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The real economy — challenges for competition policy in periods of retrenchment ([1])

Bente Tranholm-Schwarz, Peter Ohrlander, Bruno Zanettin, Mercedes Campo and Georges Siotis

1. Introduction

The financial crisis that initially affected the banking sector has in turn had an impact on the real economy. A squeeze on credit, falls in house prices and tumbling stock markets are all aggravating a slump in consumer confidence, consumption and investment. Economic growth has dropped to about 1% in 2008 in the EU, down from just below 3% in 2007, and according to the latest economic forecasts real GDP is expected to fall in 2009 by at least 2%.

This dire economic situation raises significant challenges for competition policy. First, and most directly, there is a risk that governments may want to go it alone and wage a subsidy race to rescue national companies and jobs. Governments may also be tempted to relax antitrust or merger rules. For instance, they may want to allow a merger with negative effects on competition if it is perceived as necessary to assist a firm in difficulty. They may also want to favour the creation of national champions, despite possible negative impact on consumer welfare, if such firms are perceived as being in a better position to withstand the present economic difficulties.

However, relaxing competition rules, whether in the State aid or merger area, would actually worsen the problem, because it would harm consumers, impede necessary adjustments by keeping inefficient companies in business and ultimately delay the recovery. Historical experience provides ample evidence that suspending competition rules, even temporarily, would have major negative consequences: recent research ([2]) shows that, during the 1930s, some measures, such as allowing firms to collude if they agreed to raise wages, prevented price adjustment, were counterproductive and may have delayed recovery by several years.

When implementing its competition policy, the Commission needs to address the following issue: how to ensure an effective and coherent public response to the crisis while at the same time minimising the risks of distortions of competition. When doing so, the Commission has a significant advantage: unlike most jurisdictions, EU competition policy not only enables the Commission to act firmly against distortions of competition caused by the behaviour of companies. It is also empowered to effectively control the impact of State interventions on competition by ensuring that a State subsidy race does not create disproportionate and unnecessary distortions of competition.

With this well-established range of tools, the Commission is therefore well placed to address the competition-related problems raised by the economic crisis in a comprehensive and effective way. Some adjustments in order to adapt these instruments to the seriousness and specificities of the crisis have been necessary. However, as explained below, these adaptations have respected the essential principles of the EU competition policy. In view of the specificities of State aid and merger control, this article will explain in turn how the Commission uses its instruments to tackle the effects of the crisis on the real economy.

2. EU State aid control — part of the solution

The rules on State aid in the EC Treaty are meant to address the fact that, when considering State aid measures, national governments often do not consider possible negative spill-over effects on competition and trade in the single market. Such State aid may distort competition between European businesses and undermine Europe's single market against the common European interest.

The EC Treaty thus establishes the principle that State aid which distorts or threatens to distort competition is prohibited in so far as it affects trade between Member States. However, State aid which contributes to well-defined objectives of common European interest without unduly distorting competition between undertakings and trade between Member States may be granted. ([3])

When designing general State aid rules and/or assessing State aid cases, the Commission balances the negative effects on trade and competition in the common market with its positive effects in terms of

([1]) This is a shortened version of the European Commission note to the OECD Competition and Financial Markets roundtable on Real Economy — *The Challenge of Competition Policy in Periods of Retrenchment*. The full version of this contribution may be found at http://ec.europa.eu/competition/international/multilateral/2009_feb_roundtable3.pdf

([2]) See for instance Harold L. Cole and Lee E. Ohanian "New Deal Policies and the Persistence of the Great Depression: A General Equilibrium Analysis" *Journal of Political Economy,* 2004, vol. 112, No 4.

([3]) Article 87 of the EC Treaty.

contributing to the achievement of well-defined objectives of common interest. Balancing these effects takes into account the impact of the aid on the social welfare of the EU. For that purpose, the Commission has established a "balancing test" which consists of the following questions:

(1) Is the aid measure aimed at a well-defined objective of common interest (for example, growth, employment, regional cohesion, environment, energy security)?

(2) Is the aid well designed to deliver the objective of common interest, that is to say, does the proposed aid address the market failure or another objective?

   (a) Is State aid an appropriate policy instrument?

   (b) Is there an incentive effect, i.e. does the aid change the behaviour of undertakings?

   (c) Is the aid measure proportionate, i.e. could the same change in behaviour be obtained with less aid?

(3) Are the distortions of competition and effect on trade limited, so that the overall balance is positive?

On this basis, the Commission has elaborated detailed rules explaining under what conditions (e.g. eligible costs, intensity of aid, and nature of the beneficiaries) a Member State can grant aid to its undertakings. These rules cover a wide range of categories of aid: for example aid for research, innovation, environmental protection, regional development, development of SMEs, training, employment, risk capital, rescue and restructuring of firms in difficulty.

2.1 Existing State aid rules: a good basis to tackle recessions

On the one hand, the existing State aid rules provide a good basis for Member States' response to the crisis along the lines of the European recovery plan, in particular as regards the focus on smart investments. For instance, the general block exemption regulation allows Member States to provide investment aid to SMEs. It also authorises support for training, a key element for competitiveness and critically important in times of rising unemployment when new skills need to be developed. In the same vein, support is allowed for R&D projects that would not be undertaken without aid. In addition, the Community guidelines on State aid to promote risk capital facilitate the financing of innovative and fast-growing SMEs and the guidelines on State aid for environmental protection allow investment aid for companies to improve their environmental performance and save energy.

On the other hand, to prevent a harmful State aid race, the EU has strict rules on rescue and restructuring aid for firms in difficulty, limiting the distortion vis-à-vis healthy firms. Thus, aid to rescue or restructure a company can only be granted once for the same enterprise in order to avoid repeated interventions to keep certain enterprises in the market. Furthermore, restructuring aid is conditional upon implementation of a restructuring plan and seeking to restore the long-term viability of the company. The beneficiary of the aid must make a real contribution toward the cost of its restructuring. In addition, to limit the distortions of competition, the Commission imposes compensatory measures in the form of divestitures of assets, reductions in capacity or market presence or reductions of entry barriers.

Thus, the State aid rules in place before the recession already provided a good framework to tackle the impact of the financial crisis on the real economy, by targeting smart investments and restricting the use and negative effects of rescue aid. However, the Commission came to the conclusion that these existing rules were not sufficient to address the increasingly acute impact of financial turmoil on the real economy. That is why it adopted a temporary framework addressing this problem.

2.2 New temporary framework: responding to the exceptional credit squeeze

As a consequence of the crisis in financial markets, banks have become much more risk averse than in previous years, and as a result much less willing to provide financing. This tightening of credit conditions not only affects weak companies, it can also have an impact on healthy companies, which find themselves facing a sudden shortage or even complete lack of private funding, whether loans or risk capital. It is easy to see how this can have disastrous effects on the real economy, on investments and on employment at EU level.

Therefore, in addition to the two communications on State aid to financial institutions in response to the financial crisis, the Commission also adopted a "temporary framework for State aid measures to support access to finance in the current financial and economic crisis" (the "temporary framework") in response to the growing effects of the crisis on the real economy. ([4]) The new rules target the specificities and the expected temporary nature of credit tightening while fully respecting the general principles and philosophy of the balancing test.

([4]) OJ C 83, 7.4.2009, p. 1.

The temporary framework is designed to reduce the negative effects of the financial crisis in the real economy and, to that end, pursues three objectives: *first*, to immediately unblock bank lending and thereby help to provide continuity in companies' access to finance; *second*, to ensure that limited amounts of aid reach the recipients in the most rapid and effective way; *third*, to encourage companies to continue investing in a sustainable future, including the development of green products. Its legal basis is Article 87(3)(b) of the EC Treaty. This is a rarely used provision, which is directly linked to the current financial crisis since it allows the Commission to declare compatible with the common market aid "*to remedy a serious disturbance in the economy of a Member State*".

The temporary framework provides for a number of new measures that can be applied by Member States for a limited period of time, until the end of 2010, as well as a number of limited temporary derogations from existing State aid rules. More specifically, the temporary framework allows Member States to provide the following types of aid:

- a lump sum of up to €500 000 per company for the next two years in aid to cover investments and/or working capital,
- subsidised guarantees for loans at a reduced premium,
- aid in the form of subsidised interest rates,
- subsidised loans for the production of green products (meeting environmental protection standards early or going beyond such standards),
- a risk capital injection for SMEs of up to €2.5 million per year (instead of the current €1.5 million) under certain conditions.

The aid measures that are authorised under the temporary framework are clearly tailored to address difficulties stemming from financial turmoil by lowering the costs of credit (through subsidised interest rates), facilitating access to credit (through subsidised guarantees for loans) or equity (through more general provisions on State aid to risk capital) and relieving smaller firms from financial difficulties (through the €500 000 lump sum).

Furthermore, in line with the balancing test, the Commission has ensured that the allowed aid measures are proportionate to the objectives pursued and designed to minimise the impact on competition. Thus, the temporary framework favours SMEs, since, under a well-established principle of EU competition policy, aid to SMEs is considered to be less distortive of competition at EU level. For instance, SMEs are the only beneficiaries of the temporary framework's provisions concerning risk capital injections. With regard to investment aid and subsidised guarantees, they benefit from higher aid intensity. As to the lump sum of €500 000, it will clearly be of more importance to relatively small firms than to large ones.

In addition, the temporary framework is not applicable to companies that were in difficulties before 1 July 2008. Companies whose difficulties date from before the financial crisis must address their structural problems exclusively on the basis of the general rules regarding rescue and restructuring aid, described above. However, as explained in the introduction, a number of companies may find themselves under stress despite having a sound business plan: the temporary framework can help to relieve their temporary financial difficulties. This set of rules regarding firms in difficulties is precisely devised to ensure that overprotective aid measures devised by Member States would not revitalise structurally failing firms to the detriment of competition and healthier firms.

Finally, as indicated by its title, any effect of the temporary framework will be limited in time since it is only applicable until 31 December 2010.

3. Merger control and the crisis in the real economy

There is a legitimate expectation that the effects of the economic crisis should be taken into account in full when applying competition rules. However, this must not imply that competition and in particular merger rules should be relaxed or set aside during a crisis situation in order to support specific undertakings. Rather, proper application of competition and merger rules will ultimately ensure the protection of consumer welfare. The EU Merger Regulation provides an efficient and flexible tool for this purpose. On the one hand, it provides mechanisms to prevent Member States, in pursuit of goals incompatible with those of ensuring undistorted competition, from unduly interfering with the EU merger control process while at the same time recognising their powers to protect their legitimate interests. On the other hand, it provides an efficient and flexible instrument to scrutinise mergers also in rapidly evolving markets.

3.1 The Commission's powers to maintain undistorted competition

The Commission has exclusive jurisdiction under the Merger Regulation to assess the competition impact of mergers with a Community dimension. In recent years, there have nevertheless been attempts made by several Member States to intervene to prevent or restrict the acquisition of domestic companies by companies from other Member States in cases of mergers with a Community dimension. Some of these interventions have involved the direct use of State powers, others have taken more indirect forms. The temptation on the part of some Member States to promote national champions has been particularly visible in the past few years. [5] It is conceivable that this trend may gather momentum as a result of the recession and the financial crisis.

However, the goal of achieving undistorted competition must not be undermined by efforts to create national champions to the detriment of pro-competitive domestic or cross-border mergers. Experience has demonstrated that engineering the creation or protection of "national champions" is not the way to succeed as firms that do not face competitive pressures may have an incentive to reduce output, stop innovating and cut jobs, all at the expense of taxpayers.

In Article 21 of the Merger Regulation, the Commission has at its disposal an effective tool to address such actions by Member States. This provision gives the Commission exclusive jurisdiction to assess the competition impact of mergers with a Community dimension. It stipulates that the Merger Regulation alone applies to concentrations with a Community dimension and that the Commission has sole jurisdiction to review such concentrations, and as a consequence that no Member State may apply its national legislation on competition to any concentration that has a Community dimension.

Also, the Member States are prevented from circumventing the Commission's exclusive jurisdiction by disguising their pursuit of another supposed public interest. Article 21(4) provides that "Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law". Such legitimate interests include but are not limited to public security, plurality of the media and prudential rules. Any other public interest must be communicated to the Commission by the Member State concerned and is to be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken.

Any industrial policy at Member State level which has the objective or effect of favouring national champions to the detriment of single market principles would not be considered legitimate by the Commission. Until recently, Article 21 had only occasionally been applied. However, in the last three years, the Commission has adopted more decisions under Article 21 than in the previous 15 years since the entry into force of the Merger Regulation. These experiences have demonstrated that Article 21 has proven an efficient tool in fighting protectionism.

3.2 The EC Merger Regulation is a tool that can also take rapidly evolving markets into account

When assessing the competition impact of a merger, the Merger Regulation allows the Commission to take into account rapidly evolving market conditions. In procedural terms, rescue mergers may require rapid reaction by the Commission in order to enable at least partly the immediate implementation of transactions. If appropriate in the particular case, the Commission can exceptionally accommodate this by granting a derogation from the standstill obligation pending the merger review. In substantive terms, the assessment under the Merger Regulation is flexible enough to take into account a rapidly evolving economic environment and, where applicable, the failing firm defence.

The failing firm defence allows the Commission to take into account the financial difficulties of a merging firm and its potential exit from the market when assessing the effects of the merger on competition. So far, no merging parties have relied on the failing firm defence in any of the merger cases notified to the Commission in the course of the current crisis.

To conclude on this issue, this analysis has shown, and experience has confirmed, that the EC Merger Regulation constitutes an appropriate and sufficiently flexible tool for merger control enforcement also in severe market conditions. The overall objective pursued by the Commission in applying this instrument is to ensure that competitive and well-functioning market structures are maintained not only today but also in the medium to long term.

4. Conclusion

The EU's experience in the State aid and merger field demonstrates the importance of a coordinated approach to State aid and merger control in order to avoid a damaging subsidy race or national industrial policies geared to the promotion or protection of national champions. Lessons that are valid for the EU and its Member States are equally true for the world economy. This is why a coordinated international approach to these policies would be an essential element in the global fight against this major recession.

(5) See discussion below.

Competition and the financial markets: The role of competition policy in financial sector rescue and restructuring (1)

Juergen Foecking, Peter Ohrlander and Ernst Ferdinandusse

1. Introduction

The global financial crisis has impacted heavily on the banking system in many EU countries. Recent months have seen a general erosion of confidence within the banking system. The pervasive uncertainty about the credit risk of individual financial institutions has dried up interbank lending and has consequently made access to liquidity progressively more difficult for financial institutions across the board, even those that did not engage in unsound business practices and that are fundamentally sound.

In both areas — State aid and mergers — the EU has applied strict policies to ensure that the benefits of competition are not lost as a result of protectionism, "beggar thy neighbour" policies, or the creation of national champions.

In view of the exceptional circumstances, there have been calls in recent months for the Commission to considerably "relax" or even "suspend" EU disciplines in the area of State aid or merger control, at least as long as the financial crisis lasts. This has never been an option. On the contrary, EU competition policy is not part of the problem, but part of the solution. Abandoning EU competition discipline at this time of crisis would have risked disintegration of the European single market for banking and financial services.

2. State aid measures targeting the financial sector

2.1 General principles

State interventions during the financial crisis are aimed primarily at ensuring financial stability and to some extent at ensuring the availability of adequate levels of lending to the real economy. In this way such interventions contribute to the achievement of objectives of common interest. However, they are also likely to create distortions of competition, which need to be minimised through the instrument of State aid control.

First, distortions can appear between States where banks are given an undue competitive advantage over banks in other Member States. Access to funding or capital or other forms of support at considerably lower rates than in other Member States may have a substantial impact on the competitive position of a bank in the wider single European market. Excessive aid in one State could also prompt a subsidy race among States and create difficulties for the economies of States that have not introduced similar support schemes.

Secondly, distressed or less-performing banks may receive an undue advantage compared to banks which are better-performing if the measures are available to all banks within a State without an appropriate degree of differentiation between beneficiary banks according to their risk profiles. This will distort competition on the market, distort incentives, increase moral hazard and weaken the overall competitiveness of banks.

Thirdly, public schemes which crowd out market-based operations would frustrate the return to normal market functioning. Thus public recapitalisation, in particular its remuneration, should not have the effect of putting banks that do not have recourse to public funding, but seek additional capital on the market, in a significantly less competitive position.

Experience from recent State interventions to recapitalise banks or to provide guarantees has illustrated possible anti-competitive effects at each of these three levels. Nevertheless, the EU in its communications and case assessment has shown that it is possible to strike a balance between these competition concerns and the objectives of restoring financial stability and ensuring adequate levels of lending to the real economy.

The application of State aid rules has ensured, and continues to ensure, that State support is granted on conditions that are sufficiently favourable to provide beneficiaries with effective access to capital, whilst preserving a level playing field and paving the way for a return to normal market conditions in the longer term. State interventions have accordingly been designed in a way that is proportionate and temporary in the sense that they provide incentives for banks to exit from reliance on State support as soon as market circumstances permit, in order for a competitive and efficient European banking sector to emerge from the crisis.

Finally, emergency rescue of banks (or more generally support for banks in difficulty) has hitherto

(1) This is a shortened version of the European Commission note to the OECD Competition and Financial Markets roundtable on Crisis — *The Role of Competition Policy in Financial Sector Rescue and Restructuring*. The full version of this contribution may be found at http://ec.europa.eu/competition/international/multilateral/2009_feb_roundtable2.pdf

had the effect of protecting the providers of funds (owners and creditors) and managers of banks from the consequences of past (excessive) risk taking and led to a problem of moral hazard. Measures aimed at financial stability should thus also be designed so as to mitigate problems of moral hazard. Restructuring of ailing banks has an important role to play in this respect, to ensure that incumbent owners, creditors and managers are not subsidised (given their institutional responsibility for the decisions leading to distress).

For many years, the Commission has applied rules to assess State aid to firms in difficulty. These rules are set out in the Community guidelines on State aid for rescuing and restructuring firms in difficulty ([2]) hereafter "R&R guidelines"). The R&R guidelines are of general applicationble, including to financial institutions in difficulty. In the light of the seriousness of the current crisis in the financial markets and the specific characteristics of the financial sector, restructuring banks in difficulty will become necessary to avoid serious disturbances in the economy of Member States. The Commission has in recent months adopted additional guidance, in the form of Communications, setting out standards and safeguards for the application of State aid rules in the financial sector.

The Commission's approach in its Communications and its decisions in individual cases is based on the general principles underlying the State aid rules of the Treaty. These principles require that the aid granted is well targeted, that it does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimised as far as possible.

2.2 Translation of the general principles into policy

Past experience shows that the resolution of a financial crisis generally involves three steps:

1) Stop/prevent runs on financial institutions;
2) Recapitalisation;
3) Clean up financial institutions' balance sheets by removing toxic assets and underperforming loans and restructuring.

Initially, Member States adopted measures they considered most appropriate to deal with the problems they were facing at national level. In doing so they did not always fully take into account the effects their measures had on financial markets in other Member States. To mitigate the competition risks linked to uncoordinated public action, the Commission adopted in October 2008 a Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis [3].

The second step to be taken concerns the recapitalisation of financial institutions. Such recapitalisation is necessary to restore the financial stability and the confidence needed to support lending to the real economy. The Commission adopted in December 2008 its Communication on the recapitalisation of financial institutions [4]. This Communication provides guidance to governments and enterprises as to the conditions under which recapitalisation would be acceptable under State aid rules.

As regards the third step, the Commission adopted in February 2009 guidance for the treatment of impaired assets in the EU banking sector by outlining various methods to deal with impaired assets, notably through asset purchase (including bad bank scenarios) or asset insurance schemes [5].

In conclusion, in recent months the Commission has tried to react as swiftly as possible to the unprecedented developments in the financial sector. It has provided Member States with a framework that coordinates national measures to combat the crisis and aims to avoid harmful spill-overs. By means of the guidance it has given and by its decisions in individual cases, the Commission has ensured that the schemes introduced by individual Member States will not unduly favour the beneficiaries to the detriment of their competitors or aggravate the liquidity problems of financial institutions located in other Member States. The standards and safeguards on which the guidance is based are briefly discussed below.

2.2.1 Standards and safeguards for State guarantees

The Commission Communication of October 2008 develops a number of standards and safeguards for a variety of measures, which have to be complied with by governments. The following overview lists the key standards and safeguards with respect to the most important measure covered by the communication, i.e. State guarantees:

- Eligibility for a guarantee scheme. The criteria for eligibility must be objective and non-discriminatory.
- Types of liabilities covered. As regards guarantees going beyond retail deposits, the selection of the types of liabilities covered should be target-

([2]) OJ C 244, 1.10.2004, p. 2.

([3]) OJ C 270, 25.10.2008, p. 8.
([4]) OJ C 10, 15.1.2009, p. 2.
([5]) See http://ec.europa.eu/competition/state_aid/legislation/impaired_assets.pdf.

ed at the source of the difficulties and restricted to what is necessary to tackle the different aspects of the crisis.

- Duration of the guarantee scheme. The duration of any guarantee scheme should be limited to the absolute minimum, usually set at six months (with the possibility to ask for renewal).

- Appropriate remuneration. A Member State guaranteeing bank liabilities should take appropriate steps to ensure that a significant contribution is made by the beneficiaries and/or the sector to the cost of the guarantee and the cost of State intervention if the guarantee has to be drawn upon.

- Behavioural constraints. In order to avoid distortions of competition certain behavioural constraints may be necessary. They may include the following elements:
  - ensuring that the beneficiaries do not engage in aggressive expansion against competitors not covered by a State guarantee;
  - appropriate enforcement provisions, including the sanction of removing the guarantee protection from a beneficiary in the event of non-compliance;
  - where a guarantee is drawn upon, the beneficiary has to restructure its business.

2.2.2 Standards and safeguards for the recapitalisation of financial institutions

In relation to recapitalisation measures the Commission Communication of December 2008 identifies a set of standards and safeguards. These standards and safeguards include the following:

- Pricing of recapitalisation. Closeness of pricing to market prices is the best guarantee to limit competition distortions.

- Incentives for State capital redemption. Recapitalisation measures need to contain appropriate incentives for State capital to be redeemed when the market so allows.

- Prevention of undue distortions of competition. Safeguards may be needed in order to prevent aggressive commercial expansion financed by State aid.

- Distinction between fundamentally sound and distressed banks. A distinction should be made between fundamentally sound banks whose difficulties stem only from the current general market conditions and distressed banks facing a risk of insolvency as a result of their particular business model or investment strategy.

2.2.3 Principles for the treatment of impaired assets

With regard to the treatment of impaired assets the Commission Communication of February 2009 is based on a number of principles, such as:

- Full transparency and disclosure of impairments, which has to be done prior to government intervention.

- Coordinated approach to the valuation and identification of assets eligible for asset relief measures.

- Adequate burden-sharing of the costs related to impaired assets between shareholders, creditors and the State.

- Adequate remuneration for the State, at least equivalent to the remuneration of State capital.

- Coverage of the losses incurred from the valuation of the assets at real economic value by the bank benefiting from the scheme.

- Appropriate restructuring, including measures to remedy competition distortion, following a case-by-case assessment and taking into account the total aid received through recapitalisation, guarantees or asset relief, with a view to the long-term viability and normal functioning of the European banking industry.

3. Merger review in the financial sector

In the context of the financial crisis, rescue mergers between banks as well as nationalisations of banks by Member States have given rise to new challenges for the application of EU merger control, in terms of jurisdictional, procedural and substantive issues. The Commission's analysis has however shown, and experience has confirmed, that, in any event, these challenges are an insufficient ground to relax or temporarily set aside the rules in place on merger control. On the contrary, the EC Merger Regulation constitutes an appropriate and sufficiently flexible tool for merger control enforcement also in times of crisis. The overall objective is the application of merger control in a manner that takes into account the requirements of financial stability for the banking system whilst preventing the creation of anti-competitive market structures.

3.1 Nationalisation and related jurisdictional issues

From a jurisdictional perspective, nationalisations of financial institutions by Member States are a new development. As such, the Commission treats nationalisations in a similar way to acquisitions of companies by private parties. This follows directly from Article 295 of the EC Treaty, which provides that the rules in Member States governing the system of property ownership must in no way be prejudiced by the EC Treaty.

It has to be emphasised, however, that the design or implementation of a nationalisation measure must respect all Treaty obligations, including those relating to competition.

Similar to acquisitions of control by private entities, acquisitions by public entities may therefore also be subject to mandatory notification to the Commission under the Merger Regulation. Whether an obligation to notify exists will in practice depend on the factual circumstances of the case at issue. The general rule is that no prior notification is required as long as the financial institutions are held by the State after the operation as economic units with independent decision-making power.

In particular for cases where Member States hold controlling interests in more than one financial institution, it has to be ascertained, in order to rule out an obligation to notify, that there is no room for coordination between different State-controlled banks. Finally, the acquired banks must be in a position to formulate their business strategy and carry out their day-to-day business on an autonomous basis. Nationalisations which fulfil the above criteria should not constitute notifiable transactions.

3.2 Procedural issues

One of the specific challenges the Commission faces in its review of mergers in times of crisis is of a procedural character. Timing of the review process and the possibilities to consummate a merger are normally of the essence for the merging parties and may be an even more pressing issue in rescue mergers.

The review periods provided for by the Merger Regulation are short and follow a well-defined time frame, the purpose being to ensure that the Commission has sufficient time for a thorough examination of the concentration while still allowing for a swift and foreseeable review process for the parties.

As a rule, the Merger Regulation provides for a standstill obligation pending the Commission's review, i.e. transactions notifiable under the EC Merger Regulation cannot be implemented before being cleared by the Commission. However, rescue mergers may require rapid and flexible reaction by the Commission in order to enable at least partly the immediate implementation of transactions. If required by the financial situation of the parties involved, the Commission can accommodate the necessity to implement immediately by granting derogations from the standstill obligation, taking into account the effects of such a measure on the parties directly involved in the transaction and on third parties and the possible effects on the market as such.

3.3 Substantive issues: the failing firm defence

As a practical matter, there has hitherto been no case brought before the Commission where the merging parties have raised a failing firm defence as a result of the financial crisis, be it in the financial sector or in the sectors of the "real economy". This is largely due to the fact that, with few exceptions, Member States have not as of yet "allowed" banks to fail and have been in a position to take various policy measures to this end including full nationalisation, recapitalisations and various types of guarantees.

Nevertheless, it cannot be ruled out at this stage that a failing firm scenario could arise should such measures not be sufficient or not have the intended effects with regard to any particular market or firm. In this respect, when assessing the competition impact of a merger, the Merger Regulation allows the Commission to take into account rapidly evolving market conditions and, where applicable, the failing firm defence.

In order for a failing firm defence to be accepted, three cumulative criteria are especially relevant as set out by the Commission's horizontal merger guidelines: (i) the allegedly failing firm would, in the near future, be forced out of the market because of financial difficulties if not taken over by another undertaking; (ii) there is no less anti-competitive alternative purchase than the notified merger; and (iii) in the absence of a merger, the assets of the failing firm would inevitably exit the market.

It must be noted that even if it cannot be shown that each of the three indicative criteria are met, an analysis of what would be the development of the market absent the merger could still lead to the conclusion that lessening of competition in the market is not an effect of the merger. The Commission will thus undertake a thorough prospective analysis of the market conditions and compare scenarios, with and without the proposed transaction and, where necessary, take into account remedies.

