiations the United Kingdom proposed to the Commission a wording of the appropriate measures that gave satisfactory guarantees limiting the distortion of competition by Gibraltar exempt companies. Once this second proposal of appropriate measures was accepted by the United Kingdom on 18 February 2005, it became binding.

Content and aim of the proposal

The proposal for appropriate measures comprises an overall cap on the total number of all beneficiaries, a strict limitation on new entrants, restrictions imposed on existing beneficiaries as well as monitoring and publicity obligations.

Firstly, the total number of beneficiaries of the exempt companies scheme will be limited to 8,464. This was the actual number of companies at the end of 2003. This condition will prevent any possible quantitative expansion of the scheme.

Secondly, new entrants can only be admitted to the scheme until 30.6.2006. Furthermore, only a fraction of exempt companies leaving the scheme can be replaced by new entrants. In 2005 up to 60% of companies leaving the scheme can be replaced, subject to a maximum of 823 new admissions. In the first half of 2006 only 50% of companies leaving the scheme can be replaced, but not more than the number of new entrants in 2005. The benefits under the exempt companies scheme for these new entrants will cease on 31.12.2007. Given that for an existing scheme the new beneficiaries could not have been stopped from entering, the Commission was mainly concerned with limiting the distortion of competition to a minimum. The number of new entrants is limited to a fraction of the number of companies that leave the scheme. This proportion

is further reduced for 2006. Thereby, it is ensured that the total number of beneficiaries will progressively diminish, especially taking into account the large number of exempt companies that are leaving the scheme every year.

Thirdly, beneficiaries existing before the date of acceptance of the scheme will continue to benefit until 31.12.2010. If they change legal or beneficial ownership or the field of their activities before 30.6.2006, they can benefit only until the end of 2007. However, if their legal or beneficial ownership or their field of activities changes after 30.6.2006, their benefits will cease immediately. The date for the definitive dismantling of the scheme follows Commission practice in other similar cases ⁽¹⁾. On the other hand, this was the first time that a restriction on the change of ownership or activity of existing beneficiaries was imposed. The purpose was to prevent potential new companies from entering the scheme by the way of buying existing companies with exempt certificates. The Commission also aimed to stop the expansion of existing beneficiaries into new fields of activity after their exempt status has been confirmed until 2010. Therefore companies changing ownership or field of activity are to be treated as new entrants.

Finally, the UK was invited to issue a public statement announcing the changes to be made to Gibraltar's legislation and report to the Commission about its compliance with the conditions set out in the proposal during the phasing out period.

Conclusion

This was the first time that the Commission introduced restrictions concerning the change of activity and of ownership of existing beneficiaries in a proposal for appropriate measures. This element prevents existing beneficiaries from extending the distortion of competition. At the same time imposing restrictions on existing beneficiaries contributes to a gradual phasing out of an existing incompatible measure since the beginning of the transition period.

⁽¹⁾ Commission Decision concerning Belgian Coordination Centres, OJ L 282, 30.10.2003, p. 25; Commission Decision concerning Dutch international financing activities, OJ L 180, 18.7.2003, p. 52; Commission proposal for appropriate measures concerning Irish corporation tax, OJ C 395, 18.12.1998 p. 19.

Innovation aid to the shipbuilding industry

Jörg KÖHLI, Directorate-General Competition, unit H-1

1. Introduction

In 2003, the LeaderSHIP ⁽¹⁾ initiative was established to address questions of competitiveness for EU shipyards in the areas of trade, research and innovation, financing, maritime safety, naval shipbuilding, intellectual property rights, skills and industry structure. The initiative shows the way forward for the EU shipbuilding sector, in order to ensure technological leadership, to strengthen customer focus and to facilitate the move to more knowledge-based products, services and production methods.

Taking into account the basic issues of European industrial policy, the European Commission has in its 'Framework on state aid to shipbuilding' ⁽²⁾ set out the conditions, under which it will consider aid to the shipbuilding industry, including aid for innovation, compatible with the common market. The objective of the framework is to encourage greater efficiency and competitiveness of European Community shipyards, in particular through the promotion of innovation.

Certain features make shipbuilding unique and distinguish it from other industries such as short production series, the size, value and complexity of the units produced as well as the fact that prototypes are generally used commercially. Consequently the Commission regards the shipbuilding sector as eligible for innovation aid.

The Framework aims at improving support to innovation, by taking into account notably the difficulties of applying previous provisions on innovation aid in the shipbuilding sector. While aiming at providing effective support, innovation aid must not lead to any distortion of competition in the Common Market. The procedure must be transparent and allow for sufficient monitoring, while limiting the administrative burden to the minimum necessary.

Recently the Commission approved schemes for innovation aid to shipbuilding for Germany, France and Spain. The schemes follow a similar

structure concerning their requirements for the procedures to be respected and the eligibility of the beneficiaries.

2. Common criteria for eligibility and procedures

Innovation aid may, if in accordance with the conditions set out in the Framework for state aid to shipbuilding, be granted to shipbuilding companies, ship repair companies, and ship conversion companies. Eligible applications are innovative products and processes, which are technologically new, or substantially improved products and processes when compared to the state of the art that exists in the shipbuilding industry within the European Community. The implementation of the innovative product or process must carry a risk of technological or industrial failure.

Type of applications

In the schemes, three different types of applications are eligible for innovation aid: Innovation aid may be granted for the development and design of a new class of vessel as defined by the first vessel of a potential series of ships (prototype). The three Member States intend to grant the aid also for innovative components and systems of a ship, which can be isolated from the vessel as a separate element. Finally new processes for the development and implementation of innovative processes regarding the production, planning, logistics or design may benefit from the aid.

Eligible costs

As a general condition, innovation aid for products and processes must be limited to supporting expenditure on investments, design, engineering and testing activities directly and exclusively related to the innovative part of the project and incurred after the date of application for innovation aid.

Eligible costs include costs of the shipyard as well as costs for the procurement of goods and services from third parties (e.g. system suppliers, turnkey suppliers, subcontractor companies), to such an extent that these goods and services are strictly related to the innovation.

For a new class of vessel design costs (e.g. concept development and design; functional design; costs for studies, testing, mock-ups; the planning of the

⁽¹⁾ Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, and the Committee of the Regions, COM(2003) 717 final, 21.11.2003.

⁽²⁾ OJ C 317, 30.12.2003, page 11.

implementation of the design; tests and trials of the product) are eligible. A further important cost item are incremental labour and overhead costs for a new class of vessel (learning curve). These are additional production costs that are strictly necessary to validate the technological innovation; they are eligible to the extent they are limited to the minimum necessary amount.