4. Conclusion

As set out in this paper the Commission's competition policy has been adequately equipped to deal with the challenges of the crisis in the financial sector. The fundamental principles of State aid and merger policy have provided a sound basis for dealing with the problems that the markets have been facing in these times of turmoil. In the field of State aid the Commission's policy has been focussed on maintaining a level playing field and fighting "beggar thy neighbour" policies. It has done so on the basis of its existing set of rules on rescue and restructuring aid as recently supplemented by specific rules on State guarantees, recapitalisation schemes for financial institutions and the treatment of impaired assets. With regard to mergers there has been no case for setting aside existing policy either. The rules in place allow for an appropriate response to a wide range of issues.

Competition and the financial markets: Financial sector conditions and competition policy ([1])

Stan Maes and Kamil Kiljanski

The specificity of financial markets

Financial instruments that are traded on financial markets differ from ordinary goods and services in a number of dimensions. They represent claims on *uncertain future* streams of income, whereas goods provide either *instant* services or future but relatively *certain* streams of services (in the case of durable goods). The prices of financial instruments are often more volatile, due to their sensitivity to changes in the expectations of the uncertain income stream. The role played by expectations in the pricing of claims on future streams of income also makes financial markets more prone to the development of bubbles. Financial market bubbles may arise when market expectations — the anticipation that a future stream of income will increase — lead to an immediate increase in the price of the asset, which may reinforce market expectations that the underlying stream of income will further increase in value.

Notwithstanding the above, the specificities of financial markets from a public policy perspective arise to a large extent from the special characteristics of *financial intermediaries* and in particular banks. So how do banks differ from other companies?

Instability of banks

First, banks differ from ordinary firms because their role in the transformation of maturity exposes them to relatively high risks of *illiquidity*. Banks pool and transform short-term funds into long-term investments. Liquidity risks materialise when a sudden surge in withdrawals precipitates a forced liquidation of assets at substantial discounts. As a result banks may be unable to meet all withdrawals and become insolvent. However, the anticipation that some creditors will withdraw funds will give others the incentive to withdraw themselves in order to avoid being exposed to an insolvent debtor. This in turn validates the expectation that withdrawals will occur. In other words, banks are subject to runs on deposits associated with self-fulfilling expectations that withdrawals will take place. ([2]) The occurrence of runs can be thought of as a market (coordination) failure which can be addressed by government intervention in the form of liquidity assistance by central banks and deposit insurance protection. However, deposit insurance leads to a problem of moral hazard, as the owners and managers of banks do not bear the full consequences of unfavourable realisations of their investments and are thus induced to take excessive risks. The incentive of depositors and creditors to monitor the banks is also reduced.

Second, banks differ from ordinary firms in terms of their *risk exposure*. Their main activity on the assets side involves the purchase of claims on uncertain future cash flows, and they finance these purchases through a limited amount of equity supplemented by funds provided by creditors. Given their relatively high leverage and creditor dispersion (which leads to imperfect market monitoring), the usual problem of moral hazard stemming from limited liability plays a particularly important role in banking. In other words, the management and the shareholders of banks may have an incentive to take on excessive risk on the asset side or at least remain silent about the riskiness of the pursued strategy.

Third, banks differ from ordinary firms by the extent to which they can quickly *expand* (and contract) their balance sheet and hence the volume of their business. Expansion which merely involves entering into new financial contracts (on both assets and liability sides) does not require extensive investments and lead times. Expansion which involves the accumulation of relationship capital on the asset and deposit side might take longer. In any event, banking activities are more divisible than others. Even when it involves relationship capital, it is embodied in employees and this capital is thus easily identifiable and spun off.

External effects and amplifying dynamics

As a result of these features, markets in which banks operate are subject to significant systemic risks of instability. This is due to the *negative externalities* that a bank failure (or the anticipation of it) generates on its competitors. While the failure of a company nor-

([1]) This is a shortened version of the European Commission note to the OECD round table *Principles — Financial Sector Conditions and Competition Policy*. The full version of this contribution — by Stan Maes from the Chief Economist Team — may be found at http://ec.europa.eu/competition/international/multilateral/2009_feb_roundtable1.pdf

([2]) Note that banks are not vulnerable to runs because of excessive competition. A run can even take place on a monopolist bank.

mally tends to favour its competitors and potentially even strengthens the economy as a whole by removing an inefficient player, a bank failure may weaken its competitors and negatively affects the financial markets in which they interact.

The negative externalities of a bank failure (or the anticipation of it) arise through various channels. First, as banks have extensive exposures to one another, losses of one bank will be borne by other banks (in case of failure or through a reduction in the value of their debt). The position of these banks may in turn be weakened and entail losses for their own creditor banks. Losses can spread directly through interbank exposures or indirectly through guarantees, credit lines, or insurance against credit risks (credit default swaps or CDS) that are being drawn and called. Second, pure informational contagion can arise such that the failure of one bank leads to an adjustment in the expectations regarding the viability of other banks perceived to be "similar" (even in a simplistic sense).

The development of negative externalities across banks is also subject to amplifying dynamics. What can initially appear to be exogenous risk triggers some reaction among banks which generates endogenous risk. To illustrate, following the realisation of losses on its assets, a bank may attempt to reduce its leverage (and indeed will often be compelled to do so by capital regulation). It will thus sell securities, which might trigger a fall in price of these securities, thereby inflicting a new round of losses on the securities portfolios of other banks, which generates the need to deleverage further. Alternatively, the bank can reduce its leverage by restricting its credit to the real economy, which increases the probability of default of all other borrowers in the economy, again inflicting a new round of losses on their credit portfolio and a similar downward spiral.

The need for ex ante and ex post regulation

Overall, the social costs of a bank failure (or the anticipation of it) exceed the private costs by far. This underlies the need for government intervention both ex ante and ex post (in times of crisis). There is extensive ex ante financial regulation (capital adequacy regulation, licensing requirements, deposit insurance, bank supervision, etc.) as well as ex post intervention and it is in the latter that competition enforcement has an important role to play.

It is beyond the scope of this article to comment extensively on the origin of the current financial crisis and the design of ex ante regulation. It would appear, however, that inadequate policies have contributed to the current crisis and its magnitude, given that the aggregate exposure to subprime loans which has triggered the crisis is relatively small compared to the pervasive repercussions it has triggered. In light of the heavy regulation that applies to banks and their role in the monetary system, the main causes of the crisis indeed seem to be monetary policy (which, with the benefit of hindsight, was far too lax, leading to the creation of major asset price bubbles), flaws in the regulatory design (that have set the wrong incentives and allowed loopholes to be exploited), and inadequate supervision (allowing the shadow banking sector to grow out of control and excess confidence that a securitised market-based financial sector would be more resilient to shocks than a bank-based financial sector).

Competition policy in the financial sector

In principle, the degree of competition might affect the probability that a financial crisis develops through two channels. First, competition affects the value of bank franchises. Faced with difficulties, banks might, in the presence of imperfect monitoring by the regulators and the markets, face the choice of either strengthening their capital base or further enhancing risk taking, hoping that positive outcomes will materialise (this is commonly referred to as "gambling for resurrection"). The relative attractiveness of these options depends on the regulatory framework and the scope for moral hazard (i.e. the extent to which shareholders and managers will lose in the event of failure) but also on the value of bank franchises (which would be lost in case of failures). The value of the bank franchise can be seen as the present value of the rents that can accrue from pursuing banking activities and is partly determined by competition. Intensive rivalry might reduce the number of bank franchises and increase the likelihood that, faced with a shock, banks will choose to gamble for resurrection. Serious doubts can be cast on the relevance of this effect in the context of the current crisis as the return on equity in banking was high in the years preceding the crisis, both in absolute terms and on a risk-adjusted basis. And indeed, to the best of our knowledge, neither banks nor regulators have suggested that rents in banking were insufficient in the context of the public policy debate surrounding the financial crisis.

Second, when faced with insufficient prudential regulation, competition between banks may put pressure on prudent banks even if they do not face immediate difficulties. If some of their competitors take excessive risks to generate high current profits, prudent banks may be tempted to gamble in order to maintain their ability to attract funds. But also for this second potential impact of competition on risk-taking, competition policy is the wrong instrument. First, even very lax competition policy (e.g. inactive merger control) is unlikely to eradicate the problem due to the existence of residual competition in global markets. Second, inactive competition policy would bring about unwanted side-effects. Besides the usual monopoly distortions, this policy would also create a banking landscape where "too big to fail" is the norm, thereby exacerbating the problem rather than addressing it. Therefore, if there is recognition that prudential regulation is not strict enough to prevent excessive risk-taking, the logical policy consequence is not to use competition policy to remedy this, but to adapt prudential regulation itself. This allows the root of the problem to be addressed without being exposed to the detrimental side-effects of indirect regulation via competition authorities. In short, while situations are conceivable where competition may increase risk-taking among banks, lax *competition policy* would more likely exacerbate than solve the problem.

The role of State aid control on the ex post regulatory response

As indicated earlier, competition policy and enforcement have an important role to play in the ex post regulatory response. The public policy challenge in response to the development of a financial crisis is to maintain financial stability while preserving incentives for appropriate risk taking and competition in the future.

EU State aid control is particularly relevant when distortions of competition arise across Member States. Its main objective is thus to establish rules allowing States to intervene in the presence of market failures while avoiding distortions of competition by maintaining the level playing field for undertakings operating in the EU. EU State aid control is thus characterised by a high degree of transparency, supporting the establishment of a level playing field in the common market.

The main issue of incentives arises in terms of moral hazard for the recipient of support. The rescue of banks (or more generally support for banks in difficulty) might have the effect of protecting the providers of funds (owners and creditors) and the bank managers from the consequences of past (excessive) risk taking. The rescue measures might strengthen the expectation that insurance will be provided in future cases of distress and create renewed incentives for excessive risk taking. Measures aimed at financial stability should thus be designed so as to mitigate problems of moral hazard. The rescue (or support given to banks in difficulty) also affects competitors directly and distorts their own incentives to compete. If banks that have not indulged in excessive risk taking observe that their competitors are bailed out, incentives for appropriate risk taking will be further impaired.

Distortions of competition associated with moral hazard and the consequences of rescues for competitors can be addressed by mandatory financial and corporate restructuring of banks. Financial restructuring in particular can ensure that incumbent owners, creditors and managers are not subsidised (given their institutional responsibility for the decisions leading to distress). State aid control has an important role to play in this respect.

One of the root causes of the current turmoil is indeed moral hazard: numerous financial institutions (FIs) have become too big to fail (TBTF) or too interconnected to fail (TITF). This of course means that banks have a strong incentive to become TBTF/TITF, as they will benefit from an implicit free insolvency insurance. Banks do not only want to become big, but they can and do effectively expand (and shrink) their balance sheets much more easily than ordinary firms, because their assets and liabilities are mostly intangible and because their regulatory leverage limitations are imposed based on the amount of risk-weighted assets (implying that additional individually risk-free assets can be piled on without constraining the bank).

Many FIs are TBTF and therefore require public support in the current crisis, as the social costs of failure would greatly exceed the private costs to shareholders and creditors. While accepting the need for intervention, it is important to ensure that flawed business models are not rewarded for their failure and that expectations that financial institutions are TBTF, and will therefore be bailed out, are not reinforced.

This can be achieved through the design of the mandatory restructuring plans that banks that are not fundamentally sound have to elaborate. Restructuring plans are part of the obligations imposed on FIs that are not fundamentally sound for receiving public support. Three central pillars of these plans are the private contribution to the coverage of the restructuring costs (aid kept to the minimum), compensatory measures, and long-term viability. The first requirement ensures that the restructuring costs are borne by the owners, creditors, and managers of the entity receiving support, to the extent possible. The second is aimed at reducing the competition distortion. The third pillar seeks to ensure that state intervention has a lasting positive effect on the aided firm and the sector in which it operates. Return to viability should also ensure that the firm will not require additional State support in the future. It should be stressed that orderly liquidation may eventually constitute a realistic alternative to restructuring.

By contrast, fundamentally sound banks that become distressed through contagion (i.e. through the development of systemic effects) in principle do not require mandatory financial and corporate restructuring, given the absence of a clear moral hazard problem.

The implementation of financial and corporate restructuring may have to be tailored to the specificities of the financial industry. For non-financial firms, competitors are normally hurt by the rescue, as they would otherwise have faced less competition. Compensatory measures involving asset disposals and/or capacity reductions can then reduce the extent of the distortion of competition imposed on competitors. For FIs, the rescue might actually benefit competitors because of systemic linkages. Indeed, the experience of Lehman Brothers has shown that the uncontrolled disappearance of players with a flawed business model may effectively hurt the remaining banks. The importance of inter-bank lending means that banks are each others' creditors and the failure of one bank will therefore hurt other banks as creditors. The disorderly unwinding of a systemically relevant bank may also affect the pricing of some assets that have to be sold abruptly, and with consequential high losses, potentially also depressing market prices. Finally, a bank failure may hurt investors' and depositors' trust in the financial system, which is paramount to the efficiency of financial markets. For that reason, bank rescue may need to be authorised very swiftly to avoid serious disturbance in the economy.

However, as in other sectors, the need to contain moral hazard and to preserve effective competition requires that rescued banks provide restructuring plans in order to: (i) restore long-term viability, (ii) limit State aid to the minimum necessary and (iii) introduce compensatory measures limiting the distortion resulting from failing banks being still in business and taking away market shares from sound competitors. In the case of fundamentally sound banks, there may be less of a need to consider compensating measures. The fact that banks may remain TBTF is still a source a concern. In this respect, there are complementarities between competition enforcement and regulation (for instance, capital requirements proportional to the systemic incidence of individual banks) that should be exploited.

The (non-)alternative of relaxing merger control

Relaxing merger control might be considered as an alternative to state aid support for banks in distress. There are at least four reasons that discredit this idea.

First, it may not work. Whereas State aid provides immediate support, monopoly rents might take time to materialise. Net benefits for the merged entity are also uncertain. If cost for the consumers can be anticipated, past experience clearly indicates that the merger of two distressed institutions does not create a sound efficient one. In addition, empirical studies of banking indicate that minimum efficient size is reached quickly. Given the size of most FIs, and in particular the distressed ones, merger would not deliver the gains derived from economies of scale, as the latter have been exhausted. One should be equally sceptical about the potential benefit from exhausting economies of scope. The current turmoil is partly due to the fact that Chinese walls to keep distinct activities clearly separate have shown to be ineffective, leading to lack of transparency, agency problems, and conflicts of interests. Thus, in appraising mergers, it should be borne in mind that Chinese walls are either ineffective, or, if they can be effective, then there is no room for scope economies. A merger cannot therefore be defended by a combination of Chinese walls (for prudential purposes) and efficiency claims based on economies of scope.

Second, the duration of the stream of monopoly rents that would accrue from allowing an anti-competitive merger is potentially unlimited. By contrast, State support can be designed to be temporary and non-recurrent (with the limits of governments' ability to commit). It can also be tailored to the specific problems of the bank in distress. Third, lax merger control would plough the seeds for future systemic crises by contributing to the creation of FIs that are TBTF or TITF.

Finally, while State aid can be made contingent on financial and corporate restructuring, lax merger control is a licence to extract monopoly rents without condition. Rewarding mismanagement by the right to exercise market power would compound problems of moral hazard.

State aid and crisis resolution

The banking crisis in Europe is without historical precedent. Obviously links can and are being made to the 1933 Great Depression and the 1997-1998 crisis in Japan, but what really sets Europe apart from these episodes is that Europe's response is driven by national initiatives without a unique pan-European supervisory, regulatory, and legal framework. As a result of this and as a result of the differences in fiscal capabilities across Member States, the crisis management and crisis resolution mechanisms that are being implemented differ to a certain extent, opening the door to competition distortions and unlevel playing fields.

A particular source of concern is the lack of a pan-European special resolution regime for banks that would allow prompt corrective action by the supervisor before technical insolvency was reached. Such a regime would allow the bank to stay in business during the restructuring phase, and would allow a swift and orderly liquidation if the bank is no longer viable. In the absence of such a supra-national regime, EU State aid policy, and more particularly the Commission's rescue and restructuring guidelines and procedures, have provided and should continue to provide a robust and flexible framework enabling the EU and its Member States to take effective measures to combat the crisis in the financial markets and in the real economy, while at the same time minimising the distortive effects on competition and on the level playing field.

Implementing an effects-based approach to Article 82

Luc Peeperkorn and Katja Viertiö

Introduction

On 3 December 2008, the Commission issued Guidance on its enforcement priorities in applying Article 82 to abusive exclusionary conduct by dominant undertakings. (1) In so doing, the Commission formally endorsed an effects-based approach to exclusionary conduct by dominant undertakings.

The Guidance outlines the analytical framework that the Commission applies in determining whether to intervene against exclusionary conduct under Article 82 as a matter of priority. This will be the case if the conduct of a dominant undertaking is likely to restrict competition in such a way as to have harmful effects on consumers, whether in the short or the longer term.

The Guidance is not a statement of law. It is nonetheless an attempt to place existing case law in a coherent analytical framework. While case law can also be interpreted as allowing a more form-based approach, the assessment of exclusionary conduct under Article 82 in the way described in the Guidance ensures that the Commission intervenes where it most matters, that is, where consumer welfare is at stake.

Three main principles underpin the effects-based approach formulated in the Guidance. First, dominant companies too should be free to compete fiercely on the market as long as this competition is ultimately for the benefit of consumers. Such competition on the merits (2) may well mean that competitors who deliver less to consumers have to leave the market.

Secondly, the Commission must assess the likely effects of the conduct of the dominant undertaking, which requires sound economic analysis and cogent and convincing evidence. The Guidance assists in this task by providing a general analytical framework for the most common types of exclusionary conduct which makes it possible to identify the circumstances in which the conduct is likely to restrict competition in such a way as to harm consumers.

Thirdly, although Article 82 does not expressly provide for the possibility of exempting exclusionary conduct because of efficiencies, it would be difficult to apply an effects-based approach and effectively protect consumers without carefully examining any efficiency defences put forward by dominant undertakings. The Guidance recognises the possibility of the existence of such efficiencies and explains how they will be taken into account in the assessment.

These principles crystallise in the expression "anticompetitive foreclosure". According to the Guidance, there is anticompetitive foreclosure where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices to the detriment of consumers. The notion of "increasing prices" is shorthand for the various ways in which the dominant undertaking can influence the parameters of competition — such as prices, output, innovation, the variety and quality of goods and services — to the detriment of consumers.

Anticompetitive foreclosure is foreclosure that results in consumer harm, and is the overarching test to be used in assessing whether the Commission should intervene against exclusionary conduct by dominant undertakings.

Brief summary of the content of the Guidance — general approach

Assessment of dominance

The Guidance confirms the Commission's recent practice of not relying only or primarily on market shares when assessing dominance, but rather of making a comprehensive analysis of whether or not the allegedly dominant firm is constrained by existing competitors and their output, by expansion or entry of competitors and/or by countervailing buying power. As regards market shares, the Guidance does not refer to the *Akzo* case law that market shares in excess of 50% can be considered a strong indication of dominance; rather, based on the Commission's experience in handling cases, the Guidance states that dominance is not likely if the market share of the firm is below 40%.

(1) The text can be found at: http://ec.europa.eu/competition/antitrust/art82/index.html

(2) Competition on the merits is a concept that has often been described in terms of proportionality of the dominant undertaking's conduct. Such an approach does not provide a clear standard for the assessment of conduct, whereas an approach that looks into the effect of the dominant undertaking's conduct on competition and thereby consumers allows an objective meaning to be given to the term competition on the merits. Competition on the merits is competition that increases consumer welfare.

Anticompetitive foreclosure

The Guidance sets out a two-step approach to assessing allegedly abusive exclusionary conduct by dominant undertakings: the first step entails determining whether the allegedly abusive conduct is likely to restrict competition and thereby harm consumers, while the second step consists in analysing whether any efficiency defences by the dominant undertaking are such as to outweigh the identified negative effects of the conduct.

Assessing the likely effects of the conduct of the dominant undertaking is not an easy task. It entails comparing the current or likely future situation in the relevant market with an appropriate counterfactual. This requires a comprehensive analysis of a number of factors described in paragraph 20 of the Guidance (the so-called "paragraph 20 factors"), such as the conditions on the relevant market (for example the existence of economies of scale and/or scope), the duration of the conduct of the dominant undertaking and the part of the market affected by it, any direct evidence of an exclusionary strategy or of actual foreclosure, and also the situation of the dominant undertaking's competitors, customers and input suppliers.

In the case of pricing conduct — such as rebates and predatory pricing — the Guidance provides that the Commission will in addition investigate whether the pricing conduct is capable of foreclosing (hypothetical) competitors that are as efficient as the dominant undertaking ("equally efficient competitor test"). The Guidance establishes a soft safe harbour for where the prices of the dominant undertaking cover its long-run average incremental costs (LRAIC). If the dominant undertaking's prices do not cover its costs, the Commission will still look at the above-mentioned "paragraph 20 factors" before determining whether there is likely anticompetitive foreclosure.

Notwithstanding the "equally efficient competitor test" the Commission may intervene against conduct that can exclude only less efficient rivals in certain particular circumstances, namely where restriction of less efficient competitors is likely to result in consumer harm, in particular in the longer term. Such situations may arise, for example, if the dominant undertaking is super-dominant (for example owing to economies of scale and scope and network effects) and there is reason to preserve the very low level of competition still remaining on the market and prevent complete monopolisation.

Objective necessity and efficiency defences

Where the Commission has found that the conduct of the dominant undertaking is likely to restrict competition and result in harm to consumers, the dominant undertaking can seek to rebut this finding by presenting evidence that its conduct is objectively necessary or justified by efficiencies which are such as to outweigh the negative effects identified by the Commission. The Guidance recognises the possibility of the existence of such an objective necessity only in rather limited circumstances, while it recognises the possibility of an efficiency defence in more general terms and mentions a series of possible examples of efficiencies. ([3])

The criteria that the Commission will use in assessing efficiencies mirror those that it applies under Article 81. The efficiencies must be the result of the conduct in question. The conduct must be indispensable for achieving the efficiencies, i.e. there must not be a less anticompetitive way of achieving the efficiencies. The conduct must not eliminate effective competition by removing all or most sources of actual or potential competition. Last, but not least, the likely efficiencies must outweigh any likely negative effects on competition and consumers that the Commission has established.

Brief summary of the content of the Guidance — specific types of conduct

The Guidance applies the above-mentioned general framework to those types of conduct that are the most common in the Commission's experience. These conduct-specific sections cover exclusive dealing, tying and multi-product rebates, predatory pricing and refusal to supply. Each section describes factors, arguments and efficiencies which are specific to that conduct and will be integrated in the general framework of assessment.

Exclusive dealing

The section of the Guidance on exclusive dealing covers both exclusive purchasing and conditional rebates. For both, the Commission will investigate whether the customers of the dominant undertaking are able or willing to switch their entire demand to alternative suppliers. If they are, i.e. if the dominant undertaking's competitors are able to compete for the full demand from customers, exclusive purchasing and conditional rebates by the dominant undertaking are unlikely to raise competition concerns, unless the duration of the exclusive purchasing obligation or rebate scheme hinders entry or expansion by competitors. The situation is different if the dominant undertaking is an unavoidable trad-

([3]) However, in the Commission's assessment, it is unlikely that predatory conduct will create efficiencies. Also, as the overall test is a consumer harm test, any argument presented by the dominant undertaking that its conduct is only aimed at meeting competition ("meeting competition defence") is irrelevant.

ing partner for at least part of the demand in the relevant market. This may be the case if its brand is a "must stock" item or because its competitors are capacity constrained. In such a situation, exclusive dealing, even if of short duration, is more likely to lead to anticompetitive foreclosure.

An individual customer may have an interest in entering into an exclusive purchasing obligation where the dominant undertaking rewards him or her for the exclusivity. However, the compensation given to an individual customer for the loss of competition does not make up for the fact that the cumulative effect of the exclusive purchasing obligations entered into by many customers may be such as to prevent the entry and expansion of competing undertakings and thereby to restrict competition so that consumers are harmed overall.

For conditional rebates, the Commission will investigate whether equally efficient competitors are able to compete with the rebate scheme of the dominant undertaking. This requires establishing the part of the sales that is affected by the rebate (the so-called "relevant range"). Whereas for incremental rebates the relevant range comprises all the sales above the threshold, for retroactive rebates the Commission will have to estimate how much of the demand of the dominant undertaking's customers can realistically be switched to competitors. The rebate is then deducted from the price paid for the relevant range. This gives the effective price, and the equally efficient competitor test entails checking how this effective price compares with the relevant cost benchmark. If the effective price is below average avoidable costs (AAC), then the rebate is capable of foreclosing equally efficient competitors. The opposite holds true where the effective price is above LRAIC. If the price is between AAC and LRAIC, the Commission will have a closer look at whether and to what extent competitors can resort to any counterstrategies. Even if the rebate does not involve a sacrifice (indicated by pricing below AAC) on the part of the dominant undertaking, it may still restrict competition in such a way as to harm consumers.

Tying and multiproduct rebates

This section of the Guidance deals with situations where the dominant undertaking ties or bundles two or more distinct products in order to prevent customers from switching to competitors and thereby foreclose competition. The foreclosure will in the first place affect the tied market, but may ultimately also affect the tying market. The Guidance provides that the Commission will intervene where the undertaking is dominant in the tying market, the products concerned are distinct, and the conduct leads to anticompetitive foreclosure on either the tied or the tying market or both.

As with single-product rebates, the Commission will investigate whether equally efficient competitors are able to compete with the multi-product rebate of the dominant undertaking. Here the "relevant range" consists of the sales of the bundled product. The equally efficient competitor test is applied by checking whether the incremental price that the customer pays for a particular product in the bundle (the tied product) is above or below the incremental cost (LRAIC) of producing that product. However, if competitors can also compete with bundles, the Commission will investigate whether the price of the bundle of the dominant undertaking as a whole is predatory.

Predatory pricing

According to the Guidance, the dominant undertaking engages in predatory pricing where it deliberately incurs losses or foregoes profits in the short term in order to foreclose competitors and thereby strengthen or maintain its market power to the detriment of consumers. Predation thus differs from the above-mentioned types of conduct in that it always involves a sacrifice. Pricing below AAC is a clear indication of sacrifice. If a dominant undertaking charges a price below AAC for all or part of its output, it is not covering the costs that could have been avoided by not producing that output, i.e. it is incurring a loss that could have been avoided. But sacrifice may take other forms and pricing above AAC may in certain circumstances also be indicative of sacrifice if there clearly were more profitable alternatives available to the firm. For instance, direct evidence obtained from the dominant undertaking during an inspection may reveal a predatory strategy, such as documents containing a detailed plan to sacrifice in order to exclude a competitor.

Whatever its form, the Commission will investigate whether the sacrifice incurred by the dominant undertaking is likely to foreclose competition and thereby allow the dominant firm to maintain and/or strengthen its market power. In this context, the Commission will investigate whether the prices applied by the dominant undertaking are capable of foreclosing equally efficient competitors. This entails checking whether the dominant undertaking is pricing below LRAIC. If this is the case, the Commission will have a look at the "paragraph 20 factors" to assess whether the conduct of the dominant undertaking is likely to result in anticompetitive foreclosure.

The Guidance does not require the Commission to show that after having foreclosed its competitors, the dominant undertaking increased its prices above the level obtained before the conduct, or that the dominant firm actually recouped its losses. Consumer harm may also result if the conduct prevented or delayed a decline in prices that would likely have occurred absent the conduct. However, the Commission will investigate whether the dominant undertaking can reasonably expect its market power after the predatory conduct comes to an end to be greater than it would have been had the undertaking not engaged in that conduct, that is to say, whether the undertaking will be in a position to benefit from the sacrifice and thereby harm consumers.