Additional production costs are defined as the labour costs and associated overhead costs according to normal practice in the shipbuilding industry, for a new class of vessel, compared to the production costs of the subsequent vessels of the same series (sister ships). Usually, due to the technical challenges associated with constructing a prototype, production costs of the first vessel normally exceed production costs of the subsequent sister ships ⁽¹⁾.

For new components or systems of a ship, design and development costs, costs for the testing of the innovation part, mock-ups, material and equipment and in exceptional cases, the costs of construction and installation of a new component or system are eligible to the extent that they are strictly related to the innovation.

Finally, for new processes eligible for innovation aid, design and development costs, costs for material and equipment, if applicable costs for the testing of the new process and costs for feasibility studies undertaken within 12 months prior to the aid application may be supported.

The maximum aid intensity is 20% of the eligible costs. In case the shipyard includes the costs for the procurement of goods and services of suppliers, these items must not include similar aid elements granted to the suppliers.

All projects exceeding EUR 150 per cgt for a ship or EUR 5 million for new processes have to be notified to the European Commission as ad hoc aid for individual assessment.

Common procedures to follow in Germany, France and Spain

An application for aid under this scheme must be submitted by the beneficiaries to the national authorities prior

⁽¹⁾ Accordingly, in exceptional, duly justified cases, a maximum of 10% of the labour and overhead costs associated with the construction of a new class of vessel can be considered as eligible costs, if necessary to validate the technical innovation. Labour costs include wages and social costs. A case is considered to be duly justified if the additional production costs, as defined above, are estimated to exceed 3%.

- to the applicant entering into a binding agreement to implement the specific shipbuilding, ship repair or ship conversion project for which innovation aid is sought.
- to the applicant starting to implement a new process in relation to shipbuilding, ship repair or ship conversion for which innovation aid is sought.

The application for innovation aid must include a description of the innovation, both in qualitative and quantitative terms. The national authorities shall seek confirmation from an independent entity that the aid is sought for a project that represents a technologically new or substantially improved product or process compared to the state of the art that exists in the shipbuilding industry within the European Community, and that it falls into one of the above mentioned eligible categories of products and processes (qualitative appraisal).

The national authorities will seek confirmation from an independent, certified and technically competent entity that the aid is sought for a project that represents a technologically new or substantially improved product or process compared to the state of the art that exists in the shipbuilding industry within the European Community. Such independent entity shall furthermore confirm that the eligible costs have been calculated, exclusively, to cover the innovative parts of the relevant project (quantitative appraisal).

Ex-post monitoring

In order to ensure transparency and effective monitoring, the three Member States will provide the European Commission with summary information on each project including the evidence and risk of the innovation and an overview of the eligible costs. Such information should also include a copy of the initial aid application.

3. Specific aspects in Germany, France and Spain

Germany

The German scheme, having a maximal duration of 6 years, provides a budget of nearly EUR 27 million in total for the period of 2005 to 2008. Subject to certain conditions, the beneficiary may have to reimburse the granted innovation aid. Reimbursement should start as soon as the benefit or objective of the aid has been achieved. Such benefit is considered to be achieved if the applicant uses the innovation a second time.

Since the Framework on state aid to shipbuilding is only applicable until 31 December 2006, the Commission may ask for appropriate measures should the Framework be amended.

Applications for the aid should be sent to the Bundesamt für Wirtschaft und Ausfuhrkontrolle (BAFA), which has been appointed by Germany to carry out the administrative task of the scheme. The applications have to be accompanied by a confirmation of an independent expert that the project is eligible for innovation aid. Before the applicant may issue a formal request for the expert's project verification it has to ask for the BAFA's agreement on both the selection of the expert and the expert's task description.

France

The French scheme, with an annual budget of EUR 25 million, provides innovation aid in the form of grants and will expire at the latest six years after its approval by the Commission. Like the case for Germany, the Commission may ask for appropriate measures should the relevant Community rules be modified after 31 December 2006.

Applicants shall send their request for innovation aid to the Direction Générale de l'Industrie, des Technologies, de l'Information et des Postes of the Ministère de l'Industrie (DIGITIP), which will take into account the conclusions from an independent, certified and technically competent expert.

Such independent expert shall confirm that the project is eligible for the aid according to the cri-

teria as provided by the scheme. The DIGITIP will carry out an open call for tender to establish a list of competent experts, which will include their qualifications. In particular, the call for tender will focus on the main classification societies for ships. For each project France will select the expert on the basis of its specific qualifications and of the expert's availability as well as in agreement with the applicant for innovation aid.

With regard to Alstom Marine, the shipbuilding branch of Alstom (France), no innovation aid will be granted to Alstom on the basis of the scheme before 7 July 2006 (two years after the Commission's decision on the restructuring of Alstom was taken and in application of this decision).

Spain

The scheme will expire on 31 December 2006. Further to innovation aid, it also allows for aid to shipbuilding companies for regional investment, and for research and development (R&D). For all types of aid, the scheme's total budget amounts to approximately EUR 20 million annually for the next two years.

Gernecia Naval, which Spain will charge to carry out the administrative tasks for the projects, will handle applications for the aid.

Spain will not grant such aid to IZAR before the Commission's state aid decisions related to this company have been implemented. Furthermore, no such aid will be granted to the civil activities of the new company Navantia.

The Commission opens investigation procedure regarding aid to Polish car producer FSO (ex DAEWOO)

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On 19 January 2005 the Commission decided to launch a formal investigation into the compatibility with EC Treaty State aid rules of a series of State measures for the restructuring of the Polish car producer Fabryka Samochodow Osobowych S.A. (FSO, ex DAEWOO) (1).

Background context

The case was notified under the so-called interim mechanism pursuant to Annex IV.3 of the Accession Treaty. This mechanism allows the Commission to assess aid measures 'granted before accession' and 'applicable after accession' and either put them on the existing aid list or open the formal investigation procedure in case of objections. The Commission's preliminary assessment in the FSO case focused in a first step on determining under which of the following three categories the proposed aid measures would fall:

(a) Granted before accession (2) but not applicable after accession (3): These measures, which have already been finally and unconditionally granted for a given amount before accession, cannot be examined by the Commission either under the procedures laid down in Article 88 EC Treaty or under the Accession Treaty (Annex VI.3). Given that the interim mechanism only determines whether a given measure constitutes existing aid for the purpose of State aid procedures taking place after accession, it nei-

ther requires nor empowers the Commission to review aid measures which are not applicable after accession.

(b) Granted before accession and applicable after accession: These measures which can still give rise, after accession, to the granting of additional aid or to an increase in the amount of aid already granted, are subject, if they fulfil the relevant conditions, to a lighter assessment under the interim mechanism provided for in Annex IV.3 of the Accession Treaty and can become 'existing aid' if found compatible with the common market.

(c) Not granted before accession and constituting new aid: The relevant criterion for determining whether this is the case is the legally binding act by which the competent national authorities undertake to grant the aid. Measures not granted before accession constitute new aid and the Commission assesses their compatibility with EC Treaty State aid rules.

The facts

FSO is a large Polish producer of passenger cars and other mechanical vehicles, trailers, spare parts and accessories located in Warsaw and employing more than 3000 people. It has been in difficulties since 2000, when its biggest shareholder Daewoo Motor Corporation Ltd. went bankrupt. Its sales dropped heavily, it had significant losses and its market share in Poland fell from around 30% in 1999 to 2.2% in 2004.

The restructuring plan (end 2003 to end 2006) was based on the assumption that a strategic investor for FSO would be found and was approved by the Polish Office for Competition and Consumers Protection on 31 March 2004. According to the latest information, the Polish government started exclusive negotiations with an investor for the sale of FSO, who purchased already a large amount of FSO's debts from its biggest creditors and presented to the government an investment offer including a revised five-year business plan and a restructuring plan. The plan is focussing on the reduction of manufacturing capacity and on product, technical and technological, financial, employment, organisational, purchasing and management restructuring activities. Financial restructuring measures of private and public liabilities include an under-

(1) OJ C 100, 26.4.2005, p. 3.

(2) The Commission considers aid to be put into effect before accession when the date of entry into force prior to accession has been unconditionally set, so that no further action is required for the measure's entry into force.

(3) The following types of aid are considered to be 'applicable after':

- Aid schemes on the basis of which aid awards can still be made after the date of accession without further implementing measures being required.
- Aid that is not linked to a specific project and that is awarded before accession to one or several undertakings for an indefinite period of time and/or an indefinite amount.
- Individual aid measures for which the precise economic exposure of the State is not known on the date the aid is granted nor on the date of accession. In these cases, the maximum amount of aid may be capped, but the real liability of the State may still vary. This category of measures covers for example tax measures and (guarantees covering) credit lines with drawing facilities that extend beyond the date of accession.

standing with FSO's main creditors regarding the restructuring of some of its debts, a settlement agreement with 621 other mainly private creditors and 41 State aid measures such as a guarantee, write-offs, deferrals of payment, division into instalments, loans guaranteed by the State Treasury and assistance in the form of subsidies and additional capitalisation. Overall restructuring costs are estimated at around EUR 1.1 billion. According to the Polish authorities, the total amount of the planned State aid is EUR 172.4 million, which corresponds to 15% of the total restructuring costs.

The assessment

On the basis of the information provided, the Commission has found that certain one-off measures (of about EUR 35 million) — in particular deferrals and arrangements into instalments of FSO's debts deriving from tax and social security payments obligations, a tax waiver on the income of certain banks which had concluded an understanding with FSO, grants to finance the employees severance pay and a capital injection — were granted between 22 January and 30 April 2004 and therefore before accession. These measures are not applicable after accession as the total liability of the State was known at the time when the measure was adopted. The Polish authorities provided copies of the agreements between the relevant public institutions and FSO, of the decisions of the relevant public institutions or of final acts which were legally binding the public authorities to grant a determined amount of aid before accession. These documents included the State aid amounts and all other details concerning the granting of the aid and the final exposure of the public institution. On the basis of this evidence, the Commission decided not to analyse these measures as they neither fall under the interim mechanism nor constitute new aid.

The Commission further found that the remaining measures of about EUR 138 million have not been granted before accession and therefore constitute new State Aid within the meaning of Article 87(1) EC Treaty. The Commission came to this conclusion as the Polish authorities either did not provide evidence as to whether and when the measures were granted claiming that there were only oral agreements or provided only generic or written declarations of the public institutions to the Polish Office for Competition and Consumers Protection, not entailing a legal obligation towards FSO.

The Commission assessed these new aid measures in the light of the 1999 restructuring guidelines ⁽¹⁾,

⁽¹⁾ Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 288, 9.10.1999, p. 2.

applicable at the time of the notification. As the information provided was not sufficient to ascertain whether the acquisition of FSO by the investor was taking place at market value, the Commission did not at this stage exclude that the agreement between the State Treasury and the investor might contain additional aid elements. On the basis of a preliminary assessment of the restructuring plan of FSO, the Commission had doubts that all these measures would be in line with the guidelines and therefore decided to initiate the investigation procedure in respect of the part of the aid measures which seem to constitute new aid ⁽²⁾. The Commission expressed its doubts that the current restructuring plan meets all conditions of the restructuring guidelines and in particular that:

- the investor's plan sets out the necessary means for restoring the long-term viability, in particular as the planned production of cars in 2005 and in 2006 is lower than the level indicated as the break-even point for profitability;
- undue distortion of competition is avoided as the Polish authorities have not provided sufficient information on the market and on possible compensatory measures;
- the aid is strictly limited to the level necessary for the restructuring of FSO because certain aid measures seem to be more an incentive for the investor than restructuring aid limited to the minimum necessary; and
- the one time — last time principle is respected.

To clarify these doubts, interested parties were requested to comment on these doubts. Poland was requested to provide more detailed information on a number of issues, mainly concerning the events following the bankruptcy of Daewoo Motor Corporation Ltd, the agreements for debt restructuring, the updated restructuring plan, market information and FSO's production capacity, return to viability and own contribution.

Conclusions

This is the first time that the Commission has opened the formal investigation procedure on State aid measures notified by a new Member State

⁽²⁾ In order to assess the compatibility of the new restructuring aid measures, the Commission looked at the whole restructuring plan and at all aid measures endorsed by the authorities.

as having been granted before accession, but considered by the Commission as not having been granted yet. Although this case was notified on 30 April 2004 under the interim mechanism, by letter of 6 January 2005 the Polish authorities accepted that the Commission would treat the notification also as a notification under Article 88(3)

EC Treaty with regard to any measures which would be found to constitute new aid. This case is of interest for the Commission's in-depth analysis of the moment at which an aid is granted and might constitute a precedent for pending new Member States' cases and for future cases notified by the actual candidate countries.

Restructuring aid in favour of Chemische Werke Piesteritz GmbH

Sabine CROME, Directorate-General Competition, unit H-1

On 2 March 2005 the European Commission terminated a three year long investigation into aid measures granted to Chemische Werke Piesteritz (CWP), an eastern German producer of phosphoric acid and phosphates. The Commission concluded that an amount of € 6.7 million provided in 1997 and 1998 constituted incompatible State aid and ordered its recovery. In total, the Commission examined aid measures of EUR 19.2 million granted to CWP at the time of privatisation in 1994 and for its restructuring in 1997 and 1998.