Refusal to supply

This section of the Guidance deals with situations where the dominant undertaking refuses to supply an input requested by undertakings that compete with it on a downstream market. It covers both outright refusals to supply and constructive refusals to supply.

If a refusal to supply is considered to infringe Article 82, then the remedy entails imposing an obligation to supply on the dominant undertaking. Such an obligation may induce free-riding by the downstream competitors on the dominant firm's investments and may reduce the incentives of the dominant undertaking and its competitors to invest and innovate, which would be detrimental for consumers. The Guidance therefore emphasises that the consequences of imposing an obligation to supply must be carefully considered.

As it is inherently difficult to balance the incentives to invest and innovate of the different firms and the resulting effects on competition and consumers, the Commission applies a stricter standard for its intervention in case of refusal to supply than for other types of conduct. The Guidance sets out three strict cumulative conditions for the Commission to intervene in such situations. The three conditions that have to be met are that the refusal (1) must concern an input that is objectively necessary to be able to compete effectively on the downstream market, (2) must be likely to lead to the elimination of effective competition on that market, and (3) must likely lead to consumer harm. Such harm may arise, for instance, if the refusal to supply prevents competitors from bringing new products to the market or stifles innovation.

This stricter standard for intervention and in particular the first condition — that the input must be objectively necessary to be able to compete on the downstream market and that there is thus no actual or potential substitute or source of supply on which the competitors could rely — provides a practical tool for the Commission to balance the incentives to invest at stake and to establish whether the negative consequences of the refusal to supply outweigh the negative consequences of imposing an obligation to supply. The requirement that the input should be indispensable eliminates the risk that the obligation to supply undermines the incentives of the downstream competitors to invest in the input market, while the dominant undertaking can assert possible negative effects on its own incentives to invest as part of the efficiency defence.

Conclusion

The Guidance focuses on exclusionary conduct and not on exploitative conduct: this is because it is better to prevent than to cure. If markets are not functioning properly, it makes more sense to prioritise unilateral conduct which undermines the structure and functioning of the market itself than to address the symptoms.

While therefore the Guidance does not cover all categories of possible abuse, it is fair to say that it is a major step in the process of introducing a more economics- and effects-based approach to European competition law enforcement. Such an approach has already been formulated and implemented in the area of Article 81 and mergers since the late 1990s. And in recent Article 82 cases, such as *Microsoft* and *Telefónica*, the Commission already applied an effects-based approach, but what was lacking thus far was a document that provided guidance to stakeholders, in particular the business community and competition law enforcers at national level, on how the Commission articulates such an effects-based approach to exclusionary conduct under Article 82. The Guidance fills this void.

The new State aid temporary framework

Mercedes Campo (1)

1. Introduction: the financial and economic crisis

The unprecedented crisis in the international financial markets has created major challenges for the EU.

Since the beginning of the crisis, the Council has emphasised the necessity of maintaining the application of competition rules. The Commission must ensure a level playing field for European businesses and prevent Member States engaging in subsidy races which would be unsustainable and detrimental to the EU as a whole.

Although public intervention has to be decided at national level, this needs to be done within a coordinated framework and on the basis of a number of common Community principles (2). Abandoning State aid control would worsen difficulties and would ultimately be prejudicial to the European economy. Competition policy is therefore part of the solution, not part of the problem.

The Commission's response

The financial crisis first impacted heavily on the EU banking sector. The Commission reacted very quickly and adopted on 13 October 2008 the *Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis* (3) as well as a number of decisions authorising rescue aid to financial institutions.

The importance of maintaining State aid rules was confirmed again in the Communication adopted by the Commission on 26 November 2008, *A European Economic Recovery Plan* ("the Recovery Plan"). This document constitutes a global action plan to drive Europe's recovery from the current financial crisis. This plan rests on two pillars:

– a boost to purchasing power that increases demand and confidence in the economy; and

– immediate actions that will boost long-term competitiveness, such as investing in a greener economy through technology.

The Recovery Plan already refers to the adoption by the Commission of temporary guidelines to enhance access to finance for business.

Further, on 5 December 2008 the Commission adopted, as a companion document to the Communication on the financial sector, a *Communication on the recapitalisation of financial institutions in the current financial crisis* (4). This document provides guidance on how Member States can recapitalise banks to ensure adequate levels of lending to the rest of the economy and stabilise financial markets whilst avoiding excessive distortions of competition.

This Communication already takes into account the effects of the crisis on the real economy, stating that financially sound banks may need State capital to ensure an adequate level of loans to companies. It also stresses the need for appropriate safeguards to ensure that public capital is used to sustain lending to the real economy and not to finance aggressive commercial conduct to the detriment of competitors.

The Communications on the financial sector are aimed at reactivating the interbanking system and normal market functioning as soon as possible, while ensuring fair competition between Member States and financial entities. Their objective is, therefore, to remedy the negative effects of the "*financial crisis*".

Despite these initiatives, by the end of 2008, the impact of the crisis in the real economy was becoming more obvious, feeding into a serious downturn affecting businesses and jobs.

As a consequence and following the announcement of the Recovery Plan, the Commission adopted on 17 December 2008, in record time, a new *Temporary framework containing additional State aid measures aimed at facilitating companies' access to finance*. This Communication thus focuses on the "*economic crisis*" and its effects on the real economy.

The temporary framework states that the Commission may provide further clarifications on its approach to particular issues. Using this possibility and on the basis of its application over the last few months, on 25 February 2009 the Commission adopted a Communication amending the temporary framework so as to introduce some technical adjust-

(1) The views expressed in this article are entirely personal and do not necessarily reflect the official position of the European Commission.
(2) Conclusions of the Ecofin Council of 7 October 2008.
(3) OJ C 270, 25.10. 2008, p. 8.
(4) Commission Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

ments, in particular as regards aid in the form of guarantees.

Following the adoption of these changes, a consolidated version of the temporary framework has been published in the Official Journal [5].

2. The temporary framework: exceptional times call for exceptional measures

The new temporary framework is part of a coordinated response to the crisis. The departure point of the framework was a situation of high risk aversion on the part of banks. The credit squeeze affected (and still affects) not only weak companies without solvency buffers but also healthy companies, which found themselves facing a sudden shortage of credit due to the impossibility of obtaining credit, or to the higher price of credit. Obviously, the situation was even more difficult for small and medium-sized companies (SMEs).

Sufficient and affordable access to finance is clearly a pre-condition for investment, growth and job creation by the private sector. In the short term, this economic context has negative consequences for the viability of European companies. In the long term, it can delay investments in sustainable growth and other objectives of the Lisbon Strategy.

Although Member States already have a wide range of possibilities to grant State aid for different objectives (environmental aid, rescue and restructuring aid, etc.), there was an urgent need for additional measures targeted to the exceptional difficulties in obtaining finance.

Member States needed to take direct and quick action that could contribute to boosting confidence, facilitating investment and improving conditions for future investments. With the new temporary framework, the Commission provided them with the necessary instruments to tackle the market failure brought about by the markets' higher perception of risk.

By adopting a single framework applicable to all Member States, the Commission encouraged coordinated action to ensure transparency and a level playing field for businesses and Member States.

The new measures contained in the temporary framework needed to have considerable impact on the market, be well targeted to concrete needs but be flexible enough to adapt to the specific configuration of each Member State.

In light of the above, the new framework focused on three objectives: first, to immediately unblock bank lending, thereby preserving continuity in companies' access to finance; second, to ensure that limited amounts of aid reach the recipients in the most rapid and effective way; and third, to encourage companies to continue investing in a sustainable future, including the development of green products.

This approach is fully in line with the Council requirement that application of the competition rules be maintained. The Commission did not modify the existing State aid rules but provided additional possibilities for granting State aid tailored to exceptional circumstances.

A very important aspect of the new temporary framework is its limitation in time. It will be applicable only until 31 December 2010. This is because the Commission has considered that the current global crisis requires extraordinary policy responses *but for a limited period of time*. The proposed measures are strictly linked to the crisis and would not be justified under different circumstances.

This is why the legal basis that has been used (as for the banking communications) is Article 87(3)(b) of the Treaty, a very exceptional legal basis that allows the Commission to declare compatible with the common market aid "*to remedy a serious disturbance in the economy of a Member State*".

The potential distortion of competition that these measures could create in the common market would be, in any case, justified by the positive effects that the initiative will have in the European economy, which is suffering the worst crisis since the Great Depression.

3. The new State aid measures contained in the temporary framework

The Communication is structured in three parts: a *first part* recaps the existing State aid possibilities that Member States can already apply. There is a special reference to the General Block Exemption Regulation [6] (GBER), which allows Member States to support SMEs at different stages of their development with 26 different categories of aid. The measures covered by the GBER are exempted from the notification requirement if all the conditions laid down therein are fulfilled.

The *second part* develops new openings for Member States to grant State aid, in particular a new compatible limited amount of aid, aid in the form of guarantees, aid in the form of subsidised interest rates and aid for the production of green products.

(5) OJ C83, 7.4.2009, p.1.

(6) Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation).

Finally, the *third part* includes the temporary adaptation of existing State aid instruments: the Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises [7] and the Communication from the Commission to Member States pursuant to Article 93(1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance [8].

The temporary framework:

- applies to all sectors, without making any distinction [9]. The reason is that a horizontal approach seems more appropriate as a response to a problem that affects the entire EU economy. At the same time, Member States may adapt the new measures to their specific problems and integrate them into their national recovery plans.

  For instance, the automotive industry, one of the industries most heavily affected by the current recession, can benefit from all the measures contained in the framework. That said, subsidising green products is perhaps the most appropriate measure for this sector since it combines access to finance with the promotion of long-term objectives, such as the low carbon economy. In this context, it needs to be stressed that any aid granted on the basis of the framework must fully respect the single market rules to avoid distortions of competition and fragmentation [10];

- applies to SMEs and large companies. There is, however, more favourable treatment for SMEs, which can benefit from higher aid intensities in line with usual Commission policy.

Definition of firms in difficulty

In order to define a firm in difficulty, the Communication refers to criteria already contained in other existing guidelines. Nevertheless, these criteria should be applied retroactively at the date of 1 July 2008. Those firms which were not in difficulty at 1 July 2008, according to these criteria, can benefit from the new aid measures.

This is reflected in the text, which states that "*the aid may be granted to firms that were not in difficulty at that date (1 July 2008) but entered in difficulty thereafter as a result of the global financial and economic crisis*". Of course, "healthy" companies can also qualify for the new State aid possibilities.

However, the Community guidelines on State aid for rescuing and restructuring firms in difficulty [11] (hereafter the R&R guidelines) — based on Article 87(3)(c) of the Treaty — are still the appropriate instrument to be applied to those companies which face serious financial difficulties that cannot be solved by temporary access to finance and that require a restructuring plan. If that is not the case, the necessary restructuring of the economy will be delayed, deepening the recession and its long-term effects.

Concerning the criteria used to define firms in difficulty, a distinction has been drawn between large companies and SMEs. For large companies, the normal conditions stated in the R&R guidelines apply [12]. For SMEs, the conditions are those set out in the GBER [13], which reiterate the "*hard core*" requirements of the R&R guidelines' definition of firms in difficulty.

3.1 Compatible limited amount of aid

This measure allows the granting of €500 000 per undertaking to cover investments and/or working capital over a period of two years.

It is crucial to stress that this is not a new *de minimis* allowance of €500 000 or an increase of the *de minimis* threshold. The existing *de minimis* Regulation gives Member States the possibility of granting up to €200 000 [14] to firms during a period of three fiscal years, without any notification obligation, if a number of conditions are fulfilled. In contrast, the new measure constitutes State aid and, accordingly, needs to be notified and approved by the Commission.

As for *de minimis* aid, the fisheries sector and some agricultural activities are not included in the scope of application. Further, export aid or aid favouring domestic products is also excluded.

The objective behind this new aid measure is to provide financing, in most cases to SMEs, swiftly and with a minimum of red tape. This would help to remedy the situation of companies that are especially vulnerable to a sudden shortage of credit. SMEs play a key role in safeguarding employment. Therefore, everything must be done to ensure that viable businesses continue.

The impact on competition of this aid measure will be restricted given the limited amount of aid involved. In any event, the amount will not be enough

(7) OJ L 375; 28.12.2006, p. 5.
(8) OJ C 281, 17.9.1997, p. 4.
(9) Apart from the specific provisions governing the compatible limited amount of aid.
(10) Communication from the Commission "Responding to the crisis in the European automotive industry", 25.2.2009.
(11) OJ C 244, 1.10.2004, p. 2.
(12) Point 2(1) of the Community guidelines on State aid for rescuing and restructuring firms in difficulty.
(13) Article 1(7) of the General Block Exemption Regulation.
(14) €100 000 for the road transport sector.

for large companies in difficulty, which will need additional financing and a restructuring plan.

Other safeguards are contained in this measure: the aid can only be granted in the form of schemes and is subject to strict cumulation rules (if the new aid is combined with *de minimis* a limit of €500 000 for the period 2008-2010 applies).

3.2 Aid in the form of guarantees

The temporary framework is intended to facilitate access to loans by reducing the annual premium to be paid for guarantees granted until the end of 2010. It provides for a reduction of 25% for SMEs and 15% for large companies to be applied for a maximum of 2 years following the grant of the guarantee.

This measure also contains some requirements to limit its impact on competition. First, the maximum loan related to the guarantee cannot exceed the total annual wage bill of the beneficiary for 2008. Second, the guarantee can only cover up to 90% of the loan, which means that a risk analysis for the remaining 10% has to be carried out by the entity giving the guarantee.

The initial text of the temporary framework allowed Member States to apply a reduction of the annual premium to be paid in accordance with the safe-harbour provisions contained in the Commission Notice on Guarantees ([15]).

Normally, these safe-harbour provisions constitute the minimum annual premium which can be applied in the case of SMEs, as a simpler evaluation of whether or not a loan guarantee involves aid. The safe-harbour premiums do not distinguish between different levels of collateralisation because their aim is to serve as a simple way for Member States to grant guarantees to SMEs, without having to collect market data and without having to find a comparable market rate.

The temporary framework extends the use of the safe harbours as benchmarks to large companies. For this reason, it was necessary to take into account different levels of collateralisation (in particular for low rating categories) when calculating the permissible guarantee premiums under the framework. The basis for such calculations is the interest rate top-up as set out in the Commission Communication on the revision of the method for setting the reference and discount rates ([16]), from which 20 basis points are deducted.

The introduction of the collaterals within the safe-harbour premium gives, as a result, a new grid which will be used for the calculation of subsidised guarantees and has been attached to the Communication as an Annex.

Furthermore, the modifications to the temporary framework clarified that in addition to the two-year reduction of the annual premium, Member States may apply the new safe-harbour premiums set out in the Annex for 8 more years without reduction.

3.3 Subsidised loans

Apart from guarantees, another way to promote the granting of loans is to reduce the applicable interest rate.

In order to achieve this objective, Member States are allowed to use a methodology for the calculation of reference rates different to the one contained in the Commission Communication on the revision of the method for setting the reference and discount rates ([17]) (based on the one-year IBOR).

Under the temporary framework, Member States can apply pre-crisis spreads between overnight rates and commercial rates at the time of granting loans for contracts concluded before 31 December 2010.

For the time being, this new calculation method results in a more favourable interest rate than the application of the Commission Reference Rate Communication, constituting an incentive for companies. The aid element of the measure, the difference between both interest rates, will be considered compatible under Article 87(3)(b) for interest-rate reductions applied until 31 December 2012.

New methodology

The subsidised interest rate should be at least equal to the central bank overnight rate plus a premium equal to the difference between the average one-year interbank rate and the average of the central bank overnight rate over the period from 1 January 2007 to 30 June 2008, plus the credit risk premium corresponding to the risk profile of the recipient, as stipulated by the Commission Communication on the revision of the method for setting the reference and discount rates.

3.4 Aid for the production of green products

The new methodology for the calculation of the interest rate may be used for investment loans for the production of green products. Further, an additional reduction of 25% for large companies and of 50% for SMEs is applied to this rate for a period of two years following the granting of the loan.

([15]) OJ C 155, 20.6.2008, p. 10.
([16]) OJ C 14, 19.1.2008, p. 6.
([17]) OJ C 14, 19.1.2008, p. 6.

Only products that involve early adaptation to or going beyond future Community product standards which increase the level of environmental protection and are not yet in force can benefit from this aid.

It is important to stress that, in the Commission's view, environmental goals should remain a priority despite the crisis. The significant progress that has been achieved in recent years must not be brought to a halt because of the economic context. For this reason, it is necessary to provide temporary support to companies for investing in environmental projects.

Finally, to avoid a disproportionate impact on competition, companies related to sectors with overcapacity are excluded from the scope of application of the measure.

3.5 Temporary adaptation of existing State aid rules

The temporary framework makes concrete changes to existing guidelines to make them more effective in the current circumstances. For instance, nowadays investors are tending to invest in safer assets to the detriment of the illiquid nature of risk capital investments. Therefore, to reactivate these investments, the Commission is allowing until the end of 2010 a risk capital injection in SMEs of up to €2.5 million per year (instead of the current €1.5 million), in cases where at least 30% (instead of the current 50%) of the investment cost comes from private investors.

Further, Member States can benefit from a simplification of the "*escape clause*" contained in the Communication on short-term export-credit insurance. This clause allows marketable risks, which are usually excluded from this benefit, to be covered with public funds. This temporary modification will speed up — something which is now essential for commercial transactions — the procedures to be followed by Member States in order to use this clause.

4. Additional provisions of the temporary framework

Apart from the general reporting obligations, the temporary framework contains additional requirements. On the one hand, Member States must provide by 31 July 2009 a list of the schemes put in place under the framework and, by 31 October 2009, a report indicating the need for the Commission to maintain the application of the framework until the end of its validity.

This important information will be used to assess the effectiveness and market impact of the measures contained in the temporary framework. It should be borne in mind that the Commission, on the basis of important competition policy or economic considerations and after consulting Member States, can review the temporary framework before the established deadline. In view of the speed with which recent developments have unfolded, this possibility cannot be completely ruled out.

On the other hand, Member States must provide detailed data on the environmental benefits of the subsidised loans for green products. As mentioned before, this request is justified by the need to ensure a positive impact on the environmental objectives proportional to the potential distortion created by the subsidised green products.

Member States are also required to demonstrate that only those companies that were not in difficulty on 1 July 2008 ([18]) have benefited from the framework.

Of course, all the aid measures contained in the temporary framework need to be notified to the Commission, including the compatible limited amount of aid amounting to €500 000. To this end, the Commission has put in place specific arrangements to ensure the swift adoption of decisions as long as complete and clear notifications are submitted.

5. Concluding remarks

We can already conclude, just a few months after its adoption, that the temporary framework has been welcomed by the Member States. The great number of notifications received, as well as the number of decisions already adopted, can only confirm the above. At this stage, the following schemes ([19]) have been put in place on the basis of the framework:

- 8 schemes for aid of up to €500 000 per company proposed by Germany, France, Latvia Luxembourg, Hungary, Portugal,the United Kingdom and Austria;
- 4 schemes for interest-rate subsidies in Germany, Hungary and France;
- 3 risk-capital schemes in Germany, France and Austria;
- 3 schemes offering reduced-interest loans to businesses investing in the production of green products in France, the United Kingdom and Spain;
- 6 guarantee measures in Belgium, Germany, France, Luxembourg, Hungary and the United Kingdom.

([18]) For the limited amount of compatible aid, aid in the form of guarantees, aid in form of interest-rate subsidies and aid for the production of green products.

([19]) Data taken from the Spring 2009 update: COM(2009) 164, 08.04.2009, Special edition on State aid interventions in the current financial and economic crisis.

The significant use of the framework shows that the Commission has provided Member States with a useful tool to face the impact of the crisis on the real economy. It clearly constitutes an additional instrument to secure credit flows to firms.

Almost all Member States have adopted comprehensive fiscal, monetary and structural measures to combat the crisis in the short term. The temporary framework provides also the opportunity of encouraging investments in the future, in particular via subsidised loans for the production of green products.

The informal meeting of Heads of State or Government that took place on 1 March 2009 recognised that unblocking the flow of credit is crucial for the effectiveness of fiscal stimuli undertaken by Member States. Further, it expressed confidence in the Commission's role as guardian of the Treaty and stressed that protectionism is not the answer to the crisis.

We must not forget that the single market has been the motor of economic and social prosperity and job creation in the EU ([20]). Europe's successful economic recovery will depend on our ability to make the most of the benefits it brings ([21]).

The worldwide recession that we are facing constitutes a difficult test for State aid control policy. But, despite the current context, distortions of competition should be kept to an absolute minimum to avoid making the recovery of the European economy more difficult.

Member States should make the maximum possible use of the existing State aid possibilities for building confidence in the markets and getting the real economy back on track. The lessons to be learned from the crisis should allow Europe to come out of this recession even stronger. To quote Sir Winston Churchill: "*Difficulties mastered are opportunities won*".

([20]) The single market has raised EU prosperity by 2.15% of EU GDP year on year and added 2.75 million extra jobs between 1992 and 2006. Intra-EU trade relative to GDP rose by 30% between 1995 and 2005.

([21]) Communication for the spring European Council "Driving European recovery", 4.3.2009, COM(2009) 114 final.

Consumers at the heart of EU competition policy

John Madill and Adrien Mexis [1]

In her address at the dinner hosted by BEUC (the European Consumers' Organisation) in Strasbourg on 22 April 2008, Neelie Kroes, the Commissioner for Competition, stated that "Defending consumers' interests is at the heart of the Commission's competition policy. In concrete terms: competition gives citizens better goods and services, and ensures businesses have more opportunities to sell them."

This statement reflected the importance of competition policy to consumers, and the importance of consumer welfare when implementing competition policy. Consumers are in most cases the final beneficiaries from strong enforcement of competition rules. They will also be the ultimate losers from any lack of competition since this will mean increased costs, less choice or lower service quality. For consumer products, in some cases a breach of the competition rules may affect them directly [2], and in other cases, an infringement of competition law may take place higher up in the supply chain for a particular product. This may concern either a component part of the end-product or a separate product or service used in the production of consumer goods [3]. For instance, machinery used in manufacturing a consumer product has to be purchased or hired by the manufacturing company. Anticompetitive behaviour may thus impact on the costs or quality of production of the final product, and can indirectly affect end-consumers.

Yet consumers are more than simply passive beneficiaries or victims of competition or market abuse. As highlighted in Commissioner Kroes' remarks, informed, educated and active consumers are the real drivers behind a competitive marketplace. It is ultimately their choices and purchasing decisions at the end of the supply chain that drive a market's requirements and needs upstream, and it is these choices made by consumers that enable businesses to decide on where to focus investment and innovation in order to be successful. Where the benefits of this investment, innovation and any resulting efficiencies are passed on to end-consumers it further empowers them to exercise informed choice, building a virtuous circle and a strong economy.

It is important, therefore, that the thinking behind European competition policy is underpinned by an understanding of the needs and welfare of consumers. It is equally important that consumers feel they are able to engage with the issues raised by competition policy and enforcement. Therefore, in the process of prioritising cases, focusing resources on those cases where there is an effect on the market downstream represents good practice not only from a competition law perspective, but also in terms of the use of taxpayer's money and the punitive and deterrent value of fines. This applies in particular to cartels, which by their nature restrict the products available and/or drive prices upwards. The Commission therefore fines undertakings that engage in such behaviour.

The fact that consumers and other customers on the downstream market are most likely to suffer harm as a result of a breach of competition law also drove the thinking behind the White Paper on **damages actions** [4]. One of the key proposals in the White Paper is that consumers be given easier access to redress through representative actions — allowing designated consumer bodies to bring actions for damages on behalf of groups of consumers. This reflects the fact that if the total loss to consumers may be high but individual losses are comparatively low, the costs and risks of bringing individual actions may be prohibitive.

In all cases, including abuses of a dominant position or agreements which restrict competition (but are not cartels), the Commission can identify the effect of a particular form of behaviour on consumers, and may **seek commitments or remedies** in the place of, or in addition to, fines. The purpose of such remedies is to ensure that a market can be returned to a fully competitive state operating in the consumer interest. The Commission also uses commitments and remedies in its merger control work, anticipating the effect of any merger on competition and enabling parties to take appropriate steps to allow mergers to continue in a way that does not impede competition. Although the Commission can block mergers where they are clearly not in the interests of competition and consumer welfare, in most cases competition can be enhanced by allowing the merger with certain limitations – for instance by requiring the merged entity to sell on all or part of a

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.
(2) E.g. Bananas (Press Release IP/08/1509, 15.10.2008)
(3) E.g. Car Glass (Press Release IP/08/1685, 12.11.2008); Fasteners (Press Release IP/07/1362, 19.9.2007)

(4) Press Release IP/08/515, 3.4.2008.

business controlled by one or more of the merging parties [5].

In order to effectively assess consumer welfare, and to prioritise those markets where there is a clear downstream effect on consumers, it is vital that the Commission should "think consumer", by working with consumers and their representative associations. To enhance this work 2008 saw the creation of a dedicated Consumer Liaison Unit. The Unit is building on the work of the Consumer Liaison Officer by deepening relationships and dialogue with European and national consumer organisations, providing simpler and clearer information and links to information of greatest relevance for citizens/consumers and improving the points of contact with the European Commission for consumers regarding competition issues.

Consumers and their representatives are able to bring helpful information about potential market failure to the Commission's attention. Consumer input is also an important asset in understanding markets, as consumers and their representatives are best placed to explain directly how they perceive the impact of a particular action. Such input has been requested and used by the Commission in antitrust cases [6], in sector inquiries and on policy issues (e.g. the pharmaceutical sector inquiry [7], policy consultations such as the White Paper on damages actions and the review of Article 82 [8] or the reflection on a regulatory strategy to promote very high speed Internet [9]) and frequently in a number of merger cases. By understanding the consumer viewpoint, the Commission is better able to place all aspects of the market or issue in context when identifying issues and remedies.

When combined, we are confident that the Commission's continued engagement with and focus on consumers will ensure that competition policy is of relevance to citizens and to consumers. We will also be better equipped to respond to feedback, both on the work that the Commission is doing and on the perception of that work. Building on this feedback will serve as a good basis for further developments in competition policy and communication regarding competition issues.

(5) E.g. REWE/ADEG (Press Release IP/08/995, 23.6.2008); StatoilHydro/Jet Scandinavia (Press Release IP/08/1556, 21.10.2008)

(6) E.g. Intel (Press release IP/09/745, 13.5.2009), Rambus (MEMO/09/273, 12.5.2009)

(7) Press release IP/08/1829, 28.11.2008

(8) Press Release IP/08/1877, 3.12.2008

(9) Press Release IP/09/909, 12.6.2009

Preliminary results of Commission pharmaceutical sector inquiry raise competition concerns

Elena Kamilarova, Fabio Domanico and Alexander Riedl [1]

On 28 November 2008, the Commission presented the preliminary findings of its sector inquiry into pharmaceuticals. The report [2] shows that originator companies engage in practices that can contribute to delayed generic entry. The report also states that originator companies use patent strategies aimed at blocking or delaying the development of novel medicines by competitors. This article explains the rationale for launching the sector inquiry and presents the preliminary findings.

1. Context

The pharmaceutical sector is essential for the health of Europe's citizens, who need access to innovative, safe and affordable medicines. A lot of money is at stake: each European consumer paid almost €430 for medicines in 2007 and this amount will continue to increase as the population in Europe ages. The pharmaceutical sector is also important in terms of economic growth and sustainable employment. For instance, in 2007 the market for prescription and non-prescription medicines for human use in the EU was worth over €138 billion ex factory and €214 billion at retail prices. The sector employs more than 630 000 people in Europe. Most importantly, innovation in human medicines has enabled patients to benefit from treatments that were unimaginable a few decades ago.

2. Launch of the inquiry

Given the importance of a well-functioning pharmaceutical sector, the Commission launched a sector inquiry into pharmaceuticals on 15 January 2008. [3] The inquiry was initiated in response to signs that competition in the pharmaceutical market in the European Union may not be working well. This was indicated by a decline in innovation measured by the decreasing number of novel medicines reaching the market each year and by instances of delayed market entry of generic medicines. The inquiry sought to examine whether certain practices of pharmaceutical companies may be among the reasons for the generic delay and the decline in innovation. The inquiry focused in particular on those practices which originator companies may use to block or delay generic competition as well as to block or delay the development of competing originator products. As the industry is strongly regulated, the sector inquiry also collected comments from stakeholders on perceived shortcomings in the (implementation of the) regulatory framework.

In the course of the investigation, the Commission consulted widely with stakeholders such as industry associations, representatives of consumers and patients, insurance companies, associations of doctors, pharmacists and hospitals, the European Patent Office (EPO) and national patent offices, and national competition authorities. The Commission also carried out upfront inspections. Finally, the Commission gathered data on the basis of requests for information sent to over 100 pharmaceutical companies active in the EU as well as to various other stakeholders. The data relate to a sample of 219 substances used in prescription medicines for human use, which were sold in the EU in the period 2000 to 2007.

3. The preliminary findings

The Commission presented its preliminary findings at a public hearing on 28 November in Brussels. The preliminary report confirmed that there are delays in generic entry and a decline in innovation, and examined some of the possible causes, most prominently those stemming from company behaviour. The preliminary report confirms the key role of patent rights for the pharmaceutical sector as they allow companies to recoup their considerable upfront investments and to be rewarded for their innovative efforts. It does not identify individual cases of wrongdoing or offer any guidance on the compatibility of the practices examined with the EC competition rules. It provides the Commission with a factual basis for deciding whether further action is needed and what form it should take. The key pre-

(1) The authors wish to thank Alexander Gee and Sean Greenaway for their valuable comments. The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) The full text of the preliminary report is available on the DG Competition website: http://ec.europa.eu/competition/sectors/pharmaceuticals/inquiry/index.html. See also Press Release IP/08/1829 and MEMO/08/746.

(3) Commission Decision of 15 January 2008 initiating an inquiry into the pharmaceutical sector pursuant to Article 17 of Council Regulation (EC) No 1/2003 (Case No COMP/D2/39.514); see also Press Release IP/08/49 and the article *Commission launches sector inquiry into pharmaceuticals* by M. Alfaro Murcia, P. Gasparon, S. Larsen, H. Mische and B. Van Barlingen, Competition Policy Newsletter, Number 1/2008.

liminary findings of the sector inquiry with regard to the issues investigated can be summarised as follows:

3.1 Competition between originator companies and generic companies

Impact of generic entry

The sector inquiry confirmed that in many instances generic entry takes place later than could be expected. For a sample of medicines facing loss of exclusivity in the period 2000 to 2007, the average time to enter after loss of exclusivity was about seven months on a weighted average basis and still about four months for the most valuable medicines. On average, price levels for (originator and generic) medicines in the sample facing loss of exclusivity in the period 2000 to 2007 decreased by nearly 20% one year after the first generic entry, and about 25% after two years. Generic prices decreased significantly below these price levels.

On the basis of a narrower sample of medicines representing an aggregate post-expiry expenditure of about €50 billion in the period 2000 to 2007 in 17 Member States, the preliminary report estimates that generic entry brought savings of €14 billion. However, the savings from generic entry could have been about €3 billion more, representing a further saving of over 5% of total expenditure, if generic entry had taken place immediately after loss of exclusivity. This is a conservative estimate as certain effects (such as volumes) could not be considered.

A "tool-box" of instruments

The preliminary findings indicate that originator companies design and implement a variety of strategies (a "tool-box") in order to ensure continued revenue streams from their medicines. The successful implementation of these strategies may have the effect of delaying or blocking generic entry. The preliminary report underlines, however, that company behaviour may not be the only cause for the delay of generic entry on the market.

Patent clusters

A strategy commonly applied by originator companies is to extend the breadth and duration of patent protection by filing numerous patents for the same molecule, forming so-called "patent clusters". In some cases, individual blockbuster medicines are protected by up to 1 300 patents and pending patent applications in the EU, leading to uncertainty for generic companies seeking to enter the market without infringing an originator company's patents or patent applications. In the period 2000 to 2007, originator companies also engaged in nearly 700 cases of patent litigation with generic companies in relation to the sample of products investigated. Generic companies won 62% of all cases where a final judgment was taken but it took on average 2.8 years for a final judgment to be reached by court.

Patent opposition procedures

The preliminary findings confirm that the opposition rate (i.e. the number of oppositions filed per 100 granted patents) before the European Patent Office (EPO) is consistently higher in the closest available proxy for the pharmaceutical sector than it is in organic chemistry and in all sectors (overall EPO average). Based on the sample investigated, generic companies almost exclusively opposed secondary patents. They prevailed in approximately 75% of final decisions rendered by the EPO (including the Boards of Appeal) during 2000 to 2007, either by achieving the revocation of the patent or by having its scope restricted. Even though generic companies are very successful in opposing originator companies' secondary patents, approximately 80% of the final decisions took more than two years to obtain. The duration of opposition procedures (including appeal procedures) considerably limits the generic companies' ability to clarify the patent situation of potential generic products in a timely manner.

Patent settlements

The sector inquiry also found that, between 2000 and 2008, more than 200 patent settlement agreements were concluded between originator and generic companies in the EU, with nearly half (48%) restricting the ability of the generic company to market its medicine. 45 settlements contained — in addition to the restriction — a value transfer from the originator company to the generic company, with direct payments to generic companies alone amounting to more than €200 million.

Intervention at regulatory bodies

Originator companies also intervened before national marketing authorisation and pricing and reimbursement authorities to call into question the quality or safety of generic products or to claim that the commercialisation of these products would violate their patent rights. Although originator companies were successful in challenging the decisions of national authorities in court in a limited number of cases, such interventions resulted in additional delays for the entry of generic products onto the market.

Life cycle strategies for follow-on products

Originator companies launched second generation ("follow-on") products for 40% of the medicines in the sample under investigation when they faced loss of exclusivity between 2000 and 2007, and undertook intensive marketing efforts with the aim of switching their patients to the new medicine prior to the market entry of a generic version of their first generation product. Patents on second generation products are sometimes criticised as weak by other stakeholders for showing only a marginal improvement for the patient and limited innovation (if any). Originator companies, on the other hand, argue that incremental innovation deserves adequate protection through patent rights. In many instances, originator companies used two or more instruments from the "tool-box" in parallel and/or successively in order to protect the revenue streams from their (best-selling) medicines.

3.2 Competition between originator companies

Patent strategies

As regards competition between originator companies, the preliminary findings of the sector inquiry show that originator companies engaged in so-called "defensive patent strategies". Originator companies used patents falling into this category primarily to block the development of new medicines by their competitors and not to bring a new/improved medicine to the market. The sector inquiry also found at least 1 100 instances across the EU of overlaps between an originator company's patents relating to a medicine in the sample under investigation and the R&D programme and/or patents held by another originator company for its medicines. These overlaps create significant potential for originator companies to find their research activities blocked, with detrimental effects on the innovation process.

Patent-related exchanges, disputes, litigation and oppositions

In many cases originator companies tried to settle potential disputes, for instance through licensing. However, in approximately 20% of the cases where a licence was requested the patent holder refused to grant it. Between 2000 and 2007 originator companies engaged in litigation against other originator companies in 66 cases concerning 18 different medicines in the sample under investigation. In 64% of the cases, litigation was concluded by means of a settlement agreement. The patent holders lost the majority (77%) of cases where final judgments were given (13). The preliminary findings also showed that, between 2000 and 2007, originator companies mainly challenged each other's secondary patents. The applicant originator companies were very successful when challenging the patents of other originator companies. During that period, they prevailed in approximately 89% of final decisions rendered by the EPO (including the Boards of Appeal).

3.3 Comments on the regulatory framework

The pharmaceutical sector is highly regulated. In view of the importance of the regulatory framework for all actors, the Commission also collected comments on the regulatory framework applicable to the pharmaceutical sector. Stakeholders reported several perceived difficulties and shortcomings in relation to market entry due to the regulatory framework. As regards possible remedies, generic companies and originator companies agree on the need for a single Community patent and a unified and specialised patent judiciary in Europe. Stakeholders also highlighted certain concerns in relation to marketing authorisation and pricing and reimbursement procedures, which may contribute to delays in bringing pharmaceutical products to market.

4. Next steps

Based on a vast amount of empirical data, a large part of which had never been gathered before at a similar level of detail and accuracy, the preliminary report gives an in-depth analysis of company practices in the pharmaceutical sector. These practices can block or delay generic entry or the development of novel medicines by competitors.

On 8 July 2009, the Commission published the final report of the pharmaceutical sector inquiry, which takes into account the comments received during the public consultation. An article reviewing the findings of the final report will be published in the third edition of the Competition Policy Newsletter for 2009.

Finding the appropriate response for competitive Next Generation Access networks — Results of the first notifications under the Article 7 consultation procedure (1)

Olivier Bringer, Iratxe Gurpegui (2)

1. The challenge of ensuring a competitive transition to NGA

The current first generation broadband is provided over the copper wires which have been used for fixed telephony since the 19th century, or over the coaxial cable of cable TV operators. It has allowed the development of multiple-play offers, bundling the provision of Internet access with voice and television. Copper and coaxial wires are, however, insufficient to carry the higher guaranteed throughput required for new broadband consumption schemes, including multiple broadband access per household and new applications such as interactive applications or High-Definition Television (HDTV). To provide such services it is necessary to connect the end-users by optical fibre. Partly because of the increased competition on the market, several operators have started to undertake significant investments in new fibre-based access networks, referred to as Next Generation Access (NGA) networks.

The transition to NGA represents both an opportunity and a risk for broadband competition. Entrants depend today on regulated access to the incumbent's copper network, which limits their capacity to compete on price and services. Entrants who invest in their own fibre access networks could compete more aggressively on the market. On the other hand, not all operators are on an equal footing when it comes to undertaking investment in NGA. Incumbents are better off. They own nearly all the civil engineering infrastructure where fibre can be rolled out, which represents more than two thirds of the total investment necessary to deploy NGA. They usually hold the largest share of national retail broadband markets and benefit from unmatched economies of scale and scope. It is therefore easier for them to reach the break-even point when investing in NGA. In this context, there is a risk that incumbents might try to leverage their advantage as first movers in the provision of high-speed broadband services and as owners of the NGA infrastructure to exclude entrants from the broadband market.

As a matter of principle, competition law is the proper tool to ensure a level playing field in markets open to competition. However, in the sector of electronic communications ex ante regulation is a necessary adjunct to competition law. Incumbent operators are required to provide access to their networks, which cannot be duplicated in a reasonable time period. Such access regulation is indispensable to allow market entry, ensure consumer choice and avoid distortions of competition.

The current EU regulatory framework is based on the competition law concept of market definition. In its revised version of the Recommendation on relevant markets (3), the Commission has defined two wholesale broadband markets (market 4 for wholesale (physical) network infrastructure access and market 5 for wholesale broadband access), which the national regulatory authorities (NRAs) are required to analyse. Both market definitions are technology-neutral. Given that the same services can be provided over fibre as over copper, NRAs must include fibre-based networks in their analysis of wholesale broadband markets as long as they do not show the existence of a break in the chain of substitution. They may impose access obligations regarding new fibre loops or the underlying civil engineering infrastructure, in addition to access obligations already imposed on the copper access network.

However, contrary to legacy telecoms infrastructure, NGAs remain for the most part to be deployed and regulators have to consider the dynamics of network investment when they impose access obligations. Given the high level of investment required and the uncertainty as to demand take-up, NGA investments are generally considered to be risky. When designing NGA access obligations NRAs need therefore to give investors sufficient certainty that regulation will not jeopardise their ability to recoup their investment but also to make sure that at the same time existing competition is not being prevented.

(1) Article 7 of 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 (Framework Directive), OJ L 108, 24.4.2002, p. 33.

(2) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(3) Commission Recommendation 2007/879/EC of 17 December 2007 on relevant product and service markets 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 communications networks and services, OJ L 344, 28.12.2007, p. 65.

So far, NRAs have developed different regulatory approaches according to national market conditions and, more importantly, according to how they balance the two policy objectives of promoting investment on the one hand and safeguarding competition on the other. This article explores some of the measures notified to the Commission under the Community consultation mechanism (the so-called Article 7 procedure) and looks in particular into the key issues of the inclusion of fibre in the wholesale broadband markets, the choice of a proportional set of access remedies, the rules for the transition from copper to fibre access and the pricing of NGA access.

2. Regulatory measures notified by EU Member States concerning NGAs

In a number of Member States, NGAs remain in a development phase and were not considered in detail in the previous analyses of the wholesale broadband markets. However, in several Member States NGAs have been deployed on a larger scale in recent years and NRAs have notified measures dealing specifically with the issue of access to NGAs (4). The scope and progress of the deployment, the nature of the networks deployed (5), the deployment strategies of the market players vary between Member States. Regulatory responses take into account such specific circumstances. However, disregarding national differences, the fact is that different strategies have been pursued by national regulators, which has led to different competitive and investment prospects. On each occasion, the Commission provided observations on the national reviews of markets 4 and 5 and requested that certain decisions be amended when the analysis did not follow the principles of competition law or when the remedies proposed were not proportionate to the objectives of the regulatory framework.

2.1. The inclusion of fibre in the wholesale broadband markets

Most NRAs confronted with large-scale development of fibre access networks have concluded that fibre-based networks are included in market 4. NRAs have reached this conclusion because of current demand substitution between access to both copper and fibre networks (6). They have also, like the Finnish NRA, considered the topology and architecture of the newly built NGA and the fact that it allows the unbundling of fibre local loops. In contrast, the Spanish NRA, CMT, decided not to include fibre in market 4 on the ground that the point-to-multipoint NGA network which is being rolled out by the incumbent in Spain could not presumably be technically unbundled.

The French NRA, ARCEP, in addition to including fibre networks in market 4, also included access to civil works infrastructure (7). The Commission invited ARCEP to further justify such inclusion and stressed that access to civil works infrastructure was considered an appropriate remedy in relation to market 4, which could be imposed without the inclusion of civil works infrastructure in the relevant market.

As regards the analysis of market 5, most NRAs have included fibre in the definition of the relevant market in view of the limited differences between DSL copper-based broadband services and fibre-based high-speed broadband services at the retail level. Until now, NGAs only offer better quality broadband access services, mainly in terms of speed and symmetry, but not differentiated retail broadband products.

Moving away from the general trend, the German regulator proposed not to include access to hybrid fibre-copper loops (FTTN) on the ground that services provided over them were distinct from the services provided over copper loops (8). Accordingly, the German regulator proposed not to regulate wholesale broadband access to the FTTN network. The Commission has clearly rebutted such an approach. In the absence of evidence showing a break in the chain of substitution between products provided over copper and FTTN loops, the Commission stressed the need to regulate access to both types of networks. The German NRA reviewed its market analysis, included FTTN-based services in the relevant market and regulated access to the fibre loops.

(4) This concerns in particular Germany (cases DE/2005/262, DE/2006/457, DE/2007/646), Belgium (BE/2008/801), France (FR/2008/780 and 781), Spain (ES/2008/805 and 806), the Netherlands (NL/2008/826 and 827), Finland (FI/2008/0839) and Portugal (PT/2008/850 and 851). http://circa.europa.eu/Public/irc/infso/ecctf/library

(5) Fibre can be rolled out up to the customer's premises (Fibre To The Home, FTTH) or up to an intermediary distribution point (Fibre To The Node, FTTN) from where it is connected to the end-user via an existing copper or coaxial sub-loop. When fibre is rolled out up to the home, one fibre can be rolled out to each end-user (Point-to-Point network) or can be shared between several end-users (Point-to-Multipoint network).

(6) For example OPTA in the Netherlands considers that fibre and copper are part of the same market because the pricing of services over copper will constrain the pricing of services over fibre. Consumers will not take up new fibre-based services if the price difference with copper-based services is too large.

(7) Civil engineering typically refers to under- or above-ground assets such as ducts, sub-ducts, manholes and poles.

(8) VDSL, the DSL service provided over hybrid fibre-copper loops, allows bandwidths up to 50 megabits per second (Mbps) downstream while basic DSL services are capped at a few Mbps.

Along the same lines, the Commission expressed serious doubts on the proposal of the Spanish regulator to exclude wholesale broadband access at speeds above 30 Megabits per second (Mbps) from the relevant product market. While the CMT considered that, given uncertainties surrounding the substitutability pattern at both the retail and wholesale level, speeds above 30 Mbps should be excluded from the market, the Commission stressed that in the absence of detailed factual information and a sound substitutability analysis it was not possible to draw such a conclusion. Rather the Commission noted that there seemed to be a general trend towards higher speeds in Spain and that limiting the market to speeds below 30 Mbps was artificial. The CMT eventually withdrew the speed limit from its market definition, although as explained below it maintained the distinction in terms of the access remedy applied.

Below we explain that, despite having included fibre in market 5, not all NRAs have imposed a bitstream access [9] offer over fibre and those NRAs that have regulated such a wholesale product have regulated a limited form of it.

2.2. The choice of a proportionate set of NGA access remedies

As to access obligations, some NRAs have mandated access to the incumbent's civil engineering infrastructure to foster the roll-out of alternative fibre networks. The French and Portuguese NRAs have mandated a detailed set of access obligations (specifying processes for ducts access, monitoring compliance with such processes, ordering that a complete reference offer is put in place), while other NRAs have specified only very general obligations [10]. The Commission has observed in this regard that past and current regulatory experience, most notably in the field of LLU, has shown that a proper reference offer and stringent price control obligations are key for the access to a bottleneck input to become effective and for competition to develop.

Access to civil engineering allows competition at the lowest level of the value chain (fibre network replication). In the absence of ducts or prospects for sustainable infrastructure-based competition, some NRAs, like the Dutch and the Finnish NRAs, have imposed wholesale unbundled access to the fibre loops of the incumbent. Operators willing to compete in the high-speed retail broadband market can roll out their own fibre in the existing civil engineering or up to the fibre loops and bear the risk of the fibre investment. However, operators may not be in a position to run that risk, especially in less densely populated areas where they cannot make any economies of scale, in particular if the incumbent has already rolled out its own fibre to the relevant customers. Network competition may therefore be limited to the very dense geographic areas, where there is a business case to roll out parallel fibre networks.

For this reason, some NRAs have chosen to regulate active forms of access (bitstream) as a result of their analysis of market 5. Most NRAs have, however, chosen not to impose full-scale fibre-based bitstream remedies. Given lower level remedies (civil engineering or access to the fibre loop) and the early stage of NGA development, NRAs have generally considered it would not be proportional with the objective of encouraging efficient investment to impose full bitstream access from the start. The French NRA, despite including fibre in market 5, did not regulate fibre-based bitstream. In the Netherlands, the NRA provided only a limited fibre-based bitstream product (concerning high-quality business-grade broadband products). The Spanish NRA regulated fibre-based bitstream only for speeds up to 30 Mbps.

In the Dutch case, where the prospect of infrastructure-based competition appeared to be strong, the Commission invited the NRA to closely monitor market developments and to extend the proposed bitstream access to fibre networks if fibre unbundling turned out to be insufficient to ensure competition. In contrast, the Commission was of the view that the prospects for infrastructure-based competition did not appear so strong in Spain [11]. In particular, the Commission stressed the fact that it was not foreseeable that entrants could match the large-scale fibre deployments of the incumbent in the near future, which represented a risk that with a fibre-based wholesale broadband access product which is limited in speed the incumbent could preempt the market for retail broadband services during the period in which the deployment of fibre was taking up in Spain. Accordingly the Commission urged the CMT to reconsider imposing fibre-based bitstream also for speeds above 30Mbps.

(9) The bitstream service may be defined as the provision of transmission capacity (upward/downward channels may be asymmetric) between an end-user connected to a telephone connection and the point of interconnection available to the new entrant.

(10) For example, the Spanish NRA has decided to regulate the minimum content of the terms under which incumbents should provide access to civil engineering works and let the operators negotiate the rest of the conditions.

(11) The Commission indicated to the Spanish NRA that there was neither a complete reference offer nor a price obligation for access to the civil engineering infrastructure. Moreover, even if access to the physical infrastructure of the incumbent turned out to be an effective remedy, it might take considerable time for operators to roll out their own networks in Spain.

2.3. The rules for the transition from copper to fibre access

Where alternative operators are unbundling the copper network of the incumbent, their access could be discontinued when incumbent operators start decommissioning the access points to the copper network as they roll out their fibre networks. Some NRAs have stipulated a migration process to allow alternative operators to adjust their own networks and network extension plans accordingly. The Dutch, Belgian and Spanish NRAs have adopted specific rules for this purpose. The BIPT, the Belgian NRA, has adopted one of the most detailed sets of rules for migration ([12]).

Precise migration rules are important to avoid stranded investments that would harm the business plan of alternative operators and their confidence in the regulatory process. Absent such rules the capacity of alternative operators to stay in the market and continue investing in the NGA context could be severely undermined to the detriment of the competitive process.

2.4. The pricing of NGA access

As to the regulated prices for accessing the NGA networks, most NRAs have adopted the same regulation as that applied to prices for the unbundling of the copper local loop, namely cost orientation. Not all regulators have defined their price control methodology yet, but different approaches are already emerging.

Unlike most NRAs, the Finnish NRA does not impose cost orientation on the prices for unbundled access to the fibre loop. The reason for adopting such a decision is the early phase of the deployment of fibre in Finland and, presumably, the fact that a cost-orientation obligation could act as a deterrent for operators to take the risk of investing in NGA infrastructure. In Spain, the CMT imposes only a general obligation of cost orientation on access to ducts but does not fix the prices for access to the ducts of the incumbent. ANACOM in Portugal also establishes cost-oriented prices for access to ducts. ANACOM recognises that different duct characteristics may call for different access prices. This is the reason why the reference offer of Portugal Telecom distinguishes two geographic zones: Lisbon and Porto, where access to ducts is more expensive, and the rest of the country.

The most advanced pricing methodology was proposed by OPTA in the Netherlands. OPTA imposes cost-oriented prices for unbundled access to the fibre access network rolled out by Reggefibre, a joint venture in which the incumbent KPN holds 41% of the equity. The cost model proposed by OPTA includes geographic differentiation to reflect underlying construction costs and possible volume discounts applicable to all unbundled fibre takers per access point. But more importantly, OPTA is the first regulator to include a form of risk premium in the prices for unbundled access to the fibre loop by taking into account the remuneration expected by Reggefibre for the investment risk it takes.

The Commission has commented on the parameters of the cost model proposed by OPTA. While the Commission recognised that the business plan of Reggefibre is a good proxy to assess the risk of fibre infrastructure roll-out by an entrant company in a competitive environment, it stressed that this risk is, however, lower for an incumbent benefiting from a large customer base that it can migrate to the new fibre network, thus saving operating expenses when decommissioning the copper loops concerned. The Commission noted that the basic assumptions used by OPTA could therefore overestimate the risk of the relevant investment and invited OPTA to review the parameters of its model if KPN were to acquire the remaining shares in the joint venture.

3. The need for overall guidance: the Commission Recommendation on regulated access to NGA

Swift and competitive development of NGA will bring major benefits to the European economy as a whole. NGA networks will bring innovative broadband and content services to end-users and offer large growth opportunities to European businesses ([13]). Because it will underpin long-term sustainable growth but also create immediate jobs for infrastructure deployment, investment in broadband networks is considered key to fight back the current economic downturn and support a quicker and steady recovery of the European economy.

([12]) The BIPT has established that if the incumbent decided to close down an access point to a local loop or sub-loop, it would have to leave it open for the beneficiaries of its unbundling offer for at least five years after the announcement to the NRA. A deviation from that period should be possible on the basis of a bilateral agreement with the operators concerned. The BIPT also obliged the incumbent operator to provide for migration to a suitable alternative solution before the discontinuation of the service.

([13]) As recognised in the European Economic Recovery Plan (Communication from the Commission to the European Council: A European Economic Recovery Plan. Brussels, 26.11.2008. COM(2008) 800.1): "*High-speed Internet connections promote rapid technology diffusion, which in turn creates demand for innovative products and services. Equipping Europe with this modern infrastructure is as important as building the railways in the nineteenth century.*"

To ensure investments in fibre, a predictable and consistent regulatory environment throughout the EU is required. National regulators have started regulating access to NGA and the Commission has provided guidance on a case-by-case basis. However, as shown in this overview, investors remain confronted with a patchwork of national approaches. As a consequence, the Commission is now working on a Recommendation which would define common principles to be followed by the NRAs when mandating access to NGA. The Recommendation will provide guidance on how fibre access remedies should be designed and implemented to ensure effective competition and consumer choice while fostering efficient investment in infrastructure. The level of access to be granted to the NGA infrastructure of the dominant operator, the price control mechanism, including risk sharing, and the rules for migrating certain facilities, such as the decommissioning of local exchanges, will be among the key topics the Recommendation will provide guidance upon.

The NGA Recommendation together with close follow-up and cooperation with national regulators under the Article 7 procedure will provide the right framework to support the move to self-sustaining broadband competition while increasing regulatory certainty for market players across the EU and will help to foster investment in fibre.

Single Euro Payments Area (SEPA): Self-regulation under competition scrutiny

Jean Allix, Dominique Forest, Dovile Vaigauskaite

In the current situation retail banking remains an important sub-sector of the banking industry: the crisis has shown that solid and sound retail business allows banks to weather the present difficult circumstances much better. Payments are a particularly important business segment for banks. They ensure a recurrent revenue flow, which in the current market circumstances is vital. Payments are also vital for consumers and corporate clients, and investment in their efficiency and security can be used as a good customer-winning tool. Efficient and secure payments can facilitate an increase in trade and consumer spending, as well as help to bring down systemic risk in the financial markets. Non-cash payments are the main growth drivers for retail banking: according to a Capgemini report, the total number of non-cash payments in the EU grew by 6% per year in the period 2001-2006, (1) with a rate of 11% for cards alone. It is estimated that card usage will continue growing rapidly in the future, with the increasing number of merchants accepting payment cards together with the increasing availability of different card products. By 2013, in Italy, Sweden and Denmark for example, payments made by cards will constitute just over 60% of all non-cash transactions. In France, Spain, Belgium, the Netherlands, Portugal, UK and Poland this will amount to 40-50% and in Germany and Austria to approximately 20%. (2)

SEPA — a self-regulatory initiative of the European banking industry

The Single Euro Payments Area (SEPA), set up by the European banking industry and supported by the European institutions, is probably the most ambitious project aimed at creating a truly European payments market since the introduction of the euro. Its objective is the creation of an area of efficient non-cash payments *in euros* covering 31 countries. (3) Once implemented, SEPA will result in an integrated euro payments area, ensuring that cross-border payments become as easy and efficient as domestic payments. For the time being SEPA covers credit transfers, payment cards and direct debit, and is expected to enhance competition by removing national barriers, thus increasing competition. Efficiency gains are also to be expected from the integration of the payment infrastructures.