The Commission decision is a follow-up of a judgement of the Court of First Instance of 2001 by which the Court annulled the initial Commission decision of 1997 to approve the aid. The Court procedure was launched by a competitor of CWP, Prayon-Rupel. The Court annulled the decision mainly because Prayon-Rupel could prove that the restructuring plan of CWP was not feasible. The Commission had initiated the formal investigation procedure directly after the judgement.

CWP is located in the region of Sachsen-Anhalt in eastern Germany. The company was created in 1994 for the purpose of acquiring, as part of a privatisation, the phosphorus-based products division of the State-owned Stickstoffwerke AG Wittenberg Piesteritz.

In the context of the privatisation in 1994 CWP received aid measures amounting to EUR 4.4 million. These measures were provided on the basis of an aid scheme approved by the Commission, the so-called Treuhandregime. The Treuhandregime lays down conditions for the granting of State aid in the context of the privatisation of the state-owned companies in eastern Germany in the 1990ies following reunification. The Commission concluded that the aid measures of 1994 were granted in line with the approved aid scheme. They thus constituted existing aid which needed not to be reassessed by the Commission.

Although a first restructuring effort had already been undertaken upon privatisation in 1994, this effort failed and in 1996 CWP was faced with severe difficulties caused by insufficient equity, interruption in the supplies of raw materials and lack of liquidity. Therefore a new restructuring plan was set up. The restructuring was to take place

over the period 1997 to 2000 and mainly entailed investments in a new process for the production of phosphoric acid (the 'wet process') and a reorientation of the company's phosphate division to higher-quality phosphates.

To help the company with its restructuring the BvS and the Land Sachsen-Anhalt granted several aid measures amounting to a total of EUR 14.8 million in 1997 and 1998. The aid consisted in the waiver of the purchase price agreed in the privatisation, State guarantees as well as investment grants and investment tax refunds.

The Commission found that EUR 8.1 million of the EUR 14.8 million was covered by aid schemes approved by the Commission. These measures thus constituted existing aid which needed not be reassessed by the Commission. The remainder EUR 6.7 million was not covered by any approved legal basis and thus had to be assessed by the Commission. As CWP was in difficulties at the time of the granting of the aid the Commission evaluated these measures under the Community Guidelines for rescuing and restructuring firms in difficulty.

Aid for restructuring purposes raises particular competition concerns as it can unfairly shift the burden of structural adjustment on to other, more efficient, producers who are managing without aid. Restructuring aid is therefore allowed only in circumstances in which it can be demonstrated that the approval of restructuring aid is in the Community interest, and in particular, that a sound restructuring plan exists which should allow the company to restore its viability and competitiveness after the restructuring period.

On re-evaluating the restructuring plan for CWP, the Commission found that the restructuring plan was not sound. The plan was not carefully planned, steps were missing and costs were understated. It could thus not lead to the restoration of the company's long-term viability.

The decision was further reinforced by the fact that the plan, which originally was to run until 2000, had still not yet been fully implemented. The original restructuring plan had been modified significantly on several occasions since 1997. The technical concept for the construction of the installations for the wet process had to be changed

and expanded. This increased costs and implied a delay in the implementation of the plan which in turn further increased costs. The construction of the installations for the wet process, a core element of the restructuring plan, was interrupted in 2001 and not taken up again since then.

In addition to the condition of a sound restructuring plan the Commission found that a further condition of the Community Guidelines, i.e. the

condition of a substantial private contribution to the restructuring, was not met.

The Commission thus concluded that that the criteria of the Community Guidelines on rescuing and restructuring firms in difficulty were not fulfilled and declared the aid amounting to EUR 6.7 million incompatible with the common market. CWP must now repay the aid including interests.

Italian guarantee scheme for ship-finance: Commission signals thorough review of guarantee schemes

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Introduction

On 6 April 2005 the European Commission, after an in-depth investigation, adopted a decision declaring that an aid scheme designed to cover the risk of loans for the construction and conversion of ships in Italian yards, is incompatible with the Common Market.

The Italian authorities had notified to the Commission, in May 2001, the adoption of a Decree implementing the Shipbuilding Guarantee Fund ('the Fund'), already formally established by law in 1997, but never operational. In April 2003, the Commission opened a formal State aid investigation procedure as it had doubts about the compliance of the aid with the specific State aid rules for the shipbuilding sector.

This decision is noteworthy for two reasons. First, it provides important interpretative keys to the application of the EC State aid rules with regard to guarantee schemes. Second, it underlines the Commission's readiness to conduct a thorough and accurate analysis of the legal and economic aspects of public guarantees.

Background

Shipbuilding is an economic sector that has historically been of interest for State aid review given on the one hand the existence of structural overcapacity, depressed prices and trade distortions in the world shipbuilding market and on the other hand the regional significance with shipyards as major employers in many coastal cities.

In addition, shipbuilding projects are usually capital-intensive, in particular if put in relation to a shipyard's own capital base. In recent years the initiative 'LeaderSHIP 2015' ⁽¹⁾ initiated a programme to ensure its long-term prosperity and identified

the necessity of developing advanced financing tools in order to promote the competitiveness of the European shipbuilding industry. One element of this initiative emphasises that the extreme capital-intensity of shipbuilding projects results in 'growing difficulties for the arrangement of the ship financing' so that guarantees 'are crucial for the financing needs of European shipyards'. To this end, it is reiterated that 'in addressing these issues, some key principles have to apply: All instruments must be self-sustained and transparent. The applicable premiums must reflect the risk that is being run. The operation of the instruments has to be efficient, decisions should be clear and predictable. Any action proposed has to be in strict compliance with EU rules (...)'.

On 26 November 2003, the Commission adopted a Framework on State aid to Shipbuilding ('the Framework') ⁽²⁾ replacing the old Shipbuilding Regulation ⁽³⁾. The guiding principle of the new text is the simplification of the State aid rules applicable to this sector, both as to the form and the substance of these rules. This instrument also marks the completion of the 'normalisation' process initiated by the 1998 Shipbuilding Regulation which provided for the phasing-out of operating aid.

Notably, the Framework on the one hand extended, as far as possible, horizontal State aid rules to this sector; and on the other hand, it recognised certain specificities that distinguish shipbuilding from other industries. Moreover, notification requirements have been eased compared to the 1998 Shipbuilding Regulation.