SEPA is set up and implemented by the European Payments Council (EPC), an association of banks and banking associations representing the European banking industry. (4) The SEPA schemes developed by the EPC for credit, direct debit and payment card transactions in euros lay down sets of interbank rules and standards that have to be observed when executing "SEPA compliant" payment transactions. The schemes provide a common understanding between banks and payment services providers on how to move funds from one account to another within the SEPA area. The EPC is responsible for the development and maintenance of the SEPA payment schemes as defined in the Rulebooks published by the EPC itself.

Although SEPA is a self-regulatory project of the European banking industry, its legal framework is to a large extent predetermined by two important pieces of Community legislation: the Payment Services Directive, or "PSD" (Directive 2007/64/EC (5)) aims to establish a modern and comprehensive set of rules applicable to all payment services in the European Union and to improve competition by opening up payment markets to new entrants, so-called payment services providers. Regulation (EC) No 2560/2001 on cross-border payments in euro (6) eliminates the difference in price between cross-border and national payments, thereby creating a "domestic payment area" for euro payments in the EU.

SEPA is strongly supported by the ECB and the Commission. SEPA will make a significant contribution to the Lisbon agenda: it will improve the efficiency of EU payment markets and stimulate innovation, thereby increasing the competitiveness of the European economy. In the public sector, SEPA could be used as a platform to drive e-government, thus contributing to the efficient delivery of public services.

However, in order to reach its goals and effectively deliver the envisaged benefits to businesses and consumers, SEPA needs to be implemented in accordance with competition rules and the existing Community framework for payment services. Since

(1) World Payments Report 2008, Capgemini, p. 5.
(2) Ibid., p. 23.
(3) The 27 Member States of the European Union plus Switzerland, Norway, Iceland and Liechtenstein.
(4) At the end of 2008, the EPC had 74 members, either individual banks or banking associations.
(5) OJ L 319, 5.12.2007, p. 1.
(6) OJ L 344, 28.12.2001, p. 13.

SEPA is based on decisions of and agreements between undertakings that are (potential) competitors, it merits close competition scrutiny. Also, decisions taken by the association of banks have an important impact on users. A payment concerns not only a (contractual) relationship between banks but also a (contractual) relationship between two users, the payer and the payee, and their respective banks. The rules decided by the association of undertakings directly affect these users, which is another reason for the competition authorities to be interested.

In an informal but detailed analysis, experts from DG COMP and national competition authorities (NCAs) jointly identified competition concerns and raised a number of questions with regard to the implementation of SEPA. In view of the exceptional character of the project and its important potential consequences for European companies and consumers it was decided to address these concerns in an informal dialogue with the EPC which started in October 2007. Given their close interest and involvement in the SEPA project, the European Central Bank and DG Internal Market were involved closely in the dialogue.

The dialogue between the EPC and the European Commission

SEPA Cards Framework

Whereas for credit and direct debit transfers the EPC has set up two brand new pan-European schemes, in the field of cards its choice has been to establish rules allowing different schemes to be competitors but technically compatible and interoperable. For example, any card terminal should be able to read all SEPA compliant cards. The first milestone in the dialogue was reached in December 2007 concerning the interpretation of the SEPA Cards Framework (SCF). The dialogue in particular addressed the interpretation of the concept of "SCF compliance", which was a priority for banks as they had to start making their card payments "SCF compliant" by 1 January 2008.

As a result of the dialogue, the SCF was clarified by the EPC, most importantly by explaining that SCF compliant card schemes do not need to cover all 31 states of the SEPA territory. [7] The only requirement for a scheme to be compliant with the SCF is that it must operate in such a way that there are no barriers to effective competition between issuers, acquirers and processors; for instance, there should be a pan-European licence, no discrimination in terms of licensing and pricing between domestic and cross-border transactions, and technical interoperability. Thus a scheme may only have acquiring banks in one or a number of Member States but can still be SCF compliant. Such a decision — i.e. whether to be active in only one or a number of Member States — should be based on an individual business case analysis by the respective banks: if a merchant located within SEPA wants to accept a card from the scheme, and acquirers are willing to offer the merchant such a service, then they must be allowed to do so. An obligation for a scheme to cover the whole of the SEPA territory in order to be SCF compliant might have caused banks and national banking associations to abandon cheap and efficient national systems (e.g. Bancontact/Mister Cash in Belgium) for one of the currently only two (more expensive) existing international schemes, i.e. Maestro or V-Pay (for debit cards) and MasterCard or Visa (for credit cards). On the basis of this clarification by the EPC, the geographic coverage will be decided by market forces alone, meaning that new schemes stand a real chance of entering the market. This in turn will encourage the creation of a competitive SEPA-wide payment cards market. As a result, there are to the Commission's knowledge currently three projects aimed at creating new pan-European card schemes.

Intensive discussions also took place during meetings running from May until June 2008, with a number of subsequent meetings following up. The dialogue is still ongoing in 2009, but can already be hailed as a success since the EPC was able to provide satisfactory clarifications on a number of the competition issues identified. For instance, the EPC clarified that national banking communities were not in a position to foreclose their market through national specifications (the so-called "Additional Options Services"). Rules and conditions governing access to schemes by payment institutions and equal treatment for payment institutions and banks under the SCF were also clarified.

Conclusion

The dialogue with the EPC on SEPA brought substantial clarifications to market players and other stakeholders in 2008, and is still on track in 2009. The momentum created in the earlier stages of the dialogue should help to tackle the remaining obstacles to the achievement of a truly competitive European payment cards market. Enhancing and strengthening the competition dimension of SEPA will in turn help to achieve better services at a better price for retailers and consumers.

(7) The EPC published Questions and Answers clarifying key aspects of compliance with the SCF on 26 June 2008. See http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=132

From the stable to the table: the Commission's coordinated approach to combating soaring food prices in Europe

María Aguado Ruiz, Alina Burea (1)

Global context: the creation of a food price bubble

Reversing the trend of three decades of low food inflation, 2006 marked the start of a steep upward course for the prices of a number of commodities. The price of nearly every agricultural commodity increased dramatically in the second half of 2007 and reached peak levels in the early months of 2008, creating a global food price bubble resulting in a worldwide food crisis. In terms of concrete figures, world agricultural commodity prices rose by 70% (in dollars) between September 2006 and February 2008. As a consequence, soaring food prices undermined food security and worsened the livelihoods of the most vulnerable households worldwide, eroding their already limited purchasing power.

The rising food prices were the result of the coincidence of several global factors and trends, some structural (rising demand from developing countries, increased use of feedstock to produce biofuels) and others temporary, ranging from droughts in key grain-producing regions, through low stocks of cereals and oilseeds, rapidly rising oil and energy prices to a high level of speculation, among others.

The situation in the EU: wide differences between Member States, sectors and households

In the EU, the food supply chain accounts for 6% of EU value added and 12% of EU employment. It brings together the agricultural sector, the food processing industry and the distribution sector. The role of the food sector for the European economy, as well as the importance of foodstuffs in the daily shopping baskets of European consumers, cannot therefore be overrated. The recent price hikes resulted in a rapid increase in consumer food prices, although they were transmitted to different a degree and pace at Member State level. The likely causes of such differences in pass-through across countries were linked to various factors such as differing infrastructure costs, domestic policies, and market structures. Wide differences in food pricing between Member States could thus be observed as a result.

Although in 2008 the prices of certain commodities started to decline, the unprecedented retail price hikes (and the absence of a downward consumer price trend) have raised important concerns regarding possible malfunctions of the European food supply chain. The competitive structure of food retail markets and the regulatory hurdles which market entrants may face have also been under the spotlight. Such potential malfunctions and legislative barriers have possibly affected the transmission mechanisms linking agricultural commodity prices with producer and consumer food prices.

Commission action and its implications for competition policy

In response to these concerns, the Commission has initiated a process aimed at providing both an immediate and a long-term response to the surge in food prices, so as to mitigate the impact that this trend has on final consumers.

The Communication on "**Tackling the challenge of rising food prices: Directions for EU action**" of May 2008 (2) set up a Task Force to examine the functioning of the food supply chain, including concentration and market segmentation of the food retail and distribution sectors in the EU. The Task Force produced a first report on the situation that was incorporated into a second Communication on "**Food Prices in Europe**" (3) adopted in December 2008, which proposed a roadmap to improve the functioning of the food supply chain.

From a **competition policy perspective**, the latter Communication calls for vigorous and coherent enforcement of competition rules in the food supply markets by both the Commission and national competition authorities. Underlying questions that arise in this context relate to the need to understand whether concentration in the food supply chain is more problematic than in other sectors, whether the food supply chain is prone to price stickiness and whether such alleged stickiness can be linked to competition shortcomings. The intrinsic concern of competition authorities throughout the EU is to ensure that consumers receive the full benefits of well-functioning markets in the food sector.

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) COM(2008) 321.

(3) COM(2008) 821.

In its December Communication, the Commission committed to pay particular attention to a number of specific practices that occur with relative frequency in food retail markets. Apart from hardcore restrictions on competition such as cartels and resale price maintenance, some practices have been singled out as potentially harmful for competition. Such practices, which may thus merit closer scrutiny, always on a case-by-case basis, relate to:

- buying alliances, which, under certain circumstances, can be used as a tool for foreclosing rivals' access to essential inputs or can relate to collusive behaviour on downstream markets;
- exclusive supply agreements and certification schemes, which can lead to foreclosure of competing buyers;
- single branding and tying obligations, which may possibly restrict in-store inter-brand competition/foreclose competing suppliers;
- the use of private labels, which may possibly foreclose competing brands.

On the basis of such reflection at Commission level, DG Competition will endeavour to deploy its advocacy, monitoring and enforcement efforts in order to ensure that the food supply chain functions optimally.

National expertise as a key asset in remedying shortcomings

Given that retail markets are often defined at most as national in scope, it is crucial for competition authorities throughout the EU to address potential malfunctioning within the food supply chain in a coherent and coordinated manner. To this end, in 2008, the European Competition Network (ECN) served as a forum for discussion and exchange of best practice on issues related to food retail markets. In this context, DG Competition organised two meetings of the ECN Food Subgroup in July and November 2008. National competition authorities have been very active and have closely scrutinised many food-related sectors, as well as initiating a number of investigations (e.g. the bakery sector in Italy, the olive oil sector in Spain) and inquiries (e.g. the Grocery Monitor in Ireland), to name just a few.

Outlook

Given the gravity of the global economic crisis, the pricing of foodstuffs is likely to remain high on the political agenda throughout 2009. In January, the United Nations issued a new statement warning of forthcoming food shortages worldwide and reminding governments and policy makers of the need to continue combating soaring food prices in the context of the current economic downturn.

At EU level, the work of the Commission Food Task Force will continue this year and will be reported to the Council in December. It will also feed into the forthcoming Review of the Single Market. In parallel, DG Competition will strive to deepen its knowledge of the markets' structure and practices in order to identify and remedy any possible breaches of competition rules. To this end, further sustained coordination within the ECN will also take place.

The use of pricing analysis for market definition purposes: the Arjowiggins/M-real Zanders Reflex and Arsenal/DSP mergers

Daniel Donath ([1])

Introduction

The Commission recently considered a number of transactions in which one of the main issues during the Phase II investigation was the delineation of the geographic market. These include COMP/M.4513 — *Arjowiggins/M-real Zanders Reflex*, COMP/M.4989 — *Älo/MX* and COMP/M.5153 — *Arsenal/DSP*. While the investigations in the first two transactions examined whether the national boundaries of EEA Member States circumscribe geographic markets, or whether there is a wider EEA market, the assessment of the third transaction hinged on a world- or EEA-wide geographic market definition. The distinction between national and EEA-wide or perhaps region-wide markets is becoming increasingly important, as twelve additional Member States have joined the EEA common market since May 2004. Any Commission decisions prior to 2004 delineating markets as EEA-wide should therefore no longer be relied on, as such analysis refers to the old EU-15 Member States. Moreover, the addition of twelve new Member States with their own specificities has further increased the level of heterogeneity, which was already high among the old fifteen Member States that previously formed the European Union. It thus seems useful to provide an overview of empirical techniques that lend themselves particularly well to the delineation of geographic markets. In particular, this article sets out an easy framework that relies on pricing analysis to examine how wide the geographic markets are and uses the Arjowiggins/M-real Zanders Reflex and Arsenal/DSP transactions as concrete examples. ([2]) It is important to note that although all of the above-mentioned cases entered into a Phase II investigation, the techniques in this paper are fairly straightforward and are thus particularly well suited for investigations during Phase I proceedings. ([3]) In addition, although the article concentrates on the delineation of geographic markets, the same framework can be used for product market definition. ([4])

The article is divided into four sections. The next section contains a brief overview of the relevant question that needs to be answered to delineate the markets and explains how pricing analysis can approximate the answer to this question. The third section surveys the statistical techniques that are used for pricing analysis. The types and sources of data that are needed to perform the analysis are discussed in the fourth section. Specific examples from the Arjowiggins and Arsenal transactions are discussed in the fifth section. In addition to offering some general conclusions, the last section also discusses other uses of the data that is collected for performing pricing analysis, and in particular how the additional information in these databases can be used to strengthen the findings from the pricing analysis.

The intuition behind geographic market definition

Market definition is based on the SSNIP test that examines whether a hypothetical monopolist would profitably and permanently increase prices by 5-10% in a given candidate market. The hypothetical monopolist test requires the Commission to start with the smallest possible candidate market and to see whether such market is a relevant market, or whether it is part of a wider market, to ensure that only the most important competitive constraints on the hypothetical monopolist are included in the relevant market.

Consider for example a transaction in which there are only two firms that produce a particular product in a given Member State, and these firms are undertaking a merger. The relevant question is thus whether the given Member State forms its own relevant market, or whether it is part of a wider (for example EEA-wide) market, as the firms would be merging to monopoly if the relevant geographic market was to be defined by national boundaries. Intuitively, we need to assess whether the merging

([1]) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the author.

([2]) Älo withdrew its notification of the Älo/MX transaction during the Phase II investigation, and so this case is not discussed any further.

([3]) For example, pricing analysis was already undertaken during the Phase I investigation of the Arsenal/DSP transaction. Pricing analysis was also used to delineate product markets in the Phase I investigation in COMP/M.5190 — *Nordic Capital/Convatec* (see Recitals 27 to 30).

([4]) For example, the Commission used pricing analysis in the Arjowiggins/M-real Zanders Reflex transaction to examine whether reels and sheets are both part of a larger carbonless paper market, or whether each product forms its own product market.

parties' competitors in at least the neighbouring Member States would direct *enough of their sales* to the Member State of the merging parties to thwart a permanent price increase by the merging parties. If these additional imports make the price increase unprofitable, this implies that the relevant market is not defined by national boundaries, as the competitors in the neighbouring Member States must exert a competitive constraint on the merging parties. If, however, this price increase would be profitable, this implies that the Member State in which the merger takes place forms a relevant geographic market on its own.

The question of whether *enough sales* would be directed to a particular Member State in response to a price increase of 5-10% cannot simply be assessed by pointing to centralised manufacturing sites, low transport costs, and high levels of trade flows within the EEA, which are the usual type of arguments that Form COs contain in support of wider markets that encompass the EEA. This is because, although such statements are consistent with a wider market, they provide only limited insight as to how much substitution there is between the products of the competitors in the different Member States, and whether these competitors would have the incentives to sell more of their product in a particular Member State in response to price increases in that Member State. ([5]) Instead, the assessment of the hypothetical monopolist test requires careful empirical analysis.

There are two basic types of empirical analysis that lend themselves particularly well to the assessment of the hypothetical monopolist test. The first type of analysis, called critical loss analysis, directly assesses whether the price increase of 5-10% is profitable by comparing by how much the hypothetical monopolist's quantity sales would have to decrease to make a price increase unprofitable (i.e. the critical loss) with an actual loss that the hypothetical monopolist would incur in response to the same price increase. While the critical loss is easy to compute, it is significantly more complicated to compute the actual loss, which depends on the reaction of consumers and thus requires the demand curve and in particular its elasticity to be estimated. ([6]) Such estimation is, however, fairly difficult and has very high data requirements. As a result, there are many instances in which this method produces rather non-robust estimates or no estimates at all.

The second type of analysis, called pricing analysis, uses the key intuition that if two geographic areas are in the same relevant geographic market, then any "misalignment" in the prices specific to each geographic area would only be temporary, as prices would be forced back into line with each other due to exports from the "low price" geographic area to the "high price" geographic area. Thus, for example, if markets are EEA-wide, any "misalignment" in national prices should only be temporary, as imports would be shifted from one Member State to another. Such an analysis is clearly only an approximation to the SSNIP test question, as it does not provide a direct answer to whether or not a price increase of 5-10% would be profitable for the hypothetical monopolist. Neither does finding that prices in two geographic areas move closely together provide any insights as to the causality of the relationship between the prices. That is, such a finding does not provide any evidence for whether the competing producers in the surrounding geographic areas provide a competitive constraint on the hypothetical monopolist, and hence the prices move together, or whether the hypothetical monopolist constrains the competing producers in surrounding areas. Obviously, for merger control purposes, the latter rather than the former is required.

On the other hand, unlike critical loss analysis, pricing analysis uses fairly straightforward and easy-to-implement empirical techniques that lend themselves particularly well to examining the closeness of price movements over time. There is thus a trade-off between the evidentiary value of the findings from the pricing analysis and the ease with which the pricing analysis can be implemented. To alleviate such concerns, it is always important to supplement the findings from the pricing analysis with some factual evidence that explains how the producers in the surrounding areas can constrain the hypothetical monopolist. Consider for example an unexpected event such as a plant shutdown in a given Member State. If prices in that Member State move in line with prices in the other Member States despite this plant shutting down, as producers in the surrounding areas are shifting some of their sales to that particular Member State, it is likely that the Member State must be part of a wider market. At the same time, it is important to note that if strong price co-movements over time are not found, this generally suggests that the competitive relationship between two geographic areas is not particularly strong, and they are not in the same geographic market. Thus, while additional qualitative information is needed

([5]) It should be noted that it is indeed *necessary*, for example, to observe high levels of imports and exports within the EEA to establish that competing producers in other Member States may exert competitive pressure on the merging parties. Observing such patterns is, however, not *sufficient* to argue that markets are wider than any given Member State.

([6]) For more details on critical loss analysis, see Andrea Amelio, Miguel de la Mano and Manuel Godinho de Matos, Ineos/Kerling merger: an example of quantitative analysis in support of a clearance decision, Competition Policy Newsletter 2008, Number 1 — Spring.

in conjunction with the results of the pricing tests to argue that two geographic areas are in the same relevant market, the lack of price co-movements is usually indicative that two geographic areas are not in the same market. (7)

Statistical techniques used for pricing analysis

There are two techniques that lend themselves particularly well to examining the extent to which prices move together over time. The first technique, *correlation analysis*, measures the extent (summarised by the correlation coefficient) to which prices in one geographic area are associated with prices in another geographic area. If the prices of the two geographic areas move perfectly in line with each other, the correlation coefficient is one. If there is no relationship between the prices, the correlation coefficient is zero. As the correlation coefficient can vary between zero and one, it thus needs to be assessed whether the prices are *sufficiently* correlated to consider the two geographic areas to be in the same market. To do this, it is typical to use as a benchmark the correlation between two geographic areas that are accepted as being in the same market. For example, if it is accepted that the geographic market is EEA-wide, and the issue to be examined is whether the market is world-wide, the correlations between the prices in the different Member States may be used as useful benchmarks against which the price correlations of the different continents can be compared. Of course, there may also be instances in which no benchmark is readily available. In such a case, a view must be taken on what level of correlation is high enough to indicate that two geographic areas are in the same market. In general, it is hard to reconcile any correlation coefficient below 0.8 with the hypothesis that two geographic areas are in the same market. (8)

Although correlation analysis is fairly easy to implement, it suffers from some major shortcomings. For example, one important element of correlation analysis is controlling for common shocks to prices across the different geographic areas such as common cost movements or currency movements, as it is possible that high correlations could be driven entirely by changes in these common elements. In such an instance, the conclusion would be arrived at that two geographic areas are in the same market, although the prices may not be directly related to each other. For example, if the relationship between prices of a chemical product in two Member States is examined, such prices should be adjusted for the effect of crude oil, as crude oil usually accounts for a large portion of the product costs and may induce common movement in the prices of the chemical product in the two Member States. (9) It is, however, important to note that once it is found that prices that are not adjusted for common elements do not move together, it is no longer necessary to examine whether prices that are adjusted for common elements move closely together, as removing common elements should make the price correlations even lower.

It is also possible that although prices of two geographic areas are related, they may be subject to significant random disturbances at some point in time (e.g. there may be an event that occurs in one Member State but not in another), or prices may respond to changes in market conditions with a time lag. This may result in low correlation coefficients, as correlation analysis examines contemporaneous movements over time. Care is thus needed when interpreting the results from correlation analysis, and it is preferable to supplement the results from correlation analysis with findings from another technique such as the stationarity tests that are described next.

Stationarity analysis, which is the second technique used for pricing analysis, avoids most of the abovementioned issues. This is because it examines (using sophisticated statistical tests) whether the relative prices of two geographic areas tend to revert to a long-run average value over time. The use of relative prices means that the role of the common elements or currency effects is reduced to a minimum. Stationarity tests do not also require the use of any subjective benchmarks and are generally robust to responses with time lags and temporary random disturbances. At the same time, however, stationarity tests are more difficult to implement and can also result in misleading findings due for example to the presence of a number of structural breaks in the relative prices.

Essentially, for geographic market definition purposes, stationarity analysis amounts to examining whether the relative price series oscillate around a

(7) Unless the competitive relationship between the different geographic area has been subject to some large structural change over time.

(8) This of course assumes that appropriate care is exercised in the construction of the average price series that are to be analysed, and the below-described shortcomings of the correlation tests are properly accounted for in the analysis.

(9) There are two ways of adjusting for common effects. The most precise method amounts to obtaining a "recipe" for the production of the particular product and subtracting the portion that is accountable for by the common effect. If such a recipe is not available, the common effect can be adjusted for by using regression analysis, in which the price of the product is regressed on the price of the common effect (e.g. price of crude oil), and the portion of the price of the product that is not explained by the price of the common effect is used as the adjusted price.

constant value that is close to one over time. ([10]) If they do (i.e. the relative price series are found to be stationary), this is consistent with the two geographic areas being in the same market, as the prices can only deviate from each other for a short period of time. Consider, for example, Figure 1 and Figure 2 in the Annex that display the hypothetical price of a product in Member State A relative to the hypothetical price of a product in Member State B. In Figure 1, the relative price oscillates around 1, implying that the prices in the two Member States are on average the same, which is consistent with the two Member States being in the same market. In Figure 2, the relative price is sloping upwards, which implies that the product in Member State A is becoming relatively more expensive compared to the product in Member State B, and thus there is no long-run stable relationship between the prices that would be consistent with the two Member States being in the same market.

It is also important to note for both correlation and stationarity analysis that, as we are looking at movements of prices over time, it is necessary to have enough observations to ensure that the analysis is meaningful. In general, it is necessary to have about three years of data at monthly levels as a minimum, although five or six years of data would be preferred. In this regard, one question that arises is how data from five years ago may be useful in delineating the markets today. Thus, it is usually advisable to look at different subsamples throughout the whole period to ensure that prices move closely together over time. Consider, for example, Figure 3 in the Annex that plots hypothetical prices of a given product in Member States A and B for five years, while Figure 4 plots the same prices only for the last three years. It can be seen that although the prices appear to move closely together throughout the whole period, which is also confirmed by the correlation coefficient of 0.95, the movement is not as close if only the last three years of data are considered (the correlation coefficient is 0.46). This would suggest that the prices in the two Member States can drift apart from each other for a fairly long period of three years, which is not consistent with the two Member States being in the same market, although the correlation coefficient is very high if we look at the whole period of five years. ([11])

Data

There are in general two types of data that can be used to perform pricing analysis. The first type uses data from marketing agencies such as AC Nielsen or Gfk that for example collect scanner data in supermarkets and report aggregate statistics for each country such as the total amount of a product sold in a given country and the price at which this product is sold. ([12]) There are also periodicals such as FarmBrief in the UK that systematically collect prices of products such as fertilizers on a monthly basis by calling different purchasers and collating this information. When attempting to gather and use this data for market definition purposes, it is important to keep the following limitations in mind. First, this type of data is not available for every industry and can also be fairly costly to obtain. Second, as this data is based on a sample that is extrapolated to construct the aggregate figures, it may in some instances result in somewhat imprecise estimates. Third, as usually only the aggregate figures are available, it is not possible to see how this data was constructed and to clean any outliers in the data.

The second type of data is based on the accounting systems of the merging parties as well as their competitors. Accounting systems store information for every sale that a firm makes, including information on the date of the product sale, the type of product sold, customer name and location, the quantity of the product sold, sales revenues and production costs. It is thus possible to create weighted average prices for each firm in the industry by product and by location (e.g. country or continent) on a monthly basis by aggregating over total revenues and total sales of each firm. If the same type of data is also available from the competitors of the merging parties, this allows actual market-level prices in each geographic area to be constructed, and such prices can then be used to approximate the SSNIP test. In many instances, however, the only data available is that of the merging parties. While such prices do not correspond to market prices in most instances, they can still provide important insights into the market definition question. This is because the

([10]) If the relative price oscillates around a constant value, the relative price is said to be "stationary" (see Figure 1). If the relative price does not oscillate around a constant value and is not subject to a trend, the relative price is said to be "non-stationary". If the relative price is subject to a trend and oscillates around this trend, the relative price is said to be "trend-stationary" (see Figure 2). If the relative price is subject to a trend but does not oscillate around this trend, the relative price is said to be "trend non-stationary".

([11]) This result may be somewhat counter-intuitive. The correlation coefficient however depends on the extent to which the two variables are related (the so-called covariance) *relative* to the extent to which each of the two variables varies over time (the so-called variance), and this relationship may not be constant over time such as in the example that is considered here.

([12]) Such data is usually constructed by collecting the required information in supermarkets that account for a large percentage of total sales and is extrapolated to construct the total amount of product sold in a given country.

way that each of the merging parties sets prices in a number of geographic markets provides important evidence as to the competitive constraints that it faces in each geographic area. In particular, if a firm sets prices in two geographic areas such that the prices move closely together over time, this is consistent with these geographic areas being in the same market.

It is important to note that the data must be "cleaned" prior to constructing the weighted average prices that are used in the pricing analysis, to ensure that the results are not driven by outliers. For example, customers may often return the products they purchased, and such returns are often recorded with negative revenues and negative quantities sold. If such a return is large enough as a percentage of the total sales in any given month, this may influence the weighted average price in that particular month and, as a result, the pricing analysis. To minimise the effect of such rogue observations, it is customary to purge from the analysis all observations with nonsensical values such as negative revenues and quantities, and observations whose prices are either too high or too low compared to what we would expect the customers to pay for the products. ([13])

The Arjowiggins/M-real Zanders Reflex and Arsenal/DSP transactions

The issues that arise while defining geographic markets were discussed in great detail in the *Arjowiggins/M-real Zanders Reflex* and *Arsenal/DSP* decisions, which both contain detailed annexes that not only review the Commission's analyses and preferred empirical techniques but also discuss the arguments and alternative empirical analyses put forward by the notifying parties. This section briefly introduces both transactions in more detail and explains how the Commission applied the above-developed framework in the two cases to delineate the geographic markets.