The Italian ship financing guarantee scheme

The Fund has been established in accordance with Art. 5 of Law no. 261 of 31 July 1997. Following a tender procedure, the financial, administrative and technical management of the Fund was entrusted to Mediocredito Centrale SpA ('Mediocredito'). The Fund was intended to cover the risk of failure

⁽¹⁾ See Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, and the Committee of the Regions, COM(2003) 717 final of 21.11.2003: LeaderSHIP 2015 — Defining the future of the European Shipbuilding and Repair Industry — Competitiveness through Excellence. The initiative goes back to the Council conclusions of 14 May 2001 where the Council called upon 'the EU Shipbuilding industry to continue improving its competitiveness' on http://europa.eu.int/comm/enterprise/maritime/shipbuilding_market/doc/leadership2015_en.pdf.

⁽²⁾ OJ C 317, 30.12.2003, p. 11. For more details on the Framework see B. Gencarelli, 'E la nave va': développements récents de la politique des aides d'Etat à la construction navale, Competition Policy Newsletter, 2004 No 1, p. 74.

⁽³⁾ OJ L 202, 18.07.1998, p. 1.

to recover loans for the construction and conversion of ships, granted by banks to Italian and foreign shipowners, for works carried out in Italian shipyards. With this purpose, the Fund would provide second-priority end-financing guarantees to the above mentioned shipowners.

The financing loan was required to have a duration of no more than twelve years and amount to no more than 80% of the contract price. In addition, the financing should have been guaranteed by a first mortgage on the vessel that was the object of the financing. In order to obtain the guarantee, shipowners needed to be assessed by Mediocredito as being economically and financially sound on the basis of the criteria specified in the Decree.

The guarantee could be granted up to a sum not higher than 40% of the loan and — within this limit — could cover up to 90% of the final loss incurred by the banks for capital, interests, and costs.

The one-off premium to be paid by the beneficiaries of the Fund was set at 2.3% of the guaranteed amount for 12-year loans (decreasing it proportionally for shorter loans). Such a one-off premium would be equivalent to a premium of 0.5% per annum on the outstanding guaranteed amount of a 12-year loan.

In the course of the proceedings, the Italian authorities informed the Commission services that they were considering introducing a mechanism of risk differentiation whereby different projects would be charged different premiums according to the risk involved in financing the project. This system would have taken as departing point the original 0.5% p.a. premium. Three different risk profiles were to be established. For a 12-year loan, the one-off premium to be paid by the beneficiaries would amount to 2.065% for the lowest risk category, to 2.603% for the medium risk category, and to 3.142% for the highest risk category. This would correspond to a premium ranging between 0.4563% p.a. of the guaranteed amount for the least risky projects and 0.6562% p.a. for the most risky ones.

However, this rather rough outline of the system was not elaborated further, and no other concrete details on its possible operability have ever been submitted by the Italian authorities.

The precedents

The Italian guarantee scheme was not the first such measure assessed by the Commission in the shipbuilding sector. Indeed, on 16 December 2003 the Commission approved some guarantee schemes operated in Germany's five coastal Länder, aimed

at providing public fallback guarantees with respect to credits granted for the financing of ships built in German yards ⁽¹⁾.

The German schemes comprised two different types of guarantees: 'construction financing guarantees', which secured the pre-financing of the construction cost of the vessel by the yard, and 'end financing guarantees', aimed at financing the purchase of the completed ship after delivery.

The novelty of the measures proposed by the German authorities consisted in the introduction of a risk differentiation mechanism. While in the past, every guarantee was covered by one single premium, currently different premiums are charged for the different risks to be covered by the guarantee. For this purpose, Germany devised a rating system comprising different risk categories allowing allocation of projects according to their respective risks.

Thanks to the introduction of such a differentiation mechanism, the adequateness of the premiums charged to the beneficiaries and the other characteristics of the schemes, the Commission could conclude that the notified measures did not contain any State aid elements and thus raised no objections to their implementation.

The applicable legislation

The measure notified by the Italian authorities consisted in a guarantee scheme. The Commission outlined its approach on such type of measures in its Notice on the application of Articles 87 and 88 of the EC Treaty to State Aid in the form of Guarantees ('the Notice on Guarantees') ⁽²⁾.

The Notice on Guarantees explains clearly why — under certain conditions — a State guarantee can constitute State aid: *'the State guarantee enables the borrower to obtain better financial terms for a loan than those normally available on the financial markets. Typically, with the benefit of the State guarantee, the borrower can obtain lower rates and/or offer less security. In some cases, the borrower would not, without a State guarantee, find a financial institution prepared to lend on any terms (...) The benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. This carrying of a risk by the State should normally be remunerated by an appropriate premium. Where the State forgoes such a premium, there is both a benefit for the undertaking and a drain on the resources of the*

⁽¹⁾ More information on this Decision can be found in the following article: K. Struckmann, M. Lienemeyer, *The new German ship-financing guarantee schemes: Commission gives green light*, Competition Policy Newsletter, 2004, No. 2, p. 105.

⁽²⁾ OJ C 71, 11.3.2000, p. 14.

State. Thus, even if no payments are ever made by the State under a guarantee, there may nevertheless be a State aid under Article 87(1)'.

The Commission decision

The main issue in the present case was whether the premiums charged for the guarantees reflected the market price. In light of the general principles of State aid review, and on the basis of the provisions outlined above, it is evident that the underlying principle behind the Notice on Guarantees is that the benchmark to assess whether a guarantee is free of State aid, is the market. Indeed, if the State is obtaining remuneration for the guarantee that is equivalent to the one that a market economy operator would charge to equivalent companies, this would mean that the latter are not granted any advantage, and that the State would be acting like any private investor or creditor operating on the financial market. If, on the contrary, the price paid by the companies and the conditions applied to the guarantees are more favourable than those available in the market, then there exists a clear economic advantage for the beneficiaries, and therefore (other conditions being met) State aid within the meaning of the Treaty.

The Notice on Guarantees, in point 4.3, lays down six conditions that help the Commission to assess whether a State guarantee scheme constitutes State aid. ⁽¹⁾ Thus, the Commission had firstly to consider whether the notified scheme fulfilled these conditions, given that this would have allowed it to immediately rule out that any aid element was involved in such scheme.

⁽¹⁾ According to point 4.3 of the Notice, a State provided guarantee scheme fulfilling all the following conditions does not constitute State aid under Article 87(1):

- (a) the scheme does not allow guarantees to be granted to borrowers who are in financial difficulty;
- (b) the borrowers would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;
- (c) the guarantees are linked to a specific financial transaction, are for a fixed amount, do not cover more than 80% of each outstanding loan or other financial obligation (except for bonds and similar instruments) and are not open-ended;
- (d) the terms of the scheme are based on a realistic assessment of the risk so that the premiums paid by the beneficiary enterprises make it, in all probability, self financing;
- (e) the scheme provides for the terms on which future guarantees are granted and the overall financing of the scheme to be reviewed at least once a year;
- (f) the premiums cover both the normal risks associated with granting the guarantee and the administrative costs of the scheme, including, where the State provides the initial capital for the start-up of the scheme, a normal return on that capital.