Arjowiggins/M-real Zanders Reflex

This case was notified on 31 October 2007 and related to the acquisition of M-real Zanders Reflex ("Reflex"), a paper plant in Düren (Germany), by Arjowiggins. The parties horizontally overlapped in the production and sales of carbonless paper, tracing paper and premium fine paper. The key market reviewed in this transaction was the carbonless paper market, by far the largest of the three affected markets with EEA sales of around half a billion euros. Carbonless paper is used to make duplicate copies without a carbon layer (for example for invoicing forms and purchase orders) and is sold either in reels or sheets (sheets are created by cutting reels into smaller pieces).

The EEA carbonless paper industry mainly comprises five producers that account for around 90% of the EEA market, and there are hardly any imports into the EEA. As Arjowiggins was the largest of these five producers, the transaction would further strengthen the position of Arjowiggins with the combined entity having around half of the EEA market, and a large increase in market share coming from Reflex. The position of the merged entity would be even more marked if national markets were to be considered, as the market share data showed significant variations among the different national markets, and these markets included some of the largest Member States. ([14]) This significant variation in the presence of the merging parties is also true for the other producers. For example, Torraspapel is mostly present in the Iberian peninsula, where it is a major player. The varying presence of the different competitors in the different parts of the EEA thus suggests that the conditions of competition may not be homogeneous across the EEA and that geographic markets may be as narrow as the individual Member States.

This indication is also consistent with the findings in a recent cartel case which suggest that the cartel members agreed on price increases for each country separately for reels and sheets, as the agreed price increases were often quite different, with the maximum difference being a 15% increase for one Member State and no increase for another. ([15]) Thus, it appears that the cartel members' agreement was not consistent with EEA-wide geographic markets either. On the other hand, the notifying party pointed to centralised manufacturing, the existence of European/world-wide brands, limited transport costs and high levels of import and export within the EEA as evidence that the market is EEA-wide. Given the conflicting qualitative evidence, as on the one hand the market share variations and the cartel decision were pointing towards national markets, while on the other hand the high trade flows were consistent with a wider geographic market definition, the Commission used pricing analysis to gauge how wide the geographic market is.

([13]) In practice, it is usual to discard the top 1% of the data with the highest values and the bottom 1% of the data with the lowest values.

([14]) For example, the merged entity would have [70-80]% of the German sheets market that accounts for 13.3% of EEA sheets sales, [60-70]% of the French sheets market that accounts for 13.7% of EEA sheets sales, and [70-80]% of the Italian reels market that accounts for 14.9% of EEA reels sales.

([15]) Commission Decision 2004/337/EC of 20 December 2001 relating to a proceeding pursuant to Article 81 of the EC Treaty and Article 53 of the EEA Agreement, Case COMP/E-1/36.212 — *Carbonless paper*.

The Commission obtained monthly volume sales and value sales by country and for reels and sheets from the five largest producers of carbonless paper for the period January 2004 to December 2007 that it used to construct market-level prices in the different Member States. In addition, the Commission also obtained transaction-level data at invoice level from Arjowiggins for January 2002 to December 2007 and constructed Arjowiggins-specific average country prices in the different Member States. As discussed above, market-level prices are preferable for the SSNIP test analysis. However, combining data from five different producers may be inherently subject to measurement error, as data from five different accounting systems are put together. Given that Arjowiggins' own data was submitted at invoice level, which allowed thorough cleaning, it thus served as a useful check on the results based on the data from the five producers. Therefore, the Commission performed two types of analysis: the first one was based on the data from the five largest producers, and the second one was based on Arjowiggins' transaction data. ([16]) The analysis was performed for six out of the 29 EEA countries: Germany, France, Italy, Poland, Spain and the UK. These countries accounted for around three quarters of total carbonless paper sales in the EEA over the period. As a separate analysis carried out by the Commission pointed mainly towards separate product markets for reels and sheets of carbonless paper, the Commission investigated how wide the geographic markets are for these two products separately.

Figure 5 and Figure 6 in the Annex plot the country-level prices for reels and sheets for the six Member States. The correlation coefficients for sheets, which range from -0.16 to 0.46, suggest that the prices do not move closely together, and thus these results point towards national markets. The evidence was more mixed for reels. In particular, the French, Polish and Italian prices appear to move more closely together. ([17]) The correlations between Germany and these three countries range from 0.73 to 0.77, which is somewhat lower. The correlations between the United Kingdom and the four Member States range from 0.45 to 0.51, which suggest that the United Kingdom may be systematically different from the other Member States.

Given that (i) there is no clear benchmark against which to assess the correlation results, and (ii) some of the close price movement may be driven by movements in input costs (for example paper pulp), the correlation analysis was supplemented by stationarity tests that do not require a subjective benchmark and reduce the role of common elements to a minimum. ([18]) Taking Germany as an example, the Commission examined whether the prices in the other five Member States relative to the German prices (see Figure 7 and Figure 8 for the relevant plots) are stationary, which would be consistent with Germany being part of a wider market. Particularly the relative reels prices suggest that there are clear upward trends that are not consistent with a geographic market that would be wider than Germany. This was also confirmed by the formal stationarity tests, which implied that, with the exception of the UK for reels and Spain for sheets, there is no stable long-run relationship between the German prices and the prices in the other Member States. ([19]) Similar results were found for the other Member States such as France and Italy. Thus, the stationarity analysis did not provide any evidence that the "law of one price" holds across the different geographic markets for both reels and sheets.

In conclusion, the hypothetical monopolist test requires the Commission to start with the smallest possible candidate geographic market and to see whether such market is a relevant market, or whether it is a part of a wider geographic market. In this instance, the smallest possible relevant market was a Member State, while a wider market was the EEA. Neither the correlation analysis nor the stationarity tests provided any consistent evidence that would point towards EEA-wide markets, and instead much of the evidence points towards national markets. This is also consistent with the behaviour of the cartel members, which agreed on price increases that differed across the different Member States, and with the widely varying presence of the different producers across the EEA, which also suggests that the conditions of competition are not homogeneous across the EEA.

Arsenal/DSP

This case was notified on 17 June 2008 and related to the acquisition of DSP, a subsidiary of DSM, by Arsenal Capital Partners, the owner of Velsicol. Both of the parties were active in the production and sale of solid technical grade benzoic acid and sodium benzoate. ([20]) These products are used as antimicrobial preservatives in foods and drinks,

([16]) Given that the analysis based on Arjowiggins' own transaction data is confidential to Arjowiggins, the results are not discussed any further, although it is noteworthy that the findings are very similar to those based on the data from the five largest producers. It thus provides additional comfort in terms of the robustness of the results.

([17]) The correlation coefficients range from 0.86 to 0.94.

([18]) The price series could also be adjusted for paper pulp costs, and such adjusted prices could be used for the correlation analysis. However, such information was not available to the Commission, and thus it relied on the stationarity tests.

([19]) The relative prices were found to be trend-stationary in all the other instances.

([20]) The transaction also gave rise to an investigation of vertical issues in the benzoate plasticizer market that is not discussed in this article.

and the difference between the two is that sodium benzoate is soluble in water whereas benzoic acid is not. ([21]) There are currently only four major producers of technical grade benzoic acid in the world. These are DSP and Velsicol in the EEA, Emerald Kalama in the US, and Wuhan in China. The same four producers are also the major producers of sodium benzoate, although there are other large producers of sodium benzoate in China. The merger would thus combine the only two EEA producers of solid benzoic acid and sodium benzoate. In the case of benzoic acid, the parties would merge to a near monopoly, as imports of benzoic acid from China and the US were very marginal. As regards sodium benzoate, the merged entity would have about two thirds of the market, while the rest would be supplied by the Chinese competitors. Thus, the key question to be examined was whether the geographic market for both of these products was EEA-wide or world-wide. That is, whether in the event of price increases in the EEA, the US and Chinese competitors could thwart price increases by exporting more of both products to the EEA. As the analysis for both of these products followed the same steps, this article only discusses one of these markets, the benzoic acid market, to demonstrate the role of pricing analysis in delineating the geographic markets.

The qualitative evidence for solid benzoic acid is already highly indicative that the EEA forms its own market. This is because the European producers have a virtual monopoly in the EEA. The Chinese producers' market share amounted to [1-2]% of EEA sales, while the US producers' market share decreased by about half from 1999 to 2007, although the euro significantly appreciated during the same period. The market investigation also revealed that (i) the EEA producers' competitive advantage due to transport and tariff costs amounts to 10-15% over the Chinese and US competitors, and (ii) EEA customers did not consider Chinese benzoic acid, in particular, to be of the same quality as that of the EEA producers.

Nonetheless, the notifying party pointed to increased world-wide trade flows of benzoic acid and the fact that both Velsicol and DSP were exporting most of their output outside of the EEA as evidence that the EEA was part of a wider world-wide market. The Commission thus undertook pricing analysis to further examine how wide the geographic market for benzoic acid is.

Invoice data from the merging parties and their US competitor Emerald were obtained for the period January 2002 to July 2008. As data from the Chinese competitor Wuhan were not available, the Commission could not construct market-level prices for Asia and thus could only use market-level data to examine whether North America and the EEA are part of the same market. ([22]) The resulting correlation coefficient between the EEA and North American prices was 0.53. Given that the EEA is assumed to be a single market, the correlations between the different Member States can serve as useful benchmarks against which the magnitude of the correlation coefficient between the EEA and North America can be compared. The benchmark correlations of the four largest Member States (in terms of benzoic acid sales) range from 0.94 to 0.96. This implies that North America and the EEA are not part of the same market. Moreover, North American prices were also significantly higher than EEA prices from 2004 until 2007, which is not consistent with global markets either. The lack of any stable long-term relationship between these two continents was further confirmed by the stationarity tests, which suggested that the relative prices are trend non-stationary.

Given that data from the Chinese producer Wuhan were not available, the Commission relied only on Velsicol's and DSP's average EEA and Asian prices to gauge whether there is any evidence that would be consistent with these two continents being in the same geographic market. As the techniques that were used in the analysis of both Velsicol's and DSP's data are the same, the analysis of Velsicol's data is described as an example. The price correlation between the EEA and Asia was found to be 0.89, which may be indicative that Velsicol sets prices such that the EEA and Asia are in the same market. However, when the correlation coefficient was calculated only for the more recent three-year period from 2005 onwards, the correlation coefficient dropped to 0.18. This implies that although Velsicol may have faced similar competitive constraints in Asia and the EEA in the past (and hence sold benzoic acid for the same price in both locations), this is no longer the case for the more recent years. Moreover, the benchmark correlation between the UK and the Netherlands was calculated to be 0.97 for the whole period and 0.85 for the period from 2005 onwards. ([23]) This further shows that while the competitive conditions that Velsicol faced in the

([21]) Benzoic acid is produced in liquid form, and this liquid can either solidify to produce solid benzoic acid or can be used as an input in other products such as sodium benzoate or benzoate plasticizers.

([22]) The analysis using Velsicol's and DSP's weighted average prices yields the same findings and is thus not discussed in this article.

([23]) There was no other Member State to which Velsicol sold more than 10% of its output in any given year. To avoid the impact of outlying values and thus very low correlations among Member States that would be indicative that the markets are not wider than a given Member State, which is not sensible, the Netherlands and the UK were used to calculate the benchmark correlation.

EEA remained similar throughout the whole period (as would be expected as the EEA is assumed to be one single market), the competitive conditions in Asia relative to the EEA must have changed over time. The results from the correlation analysis were further confirmed by the stationarity tests on the relative prices, which suggested the relative prices were not stationary.

In addition to the qualitative evidence overviewed above, the conclusion from the empirical analysis that the market for benzoic acid is EEA-wide is perhaps best documented by the unexpected and prolonged simultaneous shutdowns of Velsicol's and DSP's plants in April 2007. Such an event can serve as a useful test (the so-called event study) of whether the US producer Emerald and the Chinese producer Wuhan would or could export more output to the EEA in the event that the combined entity decided to restrict sales of benzoic acid to its EEA customers. Neither Wuhan nor Emerald supplied more benzoic acid to the EEA, and the shortage of benzoic acid in the EEA lasted approximately for a year and resulted in benzoic acid price increases in the EEA. This implies that the US producer Emerald and the Chinese producer Wuhan do not exert a competitive constraint on the merging parties that would be consistent with a world-wide market for benzoic acid.

Conclusions

Market definition is based on the SSNIP test that examines whether a hypothetical monopolist would profitably and permanently increase prices by 5-10% in a given candidate market. Answering this question requires careful empirical analysis that cannot be performed by merely pointing to high trade flows or the existence of centralised manufacturing sites, although such findings are certainly consistent with the hypothesis that markets are EEA- or world-wide. This is because such statements provide only limited insight as to how much substitution there is between the products of the competitors in the different geographic areas that can potentially be in the same relevant geographic market.

Although pricing analysis only approximates the answer to the SSNIP test question, it can provide useful insights into geographic market definition when combined with additional qualitative evidence. Its advantage over techniques such as critical loss analysis, which directly answers the SSNIP test, is however that it is fairly straightforward and easy to implement.

It is now customary for companies' accounting systems to store information on each sale that is made. The stored data usually includes among other information the customer's identity and location, characteristics of the products sold, the quantity and revenue amount of the product sold, production costs and margins. When such data is collected from the merging parties as well as their competitors, it can be used to create market-level prices that can be directly used to perform the SSNIP test analysis. If it is too costly to collect such data from every competitor, or such data is not readily available, the transaction data of the merging parties can be used on its own to assess how the parties set prices in different geographic areas, as their pricing behaviour will depend on the competitive constraints that they face in each market. Thus, such an analysis can indeed provide very useful insights into geographic market definition.

The availability of transaction-level data from the merging parties can also allow a number of additional tests to be performed that are directly related to defining markets. For example, such data usually contains information on the margins earned on each sale, which allows average margin per product or geographic area to be constructed. Comparing the magnitudes of the margins across different geographic area or products may provide additional information for market definition, as the margins would be expected to be similar if two geographic areas are in the same market. Likewise, in many instances, the merging parties argue that they are subject to increasing world-wide competition, which would constrain them in the event of price increases, although the geographic market may not be world-wide. Plotting the margins of the parties thus seems to be a useful way to check on this increased competition: if margins are indeed declining over time, this may be used as evidence that the parties are indeed facing increased competition in the market. Assessing the development of margins during an unexpected event that leads to a shortage of a product is another useful test: if, following the event, the parties' margins increase for a long period, this would be consistent with the hypothesis that the parties are not constrained by other competitors in their own geographic market, and thus this market probably forms a relevant market on its own. Finally, accounting systems also include information on the characteristics of customers, such as for example whether they are final customers or distributors. This information can then be used, for example, to check whether the company prices the same way to both types of customers or not, as distributors may be more likely to multi-source and thus to more easily thwart any price increases. This may then provide further guidance on how to segment the markets.

Annex

Figure 1: Stationary relative price

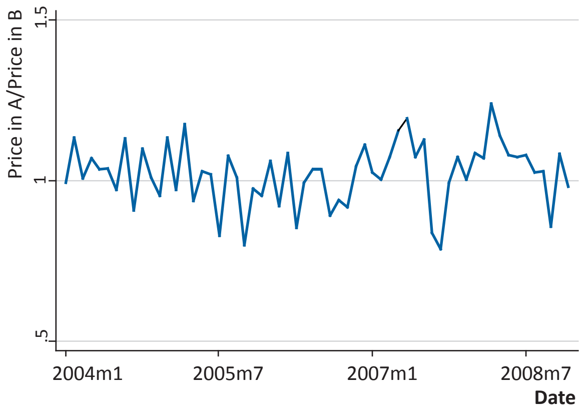


Figure 3: Monthly prices in Member States A and B from 1/2004 to 12/2008 (correlation=0.95)

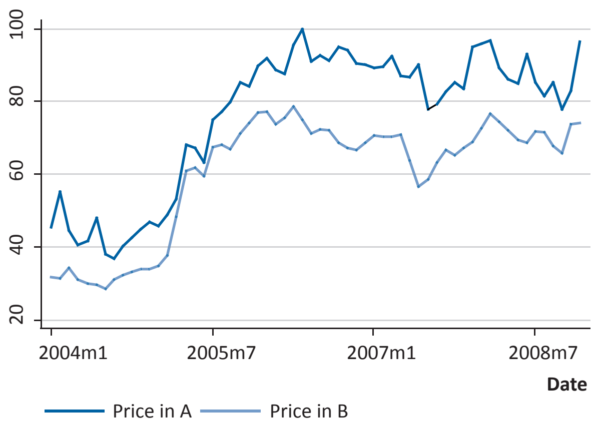


Figure 2: Trend-stationary relative price

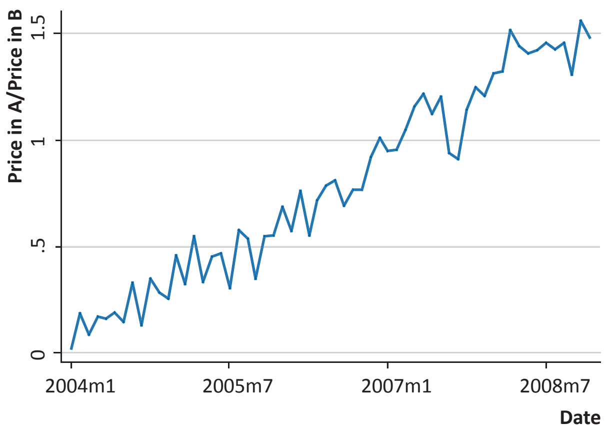


Figure 4: Monthly prices in Member States A and B from 1/2006 onwards (correlation=0.46)

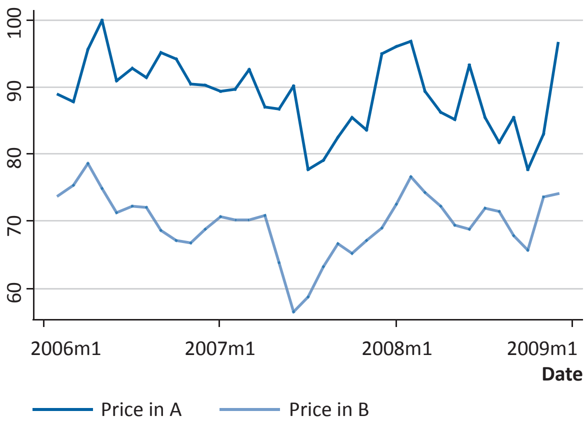
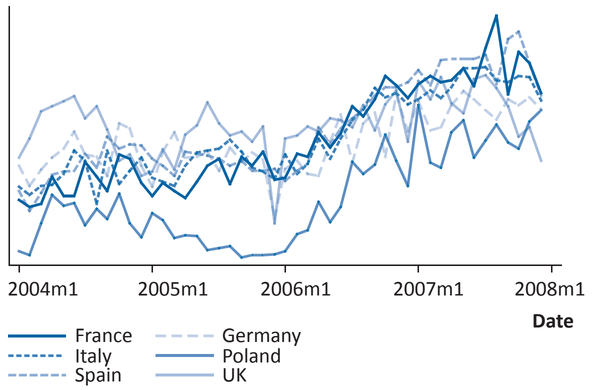
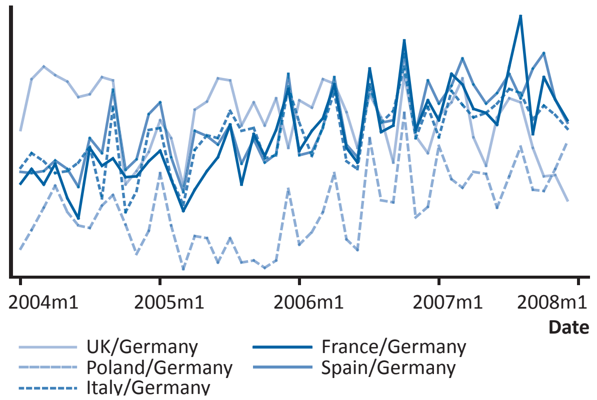


Figure 5: Average net prices of reels



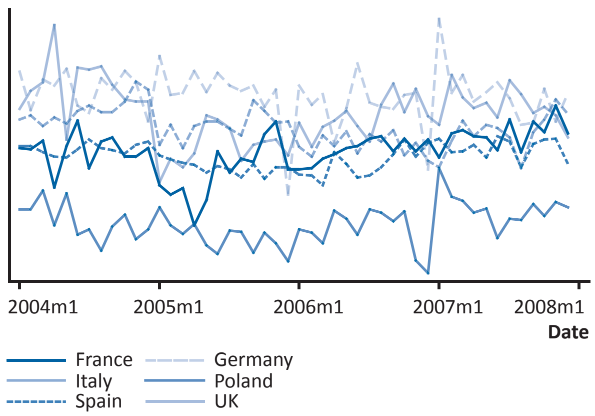
Source: Sales data from the five largest producers of carbonless paper

Figure 7: Average net country prices of reels relative to net prices of reels in Germany



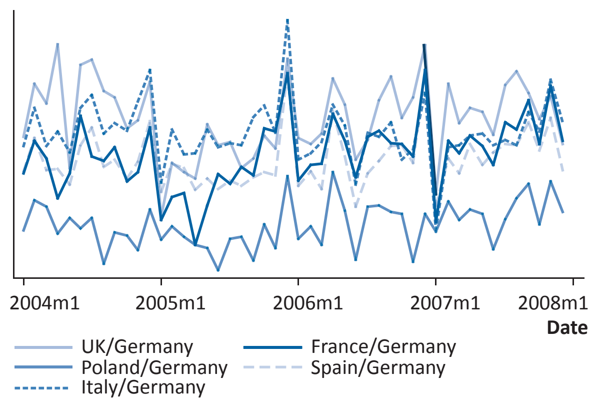
Source: Sales data from the five largest producers of carbonless paper

Figure 6: Average net prices of sheets



Source: Sales data from the five largest producers of carbonless paper

Figure 8: Average net country prices of sheets relative to net prices of sheets in Germany



Source: Sales data from the five largest producers of carbonless paper

The E.ON electricity cases: an antitrust decision with structural remedies

Philippe Chauve, Martin Godfried, Kristóf Kovács, Gregor Langus, Károly Nagy, Stefan Siebert (1)

Introduction

On 26 November 2008 the Commission adopted a commitment decision addressed to E.ON AG for suspected infringements of EU competition law involving the German electricity markets. For the first time in the Commission's decision-making practice, the decision requires the company concerned to dispose of very significant assets: E.ON will have to divest 5 000 MW of generation capacity as well as its high-voltage transmission grid (2) including system operation business in Germany.

The two asset divestiture remedies were voluntarily offered by E.ON in order to settle two different cases the Commission had launched against the undertaking with inspections in December 2006.

The first case relates to the German electricity wholesale market and the concern that E.ON may have carried out a strategy of short-term capacity withdrawal and deterrence of investments in electricity generation by third parties. The concerns in this case are removed by E.ON's generation capacity divestiture proposal. The second case relates to the German electricity balancing market and the concern that E.ON may have carried out a strategy as a TSO to favour its own supply affiliate, thereby raising costs for the final consumer. The concerns in this case are removed by E.ON's proposal to divest its German electricity transmission system.

The "wholesale" case

The Commission's competition case concerning E.ON's suspected abuse of a dominant position on the German wholesale market has its roots in the reports on the Commission's electricity sector inquiry (3) and the electricity study (4). Both reports identified the issue of capacity withholding as being the lowering of production capacity offered on the short-term market by an infra-marginal generator with a view to raising prices above competitive levels. As a consequence of such withholding, recourse is made to more expensive generation capacity along the merit curve in order to meet demand. In the final report on the sector inquiry, the Commission had indicated that some plants in the German markets were apparently not used as much as other similar plants between 2003 and 2005 (5). The electricity study report further refined the analysis through a market simulation and found that some plants produced less than they would have had done in a theoretically perfectly competitive market.

The electricity sector in general is characterised by a homogeneous, non-storable commodity-type product, with low elasticity of demand: this deprives consumers of the usual tools for adjusting to variations in price and supply. Secondly, the supply side is characterised by significant discrepancies between the costs of the various production technologies available (6): the so-called merit curve (ranking of the short-term variable costs of generation units) is relatively steep on the right-hand side. Thirdly, in many markets like in Germany, an auction price mechanism based on supply and demand curves delivers a single price for electricity sold in short-term markets. Therefore, any removal or reduction of capacity which is economic to run causes the supply curve to become steeper and intersect the demand curve at a higher price. This mechanism is illustrated in Figure 1 below. The direct effect of capacity withdrawal for any operator undertaking such action is a reduction in profits equal to those that the plant withdrawn would have reaped. The loss of profit can nonetheless be compensated by the indirect effect of capacity withdrawal, which is an increase in profits for the remaining operating plants of this operator (as well as those of other operators) due to the increased market price. In practice, capacity withdrawal requires a portfolio including (i) plants

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) Approx. 10 000 kilometres of power lines at voltage levels 380 and 220 kV.

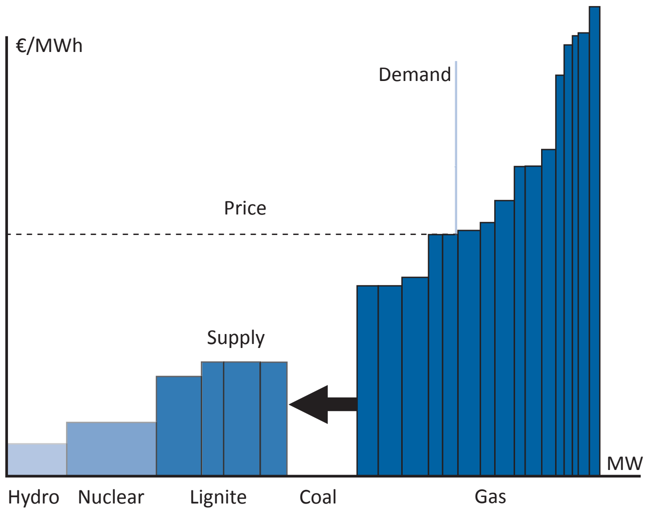
(3) http://ec.europa.eu/competition/sectors/energy/inquiry/full_report_part2.pdf, page 146, http://ec.europa.eu/competition/sectors/energy/inquiry/full_report_part3.pdf, page 311, and CPN Number 1 of 2007, page 55.

(4) See CPN Number 2 of 2007, page 18. http://ec.europa.eu/competition/sectors/energy/inquiry/electricity_final_part2.pdf

(5) See paragraphs 437-448 of the report.

(6) Unlike in many other sectors, there is in most electricity markets a scarcity of access to the cheapest technologies as well as other physical and political constraints: it is thus not possible for more expensive technologies to be systematically replaced by investment in cheaper ones. The issue is further compounded by significant variations of demand, requiring flexible plants, which are usually the more expensive ones on a per MW basis.

Figure 1: The merit-order curve and the effect of capacity withdrawal (schematic)



to withdraw (7) ("ability to withdraw") and (ii) a sufficiently large capacity of cheap plants to reap the benefits ("incentive to withdraw").

In Germany the electricity exchange EEX determines a single delivery price for every hour of the day. This price is set by the most expensive bid required to meet demand. Correspondingly, all generators selling in the exchange will sell their production at this price even though their bids may have been at lower levels. Given E.ON's significant nuclear, hydro and coal portfolio in Germany, it is one of those companies that by the nature of its production assets may be able to profitably withdraw generation capacity with a view to raising prices.

The withdrawal of generation capacity on the electricity market by a dominant operator is considered an abuse of a dominant position and therefore contrary to Article 82 EC. Such action causes serious harm to all groups of consumers by increasing the prevailing price on the spot market. Electricity consumed by end-users is procured by retail suppliers partly through the spot market (8) and partly through forward/futures products (9). The price of electricity procured through the spot market is directly affected by withdrawals of capacity. The price of electricity procured through forward products is indirectly affected by withdrawals of capacity (10). As explained above, consumers in electricity markets have limited capacity to react to price signals. Further, new investments into generation capacity require long leading times (11). This combination of sector-specific factors makes capacity withdrawals severely detrimental to consumers and is therefore contrary to Article 82 EC.

The investigation was initiated in the form of inspections on the premises of E.ON and other German electricity companies in December 2006. The Commission further requested very extensive data from the undertakings concerned to establish whether some capacity had effectively not been offered on the short-term market. In order to do so, the Commission investigated for the period 2003-2007 the company's hourly dispatch of its generation units forecasted at the time of bidding into the power exchange. As explained in the sector inquiry, sectoral practice entails marginal cost-based bidding

(7) Usually plants in the middle of the curve to limit the cost of withdrawal and be sure of the effect.

(8) Electricity sold through the spot market (EEX) represents about 25% of total consumption in Germany.

(9) Forward/futures products are wholesale products with differing levels of standardisation and different trading venues by which electricity is sold in advance for delivery over certain periods (such as a week, month, quarter or year ahead) and in a certain shapes (such as baseload — all hours of every day — or peakload — only hours 8 to 20 of every working day).

(10) A purchaser of electricity has the choice to cover its needs by buying forward or spot. Usually it tries to cover most of its needs in advance (thus forward) in order to avoid the volatility of spot markets. In doing so it will take spot prices into account to determine how much it is ready to pay for forward products. See paragraph 376 of the final report on the sector inquiry.

(11) The delay between programming a new gas-fired plant and putting it online is a minimum of five years; for a coal-fired plant it is seven years or more and for a nuclear power plant it is ten years or more. This underlines that investment in plants generally has a long lead time. Furthermore, investment in baseload plants (which are cheaper on a per MW basis and could thus exert a downward pressure on prices) takes longer, faces more environmental and political scrutiny and is sometimes restricted (nuclear plants for legal reasons, hydro plants for availability reasons).

for all available capacity sold in the short-term market [12]. The investigation therefore considered the availability [13] and the costs [14] of all plants. Based on its analysis, the Commission took the view that E.ON may have withdrawn or refrained from bidding certain amounts of capacity into the German power exchange EEX even though that capacity was available and would have been profitable to run given the market price in those hours. As discussed above, the breadth of E.ON's German generation portfolio may have enabled the company to undertake this profitably, meaning that it may have been able to earn higher profits from bidding less capacity in the short-term market while achieving higher prices on its entire portfolio due to the price increases caused by the withdrawal.

The investigation gave rise to another Commission concern: E.ON may in addition have pursued a strategy of deterring generation capacity investments by third parties by either offering them long-term contracts or shares in E.ON generation projects. Altogether such behaviour may have caused the abandonment of building significant new generation capacity, rendering the market tighter and raising prices. This would also be contrary to Article 82 EC.

Given the number of links between E.ON and some of the other large German electricity companies, the Commission came to the conclusion that E.ON was collectively dominant at least with RWE on the German wholesale electricity market. The information gathered and the analysis undertaken by the Commission indicates that E.ON may have unilaterally abused its collectively dominant position in the manner described above. This is in line with established case law whereby undertakings occupying a joint dominant position may engage in joint or individual abusive conduct; the abuse only has to be capable of being identified as one of the manifestations of such a joint dominant position [15].

The "balancing" case

Like the withholding case, the second antitrust case against E.ON, concerning the German balancing market, originates from information gathered during the Commission's electricity sector inquiry. In its final report [16] the Commission already noted the significance of balancing markets to the functioning of the broader electricity markets and the possible anticompetitive effects that can arise from integrated transmission system operators (TSOs) favouring their own generation affiliates when purchasing balancing services.

Given the non-storability of electricity and the continuously fluctuating supply and demand, it is crucial that certain actions are undertaken by the TSOs to ensure system balance. To do so TSOs purchase so-called ancillary services, which include primary, secondary, and tertiary [17] reserves for balancing, from generators and traders active on the market. TSOs are considered to be natural monopolies in relation both to their network and to their system operation functionalities in the electricity sector. At the same time, TSOs are sometimes (as in Germany) part of vertically integrated groups which also generate and supply electricity. It is thus crucial for the cost-efficient and competitive functioning of the markets for these ancillary services that the TSOs do not favour their own affiliates.

The Commission's investigation led to concerns that the E.ON TSO may in its daily practice have purchased secondary balancing power instead of tertiary balancing power. In doing so it would have favoured its own generation affiliate since it is the main one providing secondary balancing power whereas there is significantly higher competition for tertiary balancing power. Although secondary and tertiary balancing power are part of separate product markets due to their technical specifications [18], both types of reserves are called on by the TSO [19] for the purpose of balancing the system and the TSO has some flexibility to order either of the two reserves in order to resolve some unbalances. In addition it appeared that the E.ON TSO may have prevented competitive cross-border market entry for such services. Both activities have likely caused significant consumer harm by raising the costs of balancing power in Germany and thus increasing the amounts paid by consumers for network services. As a consequence, the Commission had concerns

(12) Fixed costs are covered by infra-marginal rents or sometimes on a portfolio basis by the revenues of infra-marginal plants (see CPN Number 2 of 2007, page 18 for a discussion of the issue of fixed costs).

(13) In doing so, the investigation took into account outages, periods of maintenance and technical constraints of plants (e.g. minimum up and down times of plants).

(14) In doing so, the investigation took into account all costs related to the operation of plants (fuel-related costs, operations and maintenance costs, CO_2 emission costs, start-up costs, justified additional risk-specific premiums relating to outages, etc.).

(15) Case T-228/97 *Irish Sugar* [1999] ECR II-2969, paragraph 66; Joined Cases T-191/98 and T-212/98 to T-214/98 *Atlantic Container Line* [2003] ECR II-03275, paragraph 633.

(16) http://ec.europa.eu/competition/sectors/energy/inquiry/full_report_part3.pdf

(17) These are called *Minutenreserve* in German.

(18) This is due to the different lead times they are called upon with (within a few minutes for secondary reserves and within a quarter of an hour for tertiary reserves) as well as the technical requirements for their provision on the part of the power plants themselves.

(19) Unlike primary reserves, which is an automated balancing mechanism based on frequency control instruments in the respective power plants.

that E.ON may have abused its dominant position on the market.

The remedies

E.ON proposed in February 2008 to commit to divest power plants and its transmission network. These commitments were offered at E.ON's initiative to bring to a rapid close two potentially protracted antitrust cases. The Commission's power to accept such commitments and make them legally binding is set out in Regulation (EC) 1/2003, which also expressly refers to structural remedies. It is a matter of judgment in each case whether the public interest is best served by pursuing an infringement for the past, or fixing the problem for the future. The Commission's primary objective in the present cases was to make the German electricity markets work better, for the benefit of German consumers. It therefore agreed to settle the two separate antitrust cases by accepting a remedy package which is both sufficient — in fact unprecedented in its size — while at the same time proportionate to the severity of the suspected anticompetitive behaviour in the two cases.

The commitments concerning E.ON's possible anticompetitive behaviour on the German wholesale market will result in the divestiture of 5 000 MW of production capacity or about 20% of the company's German generation portfolio. The divestiture business involves power plants (or drawing rights in the case of nuclear assets) along the entire merit curve and includes run-of-river, nuclear, lignite, hard coal and gas-fired and pump storage power plants: it includes plants which give the ability to withdraw and plants which provide an incentive to withdraw. Taking into account the plants which would remain in E.ON's portfolio after divestiture, the size and the nature and composition of the remedy remove E.ON's incentives to undertake profitable capacity withdrawal with its remaining fleet of German generation assets. Both in itself and due to the inclusion of types of plants which competitors have difficulty to access, the divestiture package also addresses the concerns that E.ON may have deterred competitors from investing in new plants. Accordingly, the commitments are sufficient to address the concerns on the wholesale market.

In the balancing case, the Commission found that E.ON's commitment to sell its German electricity transmission network along with the system operation activity to an operator without generation or supply activity (thereby ensuring ownership unbundling) would be sufficient to close its antitrust investigation: this divestiture would remove the incentives for E.ON's TSO to favour its affiliate at the expense of other market operators. The divestiture would create a level playing field in that electricity transmission zone.

According to settled case law, the principle of proportionality requires that the measures adopted by Community institutions must not exceed what is appropriate and necessary for attaining the objective pursued [20]. In the wholesale case, the Commission accepted a structural commitment in exchange for settling this case because of the nature of the suspected abuse: withdrawal of generation capacity over hundreds of hours per year, involving E.ON's fleet of over fifty power plants, would have been very difficult to monitor and would very likely have been more burdensome for E.ON than the divestiture it voluntarily proposed. Similarly, given the complexity of monitoring any behavioural undertakings on the balancing market, the Commission found that a structural solution to the possible market abuse would be most appropriate. Purchases for balancing power are decided by the TSO on a continuous operating basis (at any moment of any day and within a very tight schedule) and thus any detailed oversight would pose difficulties and be burdensome for both the Commission and E.ON.

Conclusion

The liberalisation of the European electricity sector has introduced competition with the aim of allowing customers to reap the benefits of choice and efficiency. Capacity withdrawal and deterrence of investments can deny consumers those benefits to such an extent and for so many years that it can call into question the case for liberalisation from the standpoint of consumers. It is therefore in the Commission's view vital to track such practices down and/or prevent them. The same is true for distortions of competition due to vertical integration between networks and supply.

Since the Commission's November 2008 decision, E.ON has already commenced its disposal of power plants. Any purchaser of the power plant assets for sale will have to be approved by the Commission on the basis of several criteria, in particular its independence from E.ON, competence and financial strength, as well as the absence of any prima facie competition concerns that it may raise. Preparations are also under way for the sale of the transmission business. Both divestitures are closely scrutinised by a trustee who monitors the asset separations and sales by E.ON under the aegis of the Commission.

This historic set of remedies shows, if need be, that the Commission is ready to do everything in its power to prevent unfair practices on energy markets and bring the benefits of liberalisation to consumers.

(20) Case T-260/94 *Air Inter v Commission* [1997] ECR II-997, paragraph 144, and Case T-65/98 *Van den Bergh Foods v Commission* [2003] ECR II-4653, paragraph 201.

Extension of postal monopolies: the Slovak law reserving hybrid mail delivery services for Slovenská Pošta infringed Article 86 in conjunction with Article 82

Thomas Brunhes (1)

1. Context of the procedure

On 7 October 2008, the Commission addressed to the Slovak Republic a decision based on Article 86 in conjunction with Article 82 of the EC Treaty finding that the extension of the postal monopoly in Slovakia was illegal. (2)

The Slovak Postal Act of 15 February 2008, which entered into force on 1 April 2008, reserved hybrid mail delivery services for the postal incumbent Slovenská Pošta. Hybrid mail is defined as a service whereby the content of communications is electronically transmitted to the service provider, electronically processed and converted into the physical form of a letter mail item (printed and enveloped) and then physically delivered to the addressee.

Slovenská Pošta is the provider of the universal postal service in Slovakia. It consequently has the obligation to provide delivery services to all Slovak households every working day as well as the obligation to maintain a network of postal boxes and postal offices (3). It also benefits from a reserved area, i.e. the exclusive right to distribute certain items of less than 50g, and certain intangible advantages such as a VAT exemption or the right to issue stamps.

Before the adoption of the amendment, chiefly two postal companies started providing hybrid mail services in Slovakia: Prvá Dorucovacia (PD), which was already active in 2005, and Slovak Mail Services (SMS). These companies covered respectively 65% and 87% of the Slovak population. They still relied on the network of Slovenská Pošta for postal items falling outside their territorial coverage.

The amendment had dramatic consequences on these companies, which were prevented from engaging in their most profitable activities. They urged the Commission to open infringement proceedings against Slovakia.

The Commission sent the Slovak authorities a letter of formal notice on 18 June 2008 and addressed a copy to Slovenská Pošta. After assessing and taking account of the observations of the Slovak Government and Slovenská Pošta, on 7 October it adopted a decision based on Article 86(3) of the EC Treaty.

2. Extension of the postal monopoly

2.1. Slovak legislation before the amendment of the Postal Act

Before the amendment, Section 7(2) of the Postal Act No 15/2004 stipulated that "*The postal reservation comprises clearance (collection) and distribution of items of correspondence and direct mail items up to 50 g in weight*". The wording of the law thus confirmed that the postal reservation did not apply to hybrid mail services, since hybrid mail items are in principle not collected.

Any possible doubts regarding the interpretation of the law were dispelled when the Postal Regulatory Office published on 5 March 2005 a General Authorisation which explicitly confirmed that "*hybrid mail does not fulfil the criteria laid down in Sections 2 and 4 of Act No 507/2001 on postal services as amended by Act No 15/2004 (hereafter referred to as 'the Act') and is not considered as forming part of the postal service according the Act*".

Moreover, the Government and the Postal Regulatory Office issued a number of statements that fully confirmed the legal situation as described above:

- Three days after the adoption of the General Authorisation, PD sent a letter to the Postal Regulatory Office. PD sought to obtain confirmation in writing that it could distribute postal items prepared and packaged internally.
- On 22 March 2005, the regulator answered in writing. The Postal Regulatory Office drew a distinction between postal items that the distribution company received in paper and hybrid mail items which the postal operator also printed. For the latter category, the Postal Regulatory Office confirmed explicitly that the distribution of hybrid mail items was outside the scope of

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the author.

(2) Case COMP/39.562 *Slovakian postal Law*. OJ C322, 17.12.2008 p. 10. The full text of the decision is available at http://ec.europa.eu/competition/antitrust/cases/index/by_nr_79.html#i39_562

(3) See Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, OJ L 15, 21.1.1998, p. 14, as amended by Directive 2002/39/EC of 10 June 2002, OJ L 176, 5.7.2002, p. 21. Directive 97/67/EC has since been further amended by Directive 2008/6/EC of 20 February 2008, OJ L 52, 27.2.2008, p. 3.

the postal reservation: "*if the item is delivered in electronic form and you transform it into written form, the provisions of Section 4(4) on correspondence and the related provisions of Section 7(2) on the collection and distribution of correspondence will not be satisfied. A postal service provided in such a way is not subject to the postal reservation*".

- This interpretation was shared by the Government, which stated in its resolution No 376 of 10 May 2005 that "*only a business activity involving all four stages mentioned above [i.e. clearance, sorting, transport and delivery of postal items] can be regarded as a postal service*".
- On 8 September 2006, the Postal Regulatory Office proposed an amendment of the General Authorisation in order to include hybrid mail in the reserved area. However, this proposal was criticised by the Government, the Anti-Monopoly Office and TNT. In its observations on the draft General Authorisation, the latter stated that "*collection of the postal item pursuant to Section 4(1) of the Act on Postal Services therefore does not take place in the case of hybrid mail*". The Postal Regulatory Office subsequently did not amend its General Authorisation.
- On July 2007, Slovenská Pošta lodged a complaint with the Postal Regulatory Office for alleged breach of the postal reservation by PD and its parent company which provided hybrid mail services. However, on 25 September 2007, the Office rejected the complaint on the basis that "*According to Section 5 of the Act, a postal service is provided only if an undertaking performs collection and distribution of mail (material object within the meaning of Section 4)*".

2.2. The extension of the monopoly

On 5 November 2007, Slovak Telekom issued a tender in order to select a postal service provider to deliver invoices with hybrid mail technologies. Slovak Telekom received four responses from different postal operators and decided to engage in exclusive negotiations with SMS.

However, on 8 November 2007, members of the Slovak Parliament introduced a legislative proposal aimed at reserving the delivery of hybrid mail for Slovenská Pošta.

Despite previous decisions of the Postal Regulatory Office, on 30 November 2007 the President of the Office issued a statement entitled "*Viewpoint on hybrid mail*" according to which it now considered that hybrid mail belonged to the reserved area and that it would "*assess the activity of providers of services related to hybrid mail in the light of this viewpoint as of its publication on 30 November 2007*". The President of the Postal Regulatory Office subsequently repealed on 22 January 2008 the decision of 25 September 2007.

In reaction to Parliament's legislative proposal of 8 November 2007, the Department of Approximation of Laws, the unit in charge of reviewing compliance of national law with EC law within the Governmental Legislation Division of the Slovak Republic Government Office, warned about the risk of illegality of such law in its opinion dated 3 January 2008. So too did the Anti-Monopoly Office on the same day. On 30 January 2008, the Legislative Council of the Government, which is in charge of assuring the government of the legality of all new legislation, also took a negative stance on the proposed extension of the postal monopoly.

In spite of these reactions, the proposal was eventually adopted in second and third reading on 15 February 2008 and entered into force on 1 April 2008.

2.3. Impact on the provision of value-added services

The state measure at hand had severe consequences on private postal operators which had invested in order to provide hybrid mail services to their clients as from 2005.

It also had a negative impact on the offer of services available in Slovakia. The services provided by private postal operators better matched the needs of certain companies. In particular, private postal operators provided "track and trace services", a reporting system enabling senders to gather information on whether and when mail items have been distributed to the addressee.

These value-added services, which were decisive selection criteria in tenders, were thereafter no longer available on the market.

3. Infringement of Article 86 in relation to Article 82

3.1. Restriction of competition

According to the Court of Justice of the European Communities, an abuse within the meaning of Article 82 is committed where, without any objective justification, an undertaking holding a dominant position on a particular market reserves to itself other ancillary activities in neighbouring but distinct markets, although these activities could also be carried out by another undertaking as part of its activities on this neighbouring but separate market (4). With regard to Article 86(1) in conjunction with Article 82, it is settled case law that the extension by means of a measure adopted by the State of a monopoly into a neighbouring and competitive market, without any objective justification, is prohibited as such by Article 86(1) in conjunction with Article 82 (5).

The objective of the Amendment is precisely to extend the postal monopoly already in force on the market for traditional mail services to hybrid mail services. The Amendment thus constituted an infringement within the meaning of Article 86(1) in conjunction with Article 82 (6).

Moreover, the reservation of hybrid mail delivery deprives customers of the value-added services provided exclusively by certain competitors of Slovenská Pošta. It is settled case law that "an abuse may in particular consist in limiting the provision of a service, to the prejudice of those seeking to avail themselves of it" (7).

3.2. Lack of objective justification under Article 86(2)

Under Article 86(2) of the Treaty, a restriction of competition is justified if it is necessary for the provision of a service of general economic interest. As the Court has held in a number of cases, it is incumbent on a Member State which invokes Article 86(2), as a derogation from the fundamental rules of the Treaty, to show that the conditions for application of that provision are fulfilled (8).

Slovenská Pošta is the provider of the universal postal service in Slovakia. It is also entrusted with other services of general economic interest such as the provision of postal financial services throughout Slovak territory. However, pursuant to the Postal Directive (9), the extension or even the maintenance of the postal monopoly may not finance a service of general economic interest other than the postal universal service.

In *International Mail Spain* (10), the Court further clarified the conditions under which Member States may extend the postal monopoly. They need to "*establish that, in the absence of such a reservation, achievement of that universal service would be precluded, or that reservation is necessary to enable that service to be carried out under economically acceptable conditions*".

No reliable estimate of the cost of providing the universal service

In its letter of 28 August, Slovenská Pošta submitted several studies based on the Net Avoided Cost (NAC) methodology according to which the cost of the universal service in Slovakia was at least SKK 1.5 billion.

However, after careful assessment of the said studies, the Commission came to the conclusion that the methodology used suffered from a number of fundamental defects and failed to take account of a number of relevant key points. Therefore, the Commission concluded that it could not accept that methodology.

Against this background, not only had the Slovak authorities not provided a reasonable estimate of the cost for providing the universal service in Slovakia, but they had also failed to demonstrate that the provision of this service in Slovakia is actually a burden.

No proof that the achievement of the universal service would be precluded or could not be carried out under economically acceptable conditions

The Slovak Government conceded that Slovenská Pošta was profitable in the period covered by the procedure. However, Slovenská Pošta submitted estimates on the loss of revenues which would derive from the opening of hybrid mail delivery services. Such a loss of revenue would derive from both a general price decrease on the one hand, and the loss of market share to the benefit of competitors on the other hand. According to Slovenská Pošta, this situation would not occur immediately but would likely happen as early as in 2010.

The Commission found, however, that Slovenská Pošta's forecasts were based on several premises or assumptions which proved to be untrue or unrealistic.

On the basis of the above, the assumption according to which Slovenská Pošta's financial situation

(4) Case 311/84 *CBEM* [1985] ECR 3261, at para. 27; see also Commission Decision of 21 December 2000 concerning proceedings pursuant to Article 86 of the EC Treaty in relation to the provision of certain new postal services with a guaranteed day- or time-certain delivery in Italy, OJ L 63, 3.3.2001, p. 59, paras 24-28.

(5) Case C-271/90 *Spain and others v Commission* ECR [1992] I-5833, at paras 36-38, with further reference to the judgment in Case C-18/88 *GB-INNO-BM* [1991] ECR I-5941, paras 18 and 21.

(6) Case C-271/90 *Spain and others v Commission* ECR [1992] I-5833, at paras 36-38, with further reference to the judgment in Case C-18/88 *GB-INNO-BM* [1991] ECR I-5941, paras 18 and 21.

(7) Case C-41/90 *Höfner and Elser* [1991] ECR I-1979.

(8) Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699, Case C-158/94 *Commission v Italy* [1997] ECR I-5789 and Case C-159/94 *Commission v France* [1997] ECR I-5815.

(9) Article 7 of the Directive reads "*to the extent necessary to ensure the maintenance of universal service, Member States may continue to reserve services to universal service provider(s)*".

(10) Case C-162/06 *International Mail Spain* [2007] ECR I-9911.

would deteriorate to the extent that Slovenská Pošta would not be in a position to provide the universal postal service was not supported by facts.

3.3. Remedies

The Commission found that the Amendment to the Postal Act No 507/2001, as amended, the amendment to the General Authorisation, the interpretation of these acts and their preceding versions by the Slovak authorities, in particular by the Postal Regulatory Office, as well as enforcement measures undertaken against private operators, were contrary to Article 86(1) of the EC Treaty, read in conjunction with Article 82 of the EC Treaty. The Slovak Republic had to inform the Commission, within one month of being notified of the decision, of the measures it had taken to put an end to the infringement.

The Decision has binding effects and can be directly applied by national courts.

Commission imposes the highest-ever cartel fine (more than EUR 1.3 billion) on four car glass manufacturers

Sigyn Monke [1], Lorenzo Piazza and Stephan Simon [2]

On 12 November 2008 the Commission adopted a decision and imposed fines totalling EUR 1 383 million on four manufacturers of car glass. The addressees of the decision were the Japanese firm Asahi Glass Company (AGC), the French group Saint-Gobain, UK-based Pilkington and Soliver from Belgium. These four companies participated in a single and continuous infringement of Article 81 of the EC Treaty and Article 53 of the EEA Agreement between early 1998 and early 2003. The Commission started the cartel investigation on its own initiative ("*ex-officio*") following a tip-off from an anonymous source.

The product

Automotive glass or car glass is made from float glass, which is the basic flat glass [3] product category. The automotive products consist of different glass parts such as windscreens, sidelights (windows for front and back doors), backlights (rear window), quarter lights (back window next to the rear door window), and sunroofs. The glass parts can moreover be tinted in different colour grades as opposed to clear glass. "Privacy" glass, or "dark tail" glass, is a specific category of tinted glass which reduces light and heat transmission inside the car and was also concerned by the illegal agreements and/or concerted practices covered by the decision. The market value of car glass delivered to car manufacturers in the EEA was in excess of EUR 2 billion in 2007.

The infringement

The anti-competitive practices essentially consisted in allocating supply contracts with a view to keeping their respective market positions as stable as possible. The three leading European car glass producers AGC, Saint-Gobain and Pilkington shared customers by allocating contracts for the supply of car glass parts/glass pieces for new and existing car models for which production was either planned or ongoing as well as for original equipment replacement parts/glass pieces. Soliver's participation in this collusive scheme could be established as from November 2001.

In order to allocate the contracts, the car glass suppliers exchanged price and other sensitive information and coordinated their pricing and supply policies, which allowed them to take concerted decisions regarding their responses to requests for quotations (RFQs) issued by car manufacturers and also to influence, to a large extent, the choice of supplier or, in the case of multiple sourcing, suppliers for any given contract or any given car sets or car glass pieces. The suppliers' coordinated actions were designed to maintain overall stability of their respective market positions for the purposes of the allocation of car glass pieces to be supplied to car manufacturers. The suppliers therefore closely monitored their market shares individually and jointly in relation to actual supply as well as future supply for various vehicle models not only per vehicle account but also globally. Where necessary, correcting measures were sought by the competitors in an attempt to ensure that on balance the overall supply situation at European level was in line with the envisaged allocation. The cartel covered the whole EEA territory.

Fines

In accordance with the 2006 Guidelines on fines, in assessing the gravity of the infringement the Commission took account of all relevant circumstances, in particular the gravity and duration of the infringement, which are the two criteria explicitly referred to in Regulation (EC) No 1/2003, as well as the value of each undertaking's sales of goods to which the infringement directly or indirectly related in the geographic area concerned within the EEA.

Relevant sales

On the basis of the principles laid down in the Guidelines, the basic amount is normally determined as a proportion of the value of the sales of the relevant product made by each undertaking in the relevant geographic area during the last full business year of the infringement. In view of the particularities of this case, the basic amount was calculated on the basis of an average of the sales during the infringement period, normalised to one year, rather than on the basis of the last full business year of each undertaking's participation in the infringement.

(1) Former case handler in DG COMP in the Directorate-General for Competition

(2) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(3) Flat glass was the subject of another cartel decision adopted by the Commission in November 2007 (see Competition Policy Newsletter 2008/1, p. 49), involving Saint-Gobain, AGC, Pilkington and Guardian.

In particular, the Commission has, in line with the 2006 Guidelines on fines, applied a more calibrated approach and considered the fact that in the first two and a half years, from March 1998 to the middle of 2000, it had direct evidence of cartel activity for only some of the car manufacturers with production capacity in the EEA. While this does not mean that other car manufacturers were not the subject of cartel discussions in the first two and a half years, the Commission, in view of the particularities of this case, has taken account of those two and a half years as a "roll-out phase" during which the cartelists only progressively developed their collusive behaviour towards all car manufacturers. Consequently, the Commission reduced the weight of the roll-out period between the beginning of the infringement in 1998 and 30 June 2000.

Similarly, the Commission reduced the weight of the final stage of the cartel from September 2002, when the important player Pilkington exited the cartel, to March 2003 by only taking account of each car glass supplier's value of sales to those car manufacturers for which there is direct evidence in the Decision of cartel arrangements.

Final amount

In determining the fine, the Commission considered the fact that at the time the infringement took place, Saint-Gobain had already been the addressee of two previous Commission decisions concerning cartel activities which are relevant as aggravating circumstances. This justified an increase of 60% in the basic amount of the fine to be imposed on Saint-Gobain, resulting in a total fine for Saint-Gobain of EUR 896 million.

With regard to Soliver, the ceiling of 10% of turnover pursuant to Article 23(2) of Regulation No 1/2003 was attained. Its fine was therefore limited to EUR 4.396 million.

AGC and its European subsidiary AGC Flat Glass Europe (formerly Glaverbel) filed an application under the 2002 Leniency Notice. AGC cooperated fully with the Commission and provided evidence, which represented significant added value, to help expose the infringement. The Commission, therefore, granted AGC a 50% reduction of the fine, to EUR 113.5 million.