After a careful review of the elements submitted by the Italian authorities, the Commission could not positively establish that the some of the conditions required by the Notice were met. Italy was in fact unable to demonstrate that the planned premium could ensure the self-financing of the scheme and cover all administrative costs. As a consequence, the scheme could neither be considered in compliance with the market investor test nor to be in all probability self-financing and capable of covering all the costs.

In fact, the inadequacy of the proposed premium was evidenced by the documents submitted by the Italian authorities themselves. In 2003 they conducted a market survey with the aim of investigating how much credit institutions would charge their clients for similar guarantees. Several letters received from Italian banks and submitted to the Commission, evidenced that indeed all banks questioned would charge premiums higher than 0.5% p.a. or within a range of premiums higher than the range proposed by Italy.

This conclusion was also confirmed by other sources of information obtained in the past years by the Commission. For instance, the above-mentioned German schemes for ship finance which, unlike the Italian scheme, have been running for several years, showed that higher premiums were needed to ensure that the risk of defaults is in all probability covered. In fact, the German schemes carry premiums which vary between 0.8% and 1.5% p.a., according to the creditworthiness of the beneficiary (the average being around 1 %).

In addition, the Commission considered that the Fund was not based on a realistic assessment of the risks and also this element appears to exclude that the scheme could be held to be self-financing.

Indeed, the information available to the Commission indicates that ship financing is a sector in which it is possible to assess and price individual risks, and it appears that a functioning market for the granting of end-financing guarantees for ship-building does exist. Therefore, a ship financing guarantee scheme charging the same premium to all users, if it functions under the same conditions and restrictions as market operators, cannot be in all probability self-financing. This is so because it would always be possible, for the beneficiaries with lower than average risk, to find another guarantor willing to cover their risk at cheaper premiums than the average premium. Unless a system is compulsory, this would leave the guarantee scheme offered by public authorities with the higher than average risks, which would not be able to finance the system adequately. In light also of these considerations, in absence of a clear risk

differentiation mechanism, the notified guarantee system could not be held to be 'in all probability self-financing'.

Finally, the Italian authorities had not provided the Commission with reliable and detailed estimates on all the administrative costs related to the planning, the setting-up and the running of the scheme. On this basis, the Commission could not establish whether all costs associated with the guarantee could be covered by the premiums to be collected.

The Commission was thus required to examine whether the notified aid could be considered compatible under Article 87(2) and (3) EC.

At the time of the notification, aid to the shipbuilding sector was regulated by Council Regulation (EC) No 1540/98 of 29 June 1998, establishing new rules on aid to shipbuilding (the "Shipbuilding Regulation"). According to the Shipbuilding Regulation aid to this sector would be permissible only under the conditions and for the objectives specified in such legal instrument. Also, operating aid in the shipbuilding sector was not permissible for shipbuilding contracts concluded after 31.12.2000. However, as mentioned above, on 1 January 2004 the new Shipbuilding Framework entered into force, confirming the prohibition of any operating aid within this sector.

According to the case-law and unless otherwise specified by transitory rules, notified State aids must be assessed according to the rules in force at the time the decision on their compatibility is adopted ⁽¹⁾. In the case at stake, the aid was therefore to be assessed according to the shipbuilding Framework.

The decision to open proceedings was adopted when the Shipbuilding Regulation was in force and was therefore based on the Shipbuilding Regulation. Nevertheless, the jurisprudence of the Community Courts indicates that a reopening of the administrative procedure is not necessary when the relevant provisions of the two consecutive legal texts are not substantially different ⁽²⁾. This requirement was clearly fulfilled in the present case.

Consequently, only aid in compliance with the requirements indicated and for the purposes provided for in the Framework could be considered compatible.

Although the Italian authorities had never argued that the notified measure should be consid-

ered compatible aid, the Commission examined whether the aid measure could be considered in compliance with the requirements indicated and for the purposes provided for in the Framework. The Commission assessment revealed that none of the exceptions from the prohibition of State aid to the shipbuilding sector was applicable in the present case and, consequently, that the measure identified by the Commission as constituting State aid was not compatible with the common market. For these reasons, the Commission prohibited the implementation of the Italian guarantee scheme for ship finance.

Conclusions

The Commission decision instructive in many regards. Firstly, it shows the determination of the Commission to thoroughly assess, under State aid rules, complex guarantee schemes set up by the public authorities. Moreover, it provides important elements to understand the application of the EC State aid rules with regard to this form of security.

Inter alia, the decision indicates that also for guarantee schemes the benchmark to assess whether the measure contains aid is the market. Indeed, the conditions provided for in the Notice on Guarantees are assuring a — in some way tailor made — application of the market economy investor test for guarantee schemes.

In addition, the decision underlines that the amounts of premiums collected must in all likelihood be sufficient to enable the Commission to conclude not only that the risks of default are covered, but also that all costs associated with the set up and the management of the scheme are fully covered.

This can only be obtained by applying a risk differentiation mechanism which ensures that different projects bear different premiums, according to their own risks. Indeed, in recent years risk differentiation has become very prominent in the banking sector. The Basel II accord reflects a set of new rules on banking safety under which the amount of capital European banks should hold to shield them from financial risks will not be fixed as a lump sum, but depends on the risk of their creditors. Therefore, lending banks must assess carefully, on a case-by-case basis, the risk of non repayment of a loan they are planning to grant.

The present assessment is based on this rationale, and the Commission did not hesitate to require such — market — behaviour by Member States when they engage in public financing, which is claimed to be free of aid.

⁽¹⁾ See judgement of the Court of First Instance of 18.11.2004 in case T-176/01, *Ferriere Nord SpA v Commission*, in particular points 134 to 140.

⁽²⁾ See also the above-mentioned case T-136/01, points 74 to 82.

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DIRECTORATE G**State aid I: Cohesion and competitiveness**

1. Regional aid

Deputy Head of Unit

2. Industrial restructuring

Deputy Head of Unit

3. R&D, innovation and risk capital

4. Environment and Energy

Humbert DRABBE*Robert HANKIN**Klaus-Otto JUNGINGER-DITTEL*

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*Karl SOUKUP**Wouter PIEKE**Jorma PIHLATIE*

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1. Post and others services

2. Financial services

3. Telecommunications and Media

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Deputy Head of Unit

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Marc VAN HOOF

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Alain ALEXIS

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Reporting directly to the Commissioner

Hearing officer

Hearing officer

*Serge DURANDE**Karen WILLIAMS*

02 29 57243

02 29 65575

New documentation

European Commission Directorate-General Competition

This section contains details of recent speeches or articles on competition policy given by Community officials. Copies of these are available from Competition DG's home page on the World Wide Web at <http://europa.eu.int/comm/competition/speeches/>

Speeches by the Commissioner, 1 January 2005 – 30 April 2005

27 April: Towards a pro-active competition policy in favour of innovation — Neelie KROES — The Hague, The Netherlands (Conference: Promoting Innovation and Competitiveness — a transatlantic dialogue)

7 April: The First Hundred Days — Neelie KROES — Brussels, Belgium (40th Anniversary of the Studienvereinigung Kartellrecht 1965-2005, International Forum on European Competition Law)

10 March: Taking Competition Seriously — Anti-Trust Reform in Europe — Neelie KROES — Brussels, Belgium (International Bar Association/ European Commission Conference: 'Anti-trust reform in Europe: a year in practice')

17 February: Regulating for Competition and Growth — Neelie KROES — Paris, France (OECD Global Forum on Competition)

7 February: Building a Competitive Europe — Competition Policy and the Relaunch of the Lisbon Strategy — Neelie KROES — Milan, Italy (Bocconi University)

3 February: Effective Competition Policy — a Key Tool for Delivering the Lisbon Strategy — Neelie KROES — Brussels, Belgium (Introductory statement at EMAC Open Meeting of Coordinators)

Speeches and articles, Directorate-General Competition staff, 1 January 2005 – 30 April 2005

5 April: Switchover or Catch-up? Applying the modernised EC Competition Regime in the New Media Sectors — Herbert UNGERER — Brussels, Belgium (The Law Society's European Group)

1 April: Competition Rules and the Media: Are they determinant or complementary? — Herbert UNGERER — Istanbul, Turkey (Radio and Television Supreme Council and Association of Television Broadcasters)

11 March: Closing address to the IBA conference — Anti-trust reform in Europe: a year in practice — Philip LOWE — Brussels, Belgium (International Bar Association / European Commission Conference)

23 February: Sport and Competition Law — Torben TOFT — London, United Kingdom (Broadcasting Competition Law)

15 February: Impact of European Competition Policy on Media — Herbert UNGERER — Madrid, Spain (IESE Business School & School of Communication of the University of Navarra)

Community Publications on Competition

New publications and publications coming up shortly

- *EU competition policy and the consumer*
- *Report on competition policy 2004*
- *Competition policy newsletter, 2005, Number 3 — Autumn 2005*

Information about our publications as well as PDF versions of them can be found on the DG Competition web site:

<http://europa.eu.int/comm/competition/publications>

The annual report is available through the Office for Official Publications of the European Communities or its sales offices. Requests for free publications should be addressed to the representations of the European Commission in the Member states and to the delegations of the European Commission in other countries, or to the Europe Direct network.

All publications can be ordered via the EU bookshop on this address: bookshop.eu.int

Press releases

1 January 2005 – 30 April 2005

All texts are available from the Commission's press release database RAPID at: <http://europa.eu.int/rapid/> Enter the reference (e.g. IP/05/14) in the 'reference' input box on the research form to retrieve the text of a press release. Note: Language available vary for different press releases.

Antitrust

IP/05/477 — 25/04/2005 — Antitrust: Commission prolongs and amends block exemption for liner shipping consortia

IP/05/361 — 23/03/2005 — Aviation insurers commit to reforms to promote competition and transparency

IP/05/343 — 21/03/2005 — Commission requests Sweden to end broadcasting services monopoly

IP/05/289 — 14/03/2005 — Competition: Commission consults on future of IATA passenger tariff conferences

IP/05/267 — 08/03/2005 — Competition: car prices converge in enlarged EU

IP/05/195 — 17/02/2005 — Competition: Commission secures improvements to gas supply contracts between OMV and Gazprom

IP/05/62 — 19/01/2005 — Competition: German Football League commitments to liberalise joint selling of Bundesliga media rights made legally binding by Commission decision

IP/05/61 — 19/01/2005 — Antitrust: Commission imposes € 216.91 million in fines on MCAA chemicals cartel

State aid

IP/05/465 — 21/04/2005 — Commission endorses € 1 million of aid for renovation of national heritage site of Hala Ludowa in Wrocław, Poland

IP/05/458 — 20/04/2005 — Commission closes inquiries into French, Italian and Spanish public broadcasters following commitments to amend funding systems

IP/05/457 — 20/04/2005 — State aid: latest Scoreboard reveals shift in aid towards horizontal objectives but no overall decrease in levels

IP/05/455 — 20/04/2005 — Outermost regions: European Commission authorises social aid for air passengers

IP/05/454 — 20/04/2005 — Italy: Commission encourages transfer of goods from road to sea

IP/05/398 — 07/04/2005 — Commission endorses public funding for broadband communications in rural and remote areas of Spain

IP/05/396 — 07/04/2005 — Commission prohibits Italian shipbuilding guarantee scheme

IP/05/395 — 07/04/2005 — Commission to take Italy to court for failure to recover unlawful state aid

IP/05/345 — 21/03/2005 — Commission requests Portugal and Spain to fully implement Directive on financial transparency

IP/05/344 — 21/03/2005 — Commission opens in-depth inquiry into proposed subsidy for Bavarian ethylene pipeline

IP/05/316 — 16/03/2005 — Commission authorises Slovakia to grant € 350.000 aid to mining company Hornonitrianske Bane Prievidza a.s.

IP/05/312 — 16/03/2005 — European Commission authorises German aid programme promoting combined transport

IP/05/310 — 16/03/2005 — European Commission authorises Belgian aid programme promoting combined transport in the Walloon Region

IP/05/304 — 16/03/2005 — Commission outlaws Italian tax breaks for companies listed for the first time on EU stock exchanges

IP/05/303 — 16/03/2005 — Commission endorses € 18.5 million of aid to reduce mercury emissions in Italy

IP/05/302 — 16/03/2005 — Commission endorses innovation aid for French and Spanish shipbuilders

IP/05/301 — 16/03/2005 — Commission endorses € 3.8 million in environmental aid to ACEA Group in Italy, provided previous aid is recovered first

IP/05/250 — 03/03/2005 — Commission requests Germany, Ireland and The Netherlands to clarify role and financing of public service broadcasters

IP/05/245 — 02/03/2005 — Commission orders recovery of € 6.7 million of illegal aid to Chemische Werke Piesteritz

IP/05/244 — 02/03/2005 — Commission approves £ 10 million public funding for Ford training project in UK

IP/05/243 — 02/03/2005 — Commission calls on France to put an end to certain tax exemptions for mutual and provident societies

IP/05/233 — 02/03/2005 — The European Commission has decided to investigate the aid paid to Combust

IP/05/201 — 18/02/2005 — Commission welcomes phasing out of tax benefits for Offshore Exempt Companies in Gibraltar

IP/05/196 — 17/02/2005 — the Commission approves € 33 million of public funding for an R&D project by Philips Semiconductors, Caen

IP/05/189 — 16/02/2005 — Commission refers Germany to Court of Justice for failure to recover illegal aid to Kahla

IP/05/188 — 16/02/2005 — Commission agrees to innovation aid scheme for German ship-builders

IP/05/149 — 08/02/2005 — Fair conditions of competition for regional airports: Commission launches consultation

IP/05/135 — 03/02/2005 — Commission decides Dutch exemption from waste tax for dredging sludge does not constitute state aid

IP/05/126 — 02/02/2005 — Commission takes two decisions concerning Slovenian electricity sector

IP/05/80 — 21/01/2005 — Commission requests phasing out of tax benefits for Exempt Companies in Gibraltar

IP/05/76 — 20/01/2005 — Commission refers Italy to the Court of Justice for failure to recover illegal aid

IP/05/75 — 20/01/2005 — Commission partly approves regional aid for De Tomaso Cutro in Italy

IP/05/67 — 19/01/2005 — European Commission authorises Germany to grant € 2.7 billion to its coal industry

IP/05/64 — 19/01/2005 — Commission opens inquiry into support measures for Polish car maker FSO

IP/05/63 — 19/01/2005 — Commission opens formal investigation into UK property tax on telecommunications

IP/05/58 — 19/01/2005 — Commission authorises German aid for the development of regional airports

IP/05/57 — 19/01/2005 — The European Commission wants confirmation on the recapitalisation of Alitalia

Merger

IP/05/507 — 29/04/2005 — Commission clears creation of two joint ventures between Alcatel Space and Alenia Spazio, subject to conditions

IP/05/498 — 28/04/2005 — Commission approves BBVA takeover of BNL and ABN Amro takeover of Banca Antonveneta

IP/05/487 — 26/04/2005 — Commission approves acquisition by The Dow Chemical Company of parts of Dupont Dow Elastomers

IP/05/486 — 26/04/2005 — Commission approves acquisition of WMC Resources by BHP Billiton

IP/05/485 — 26/04/2005 — Commission approves acquisition of Slovenske Elektrarne by Enel

IP/05/478 — 25/04/2005 — Sasol and Total abort proposed petroleum-based wax joint venture and withdraw notification

IP/05/474 — 25/04/2005 — Commission approves acquisition of Radianz by BT

IP/05/471 — 22/04/2005 — Commission opens in-depth investigation into Johnson & Johnson's take-over of Guidant Corporation

IP/05/464 — 20/04/2005 — Commission approves acquisition of Unipetrol by PKN Orlen

IP/05/426 — 13/04/2005 — Commission approves creation of fish farming joint venture between Nutreco and Stolt-Nielsen

IP/05/425 — 13/04/2005 — Commission opens in-depth investigation into the joint venture between Sasol and Total in petroleum-based waxes

IP/05/415 — 12/04/2005 — Commission approves the acquisition of the German chemical company Bakelite AG by the Apollo group, subject to conditions

IP/05/407 — 11/04/2005 — Commission approves acquisition of Motorpresse by Gruner+Jahr

IP/05/405 — 08/04/2005 — Commission approves acquisition of Marionnaud Parfumeries by AS Watson

IP/05/404 — 08/04/2005 — Commission approves acquisition of Scaldia and Papeteries de France by Stora Enso

IP/05/370 — 31/03/2005 — Commission clears acquisition of Novar by Honeywell subject to conditions

IP/05/369 — 31/03/2005 — Commission approves acquisition of MGM by Sony, Comcast and group of investors

IP/05/364 — 29/03/2005 — Commission approves joint acquisition of Aldeasa by Autogrill and Altadis

IP/05/360 — 23/03/2005 — Commission clears acquisition of part of Pagnan by Cargill

IP/05/357 — 22/03/2005 — Commission approves acquisition of Hungarian Exchanges and Central Clearinghouse and Depository

IP/05/341 — 18/03/2005 — Commission approves UTC/Kidde merger in the fire protection sector

IP/05/329 — 18/03/2005 — Commission approves acquisition of Teboil and Suomen Petrooli by Lukoil

IP/05/300 — 16/03/2005 — Commission approves acquisition of Veritas by Symantec

IP/05/295 — 15/03/2005 — Microsoft and Time Warner abandon acquisition of control in Content-Guard as Thomson purchases a one third stake

IP/05/294 — 15/03/2005 — Commission approves the EuroSystems transaction between BAE Systems and Finmeccanica in the defence sector

IP/05/293 — 14/03/2005 — Commission clears the acquisition of Aggregate Industries by Holcim

IP/05/280 — 11/03/2005 — Commission opens in-depth investigation into Blackstone's takeover of Acetex

IP/05/275 — 10/03/2005 — Commission clears Sephora and El Corte Inglés cosmetic shops joint venture

IP/05/262 — 04/03/2005 — Commission clears acquisition of France Télécom Câble and NC Numéricâble by Cinven

IP/05/254 — 04/03/2005 — Commission approves planned acquisition of Chips by Orkla, subject to conditions

IP/05/253 — 03/03/2005 — Commission clears the acquisition of lens producer Sola by Carl Zeiss and EQT

IP/05/249 — 03/03/2005 — Commission approves acquisition of Shell Gas by Repsol Butano

IP/05/194 — 17/02/2005 — Commission approves acquisition of Smurfit Munksjö by EQT

IP/05/177 — 15/02/2005 — Commission refers merger of two German cable network operators to Bundeskartellamt

IP/05/175 — 14/02/2005 — Commission opens in-depth investigation into Siemens' take-over of VA Tech group

IP/05/128 — 02/02/2005 — Commission refers Blackstone acquisition of NHP in the UK care homes market to the UK competition authority

IP/05/88 — 25/01/2005 — Commission clears BT's acquisition of Infonet

IP/05/86 — 24/01/2005 — Commission approves acquisition of Grey by WPP

IP/05/65 — 19/01/2005 — Commission approves sale by Banco Comercial Português of a stake in its life insurance business to Fortis

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