The resulting fines of EUR 1 383 million are the highest cartel fines the Commission has ever imposed, both for an individual company (EUR 896 million on Saint-Gobain) and for a cartel as a whole. The final amount of the fine reaffirms the Commission's determination to take robust action against cartel arrangements which severely affect consumers and businesses. The unprecedented level of the fines imposed in this case gives a clear signal to all firms of the risks that they face if they enter into price-fixing and/or market-sharing agreements. Such arrangements not only harm consumers but, in this case, had an impact on the entire car manufacturing sector, an industry which has been particularly hard-hit by the current financial crisis.

Bringing light into the dark: Commission fines long-lasting candle wax cartel more than EUR 676 million

Lars Albath, Cecilia Nilsson-Bottka, Rainer Wessely [1]

With its fifth cartel decision in 2008 the Commission imposed heavy fines on several producers of paraffin waxes and slack waxes. The decision adopted on 1 October established that these producers had been involved in anticompetitive arrangements in the paraffin wax and slack wax industry for up to thirteen years. The investigation that started off with a leniency application by Shell lasted three and a half years from the moment conditional immunity was granted until the adoption of the decision.

Introduction

Nine groups of companies — namely ENI, ExxonMobil, Hansen & Rosenthal, Tudapetrol, MOL, Repsol, Sasol, RWE and Total, all active or formerly active in the production of paraffin waxes, were found to have participated, directly or indirectly, throughout a period of up to thirteen years in illicit agreements with their competitors. By its decision of 1 October 2008 the Commission imposed a total fine of more than EUR 676 million on these companies. Shell also took part in the cartel but received immunity from fines as it was the first company to inform the Commission about the existence of the cartel.

The above groups of companies were found to have been directly or indirectly involved in a cartel in the European Economic Area (EEA) in violation of the EC Treaty's ban on cartels and restrictive business practices (Article 81 EC) for varying periods between 1992 and 2005. For some of the producers, the cartel activities extended to slack wax sold to end-customers on the German market. The features of the cartel, as found by the Commission, included price fixing, market allocation and customer allocation.

The products

Paraffin waxes comprise fully-refined paraffin waxes and semi-refined paraffin waxes (depending on the oil content) as well as hydro-finished waxes, wax blends, wax specialties and hard paraffin waxes. They are used in a wide variety of products such as candles, waxed paper, paper cups and plates, the wax coating on cheese, chemicals, tyres and car components as well as in the rubber, packaging, adhesive and chewing gum industries. Most paraffin wax in Europe, about 60-70% of the total amount produced, is used for candle production.

The raw material required for the manufacture of paraffin waxes is called slack wax. It is produced in refineries as a by-product in the manufacture of base oils from crude oil. It is also sold to end-customers, for instance to producers of particle board.

The Commission's investigation

The investigation was triggered by an immunity application by Shell. Shell decided to cooperate with the Commission under the 2002 Commission notice on immunity from fines and reduction of fines in cartel cases ("the 2002 Leniency Notice") [2] and applied for conditional immunity. Based on the information received the Commission organised dawn raids at the premises of most of the companies involved in the production of paraffin waxes and slack wax in April 2005.

Already during these dawn raids one of the companies claimed that an inspection could not be solely based on a Commission inspection decision. In its view a national search warrant should have been presented by the inspectors from the national competition authority assisting the Commission. In its final decision the Commission rejected this argument on the ground that a Commission inspection decision is binding on the company. It was pointed out that a national search warrant is only necessary if a company refuses to submit to the inspection.

In reaction to the industry-wide inspections, several companies — namely Sasol, Repsol and ExxonMobil — submitted applications for immunity or, in the alternative, a reduction of fines under the 2002 Leniency Notice. All of these companies cooperated throughout the further procedure with the Commission and were rewarded for their cooperation in the final decision.

A Statement of Objections in this case was issued in May 2007. All addressees of the Statement of Objections had the possibility to comment on the objections in writing and orally during an Oral Hearing, held in December 2007.

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) OJ C 45, 19.2.2002, p. 3.

The infringement

The Commission comes in its decision to the conclusion that ENI, Esso, H&R, Tudapetrol, MOL, Repsol, Sasol, Shell, RWE and Total were involved, directly or indirectly, in a single, complex and continuous infringement of Article 81 of the EC Treaty and of Article 53 of the EEA Agreement for varying periods of time between 1992 and 2005. The findings are based not only on the various submissions made by the immunity applicant and the leniency applicants, but to a large extent on handwritten documents that were found during the inspections.

The decision shows that, at least from 1992 to 2005, the producers of paraffin waxes and slack wax operated a cartel in which they fixed prices for paraffin waxes. The organisation of the cartel was disguised as "Technical Meetings" that were regularly attended by employees of most of the producers. Evidence shows that during these meetings the producers fixed prices for paraffin waxes and exchanged commercially sensitive information. In addition, some of the companies — namely ExxonMobil, MOL, Repsol, Sasol, Shell and Total — further engaged in market allocation for paraffin waxes and ExxonMobil, Sasol, Shell, RWE and Total were also found to have fixed prices for slack wax sold to end-customers on the German market.

The organisation of the cartel was extensively formalised and the Commission was able to show that the companies held regular meetings to discuss prices, allocate markets and/or customers and exchange sensitive commercial information. A vast amount of evidence demonstrates the presence of employees at approximately 50 of these "Technical Meetings" between 1992 and 2005. Certain undertakings did not participate in the infringement for the entire period.

The fines imposed

The fine was calculated on the basis of the Commission's 2006 Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 ([3]) (the "Guidelines on Fines"), which were in force at the time the Statement of Objections was notified. The total fine imposed amounts to EUR 676 011 400.

In setting the basic amount and the so-called "entry fee" ([4]) of the fine, the Commission took into account the respective affected sales of the companies involved as well as the combined market share and the geographic scope of the cartel agreements. In determining the gravity of the infringement, the Commission took into account the fact that price fixing, market allocation and customer allocation constitute by their nature very serious infringements of EC Treaty antitrust rules.

In accordance with paragraph 28, third indent, of the Guidelines on Fines, the Commission increased Sasol's fine by 50% as it was found to be the leader of the cartel. The Commission also increased, in line with the rules on repeated infringements in paragraph 28, first indent, of the Guidelines on Fines, the fines for ENI and Shell by 60%. Both had already been subject to prior cartel decisions by the Commission.

The cooperation of Shell, Sasol, Repsol and ExxonMobil was rewarded in accordance with the 2002 Leniency Notice. Shell, being the first company to come forward with information about the cartel, received full immunity from fines. Sasol, Repsol and ExxonMobil were granted a reduction of their fines of 50%, 25% and 7% respectively.

The fines imposed on the individual groups and the leniency reductions granted by the Commission can be summarised as follows:

	Reduction under the Leniency Notice (%)	Reduction under the Leniency Notice (€)	Fine* (€)
Shell, UK/the Netherlands	100	96 000 000	0
Sasol, South Africa and Germany	50	318 200 000	318 200 000
Repsol, Spain	25	6 600 000	19 800 000
ExxonMobil, USA	7	6 291 600	83 588 400
ENI, Italy	0	0	29 120 000
Tudapetrol, Germany	0	0	12 000 000
Hansen & Rosenthal, Germany	0	0	24 000 000
MOL, Hungary	0	0	23 700 000
RWE, Germany	0	0	37 440 000
Total, France	0	0	128 163 000
TOTAL			**676 011 400**

(*) In several cases legal entities within the undertaking are held jointly and severally liable for the whole or part of the fine imposed.

([3]) OJ C 210, 1.9.2006, p. 2.
([4]) Guidelines on fines, paragraph 25.

The banana cartel decision

Vita Jukneviciute and Bjarke List (1)

On 15 October 2008, the Commission adopted a prohibition decision against Dole, Chiquita, Weichert and Del Monte for operating a cartel for fresh bananas (2) in eight EU Member States. The Commission imposed fines totalling €60.3 million on Dole, Weichert and Del Monte. Dole, Chiquita and Weichert participated in a single and continuous infringement of Article 81 of the EC Treaty for three years from January 2000 to December 2002. Del Monte is held jointly and severally liable for the fine imposed on Weichert as it controlled Weichert at the time of the infringement. Because it was the first to inform the Commission of the existence of the cartel, Chiquita was granted immunity from fines.

The product

The product covered by the decision is fresh bananas. Fresh bananas may be sold unripened (green) or ripened (yellow). Bananas are bought all year round by a large proportion of EU consumers.

Geographic scope of the decision

The infringement which is the subject of the decision relates to the supply of bananas to the northern European region of the EU. For the purposes of the decision this region includes Austria, Belgium, Denmark, Finland, Germany, Luxembourg, the Netherlands and Sweden. The Commission has estimated that the annual retail value of the bananas sold to consumers in the eight Member States affected by the cartel amounted to around €2.5 billion in 2002.

The cartel

The decision relates to a concerted practice between certain banana suppliers by which they coordinated weekly reference prices for bananas.

The banana business is organised in weekly cycles. During the relevant period the importers of leading brands of bananas into the eight EU Member States principally served by the north European ports each set and then announced every Thursday morning their reference price (announced price) for the following week. While this reference price may be different from the transaction price obtained, changes in the weekly reference prices did constitute an important pricing signal to the market. On many occasions over the three years covered by the decision there were bilateral phone calls among the companies, usually the day before they set their price. Through these pre-pricing communications the parties disclosed their pricing intentions to competitors. By concerting in advance on reference prices set weekly and in particular on the development of these prices, i.e. whether they would be going up, going down or staying the same, the parties coordinated their price-setting behaviour instead of deciding upon their prices independently.

Fines

In setting the fines in accordance with the Guidelines on fines, the Commission also took into account the fact that at the time of the infringement bananas were subject to a very specific regulatory regime (not least under Council Regulation (EEC) No 404/93 (3) of 13 February 1993 on the common organization of the market in bananas). The banana import regime was based on import quotas and tariffs. Banana import quotas for the Community were set annually and allocated on a quarterly basis with some limited flexibility between the quarters of a calendar year.

Furthermore, in setting the fine for Weichert/Del Monte account was taken of the fact that, given the circumstances of the case, it could not be established that Weichert was aware of the pre-pricing communications between Dole and Chiquita or that it could reasonably have foreseen them.

Application of the 2002 Leniency Notice

The Commission's investigation was triggered by an application for immunity lodged by Chiquita in April 2005. Chiquita was the first to inform the Commission of the existence of a cartel. Chiquita was eventually granted immunity from any fines that would otherwise have been imposed in this case.

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) Case COMP/39.188 *Bananas*.

(3) OJ L 47, 25.2.1993, p. 1.

Mergers: main developments between 1 September and 31 December 2008

Mary Loughran and John Gatti (1)

Introduction

The level of notifications declined during the last three months of 2008, to 98, reflecting the impact of the worldwide financial crisis. Despite this slight decrease, the number of merger notifications for the year as a whole (347) was close to the second highest on record. As regards the numbers of decisions adopted there were no noticeable changes in overall levels, with the total number of decisions adopted running at 117, total first-phase decisions at 106 and total simplified procedures at 65. There was, however, a relatively high number (7) of conditional clearances in Phase I (under Article 6(2)). As regards Phase II cases the Commission cleared one case unconditionally under Article 8(1) after an investigation and three transactions subject to conditions (Article 8(2)). Two cases were abandoned in the second phase.

A — Summaries of decisions taken under Article 6(2)

Manitowoc/Enodis

On 19 September the Commission cleared the proposed acquisition of Enodis of the UK by Manitowoc of the US. The Commission's decision is conditional upon the commitment by Manitowoc to divest Enodis' entire ice-making machines business in the EEA, where the Commission identified competition concerns, including three production facilities in Italy.

Manitowoc is active in several sectors including the manufacture of lifting equipment in the shipbuilding sector and the production of cold-focused equipment in the foodservice industry (including ice-making machines, beverage dispensers and refrigeration equipment). Enodis was, at the time of the notification, a global food and beverage equipment manufacturer. In the EEA it sells a wide range of equipment, including ice-making machines, beverage dispensers, cooking equipment, coolers and refrigeration equipment.

The parties' activities overlapped in relation to ice-making machines and beverage dispensing systems. The Commission's initial investigation showed that this would raise competition concerns at EEA level and in a number of Member States, where in relation to three types of ice-making machines (self-contained cubers, modular cubers and flake machines), market shares would be very high. All other competitors of the combined entity had substantially lower market shares.

To remove the Commission's concerns, Manitowoc offered to divest Enodis' entire ice-making machines business, including three production facilities in Italy. After market testing the proposed remedies the Commission concluded that they were suitable to address the competition concerns initially identified in its market investigation.

EDF/British Energy

On 22 December conditional clearance was granted to the proposed acquisition of British Energy (BE) by Electricité de France (EdF). The Commission's decision was conditional upon EdF's commitment to divest the power generation plants at Sutton Bridge in the UK (owned by EdF) and at Eggborough (owned by BE), to sell certain minimum volumes of electricity in the British wholesale market, to unconditionally divest a site potentially suitable for building a new nuclear power station located at either Dungeness or Heysham in the UK, at the purchaser's choice, and to end one of the merged entity's three grid connection agreements with National Grid at Hinkley Point in the UK.

Electricité de France S.A. (EdF) is a company incorporated under the laws of France active in the generation and wholesale trading of electricity and in the transmission, distribution and retail supply of electricity to all groups of customers. In the UK, it is active mainly in coal and gas-fired power generation and the wholesale, supply and distribution of electricity. British Energy (BE) is a UK-based company active in the markets for the generation and wholesale of electricity and supply to industrial and commercial customers. BE has a predominantly nuclear power generation portfolio.

The activities of EdF and BE overlap at the level of generation and wholesale as well as the supply of electricity to industrial and commercial customers. Although the combined entity would not have had extremely high market shares, the Commission found during its investigation that the transaction,

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as initially notified, would have been likely to raise serious competition concerns in four main areas.

First, due to the combination of the flexible generation portfolio of EdF and the baseload generation portfolio of BE's nuclear power plants, the Commission was concerned that the proposed transaction could have made it easier for the merged entity to withdraw electricity supplies from the market in order to increase the price.

Secondly, the Commission was concerned that the combination of the short generation position of EdF and the long generation position of BE was likely to lead to increased internal use of electricity that would otherwise have been sold to the market. This would have led to a reduction of liquidity which could have had negative effects in both the wholesale and the retail supply markets.

Thirdly, the Commission was concerned that there were a limited number of sites likely to be suitable for the construction of a first wave of new nuclear reactors in the framework of the UK policy on building new nuclear power stations. BE owned many of the sites most likely to be suitable for new nuclear build, while EdF owned key land at two such locations. The transaction, as originally notified, would therefore have led to a high concentration in the ownership of sites most likely to be suitable for new nuclear build.

Finally, the combination of EdF's and BE's current rights to connections to the electricity transport network would have enabled the merged entity to hold connection rights beyond its combined capacity expansion plans, with the risk of unduly delaying the power generation projects of its competitors.

To address these concerns, the parties submitted remedies. Further to the results of the market test of these remedies and in its own assessment, the Commission found that the remedies proposed were not sufficient to remove the competition concerns with respect to the first two areas of concern. However, subsequently, the parties submitted an improved remedy package comprising commitments to divest EdF's power generation plant at Sutton Bridge and BE's generation plant at Eggborough, to sell certain minimum volumes of electricity in the wholesale market for a certain period of time when the combined entity would have had the ability to internalise the use of electricity that it produces, to divest a site potentially suitable for building a new nuclear power station located at either Dungeness or Heysham, and to end one grid connection agreement with National Grid at Hinkley Point.

The Commission concluded that the revised remedy package was sufficient to remove all identified competition concerns.

WPP/TNS

On 23 September the Commission gave its conditional approval to the proposed acquisition of TNS by WPP, both UK-based groups globally active in the information and communications services sectors. The Commission's decision is conditional upon WPP's commitment to divest television audience measurement services in the EEA and TNS' market research services business in Ireland.

WPP is an international marketing communications services group. It provides services such as advertising, marketing data services (including media management and market research services), insight and consultancy, public relations and public affairs. TNS is a global insight, information and consultancy firm which provides a full range of market research and information services. The activities of WPP and TNS overlap in the provision of market research services and media measurement services and the transaction would result in a number of markets being horizontally and vertically affected.

Following consultation of a wide range of customers, intermediaries and competitors in all the affected markets, the Commission identified serious competition concerns with respect to market research services in Ireland and television audience measurement services at EEA level. In Ireland, the Commission was particularly concerned by the new entity's post-merger strength in the provision of market research services which would enable it to increase prices and lower the quality of the service provided.

Regarding television audience measurement services at EEA level, the new entity would have a combined market share of above sixty percent. The current transaction as notified would have been a merger from three to two between the closest competitors, and would lead to the elimination of an important competitive force.

To remove the Commission's concerns in Ireland, WPP offered to divest TNS' market research services in Ireland and, to allay concerns for television audience measurement services at EEA level, to divest either WPP's shares in its joint venture AGB Nielsen or TNS' television audience measurement services business. After market testing the proposed remedies, the Commission concluded that they were suitable and viable to address the competition concerns identified in its market investigation and, on this basis, decided to authorise the transaction, as modified by the commitment.

Teva/Barr Pharmaceuticals

On 19 December the Commission gave conditional approval to the proposed acquisition of Barr Pharmaceuticals of the US by Teva Pharmaceutical Industries of Israel. Both companies produce generic medicines. To remedy the Commission's competition concerns in the field of cancer drugs and prescription vitamin products on a number of national markets, Teva made the commitment to divest fifteen cancer drugs in the Czech Republic, Hungary, Poland, Slovakia and Slovenia, as well as two other drugs in Poland.

Teva is a global pharmaceutical company mainly specialising in the development, production and marketing of generic medicines. Teva is the largest generics producer in the world. Barr is a global pharmaceutical company primarily engaged also in the development, production and marketing of generic medicines. Generic medicines are chemically equivalent to original medicines and sold once the patent for the latter has expired.

The merger was found to be complementary to a large extent. Where overlaps between Teva's and Barr's activities occurred, the Commission investigated a number of national pharmaceuticals markets in Central and Eastern Europe, Germany and the United Kingdom. The Commission found that competition concerns could be excluded in these markets, because Teva's and Barr's joint market shares were moderate and a sufficient number of competitors would remain after the merger.

However, the Commission found that the proposed transaction — as originally notified — would have raised competition concerns for 17 pharmaceuticals markets in the Czech Republic, Hungary, Poland, Slovakia and Slovenia. The Commission's concerns related primarily to the field of cancer drugs, where both Teva and Barr had overlapping product portfolios in these countries. The Commission was concerned about the removal of Barr as a competitor to Teva for the generic versions of these drugs and for two prescription vitamin products in Poland. There was a risk that the lack of competition in these markets would lead to higher prices for hospitals and patients.

To address the Commission's concerns, Teva offered to divest the carboplatin and cisplatin businesses in the Czech Republic, Hungary and Slovenia, the fluorouracil business in the Czech Republic, the methotrexate businesses in the Czech Republic and Hungary, the paclitaxel businesses in the Czech Republic and Poland, the calcium folinate business in Poland, the tamoxifen business in Slovakia and Barr's calcium folinate business in the Czech Republic. In addition, Teva offered to divest its pyridoxine and riboflavin businesses in Poland.

In view of these commitments, the Commission concluded that the transaction would no longer raise competition concerns.

Galp Energia /ExxonMobil Iberia

On 31 October the Commission cleared, subject to conditions, the proposed acquisition by Galp Energia of Portugal of Esso Portuguesa, Esso Española and part of ExxonMobil Petroleum & Chemical. The Commission found that the proposed transaction as initially notified would have given rise to competition concerns in certain refined oil product markets in Portugal. To address the Commission's concerns, Galp offered to divest certain assets and shareholdings.

Galp is a vertically integrated energy company exploring for, producing and marketing oil and petroleum products mainly in the Iberian Peninsula. Esso Portuguesa and Esso Spain supply petroleum products in Portugal and Spain (including retail and non-retail motor fuels, LPG and aviation fuels). The acquired part of ExxonMobil Petroleum & Chemical BVBA operates in lubricants and specialties businesses in the Iberian Peninsula. All three businesses to be acquired are subsidiaries of the ExxonMobil Corporation of the US.

The Commission's investigation revealed that the proposed transaction would not significantly modify the structure of the relevant markets in Spain as a number of credible and more significant competitors would continue to exercise competitive constraint on the merged entity.

As regards Portugal, the Commission found that the proposed transaction, as initially notified, could have raised competition concerns in a number of markets in Portugal. These markets were: non-retail sales of diesel, LPG in bottles, LPG in bulk, into-plane aviation fuel and lubricants. In all these markets Galp held significant market shares even before the transaction and the merger would have led to a further strengthening of its dominant position.

To resolve these competitive concerns, Galp proposed to divest a sea terminal, which also serves as an LPG bottling plant, a storage facility for liquid fuels and LPG and a blending plant for lubricants. Galp also undertook to divest certain Esso shareholdings in airport joint ventures and other assets for into-plane operations in Portuguese airports.

The divestitures also include staff, customers and supply contracts. After testing these commitments with stakeholders, the Commission concluded that the businesses to be divested would be viable and that the divestitures would resolve all identified competition concerns.

Rail Cargo Austria/MÁV Cargo

On 25 November the Commission cleared the proposed acquisition of MÁV Cargo of Hungary by the Austrian company Rail Cargo Austria (RCA), both active in the provision of rail freight transport and freight forwarding services. The Commission's decision was conditional upon RCA's commitment to remove structural links and review contractual links with GySEV (Raaberbahn).

RCA is a subsidiary of the state-owned Austrian ÖBB Holding AG railway company. RCA is engaged in rail freight transport and freight forwarding in Austria, Germany, Slovenia, Hungary and Slovakia. MÁV Cargo is a subsidiary of the Hungarian state-owned MÁV railway company. MÁV Cargo is active in rail freight transport and freight forwarding, mainly in Hungary and to a lesser extent in other European countries.

The proposed transaction, as initially notified, concerned the acquisition of MÁV Cargo by RCA in a consortium together with GySEV, an integrated rail and infrastructure company with its own rail network located both in Austria and in Hungary. GySEV is active in rail passenger and freight transport in Austria and Hungary with a focus on rail freight cross-border transport.

Notwithstanding the full liberalisation of the markets for rail freight transport in 2007, these markets are still characterised by limited competition and strong incumbents cooperating for cross-border rail freight transport.

The Commission identified serious competition concerns that would have arisen from the implementation of the proposed transaction, as initially notified, because it would have resulted in removing the closest potential competitor for RCA on the Hungarian rail freight transport market and for MÁV Cargo on the Austrian market.

To remedy these concerns, RCA gave the commitment to cut its entire structural links and review its contractual links with GySEV, thereby strengthening GySEV as an independent player and a competitor of the new entity created by the merger. The Austrian and Hungarian Governments, as the main shareholders of GySEV, will ensure that the structural links with the merged entity are cut and the influence of Austria over GySEV's rail freight activities is limited.

After market testing the proposed commitments, the Commission concluded that they were viable measures, suitable to address the competition concerns identified in its investigation.

BNP Paribas/Fortis

On 3 December the Commission gave its approval to the proposed acquisition of the Belgian and Luxembourg subsidiaries of Fortis Holding, namely Fortis Bank Belgium, Fortis Banque Luxembourg, and Fortis Insurance Belgium, by BNP Paribas, a bank with retail operations primarily in France. This clearance is subject to the full divestment of BNP Paribas Personal Finance Belgium SA/NV ("PFB"), formerly Cetelem Belgium, including its stake in Fidexis and in the credit processing venture Cetelem Services (an EEIG), to which, inter alia, KBC Bank is also a party. The Commission's concerns related to the issuing of credit cards in Belgium and partly in Luxembourg, where the merged entity would have become by far the largest player, thereby reducing clients' choice for credit cards. To address the Commission's concerns, BNP offered to divest entirely its Belgian credit card arm, PFB.

BNP Paribas is present in Belgium and Luxembourg in credit cards through its subsidiary PFB, which issues cards under the Mastercard label and Aurora brand. It is also present through Fimaser, a Belgian joint venture with the retail chain Carrefour; Fidexis, a 100% owned subsidiary of PFB; and KBC Pinto Systems, a joint venture with the Belgian bank KBC. All of these activities rely on Cetelem Services EEIG for certain support needs. This is a European Economic Interest Grouping in which PFB itself, Fimaser, KBC Pinto Systems, and UCB Hypotheken n.v. (also a subsidiary of BNP Paribas) are members.

The Commission's concerns centred on credit cards as a payment instrument as well as on the provision by the parties of credit to consumers through the cards. The Commission's concerns did not relate to the acquiring side of the market.

BNP Paribas' Belgian consumer finance business is by a long way the largest player in card-based credit, while Fortis is active in the same area, in particular through its Alpha Credit subsidiary. Fortis is at the same time a major issuer of cards in Belgium and a major supplier of card and general banking services to both private and corporate clients.

The Commission's investigation indicated that in Belgium the merged entity would have become by far the largest player in card issuing and the related provision of credit, and that the transaction, as initially notified, would have reduced choice in the market, both from the standpoint of commercial partners involved in distribution and co-branding arrangements with card issuers and from the viewpoint of the final cardholder. Debit cards linked to a personal account were considered separately. In this area, the parties' activities did not overlap to any significant extent.

In Luxembourg, the Commission came to the conclusion that the transaction would not lead to competitive concerns as regards credit, but that such concerns could not be ruled out for credit cards.

BNPP's commitment to divest PFB would substantially offset the increase in market share due to the merger on the problematic markets, and would maintain robust competition for the benefit of consumers. The Commission also analysed a number of other markets in which the overlap of the parties was limited and concluded that these markets did not raise competition concerns.

B — Summaries of decisions taken under Article 8(1)

KLM/Martinair

On 17 December the Commission gave unconditional clearance to the proposed acquisition of Martinair by KLM, both Dutch airlines active in the transport of passengers and cargo. In September, the Commission opened an in-depth investigation because of concerns regarding the potential impact of the proposed transaction on passenger transport, in particular between Amsterdam and Curacao and Aruba (in the Netherlands Antilles). The in-depth investigation, including a consumer survey at Amsterdam airport, showed that the transaction would have only limited market impact.

KLM is a full-service air carrier with its home base at Amsterdam's Schiphol airport. KLM is part of the Air France-KLM group. Martinair is also based at Schiphol and is currently owned 50/50 by KLM and the sea and land transport company Maersk. Both parties are active in air transport of cargo and passengers between Amsterdam and various destinations worldwide. Martinair's passenger fleet only serves intercontinental destinations. The parties' passenger operations overlap mainly on routes connecting Amsterdam to various long-haul destinations, namely Vancouver, Toronto, Miami, Havana, Punta Cana, Cancun, Curacao and Aruba.

On 8 September, the Commission opened an in-depth inquiry because of concerns related in particular to the impact that the transaction could have on passenger transport between Amsterdam and Curacao and Aruba.

The Commission's in-depth investigation showed that the effects of the proposed transaction would be limited, not only because KLM already jointly controls Martinair, but also because Martinair's competitive strength has been constantly decreasing and, to regain its strength, Martinair depends on KLM's agreement to a renewal of its long-haul passenger fleet. The investigation included a consumer survey carried out at Schiphol airport (Amsterdam). The survey indicated that a significant proportion of passengers would either not travel at all or travel elsewhere if there were a sustained price increase for flights to these two destinations, which limits the potential for price increases. The investigation also revealed that the merged entity would be constrained by its competitor ArkeFly on these two routes. As a result, any price increases on the part of the merged entity would be likely to be unprofitable.

As regards the wholesale supply of airline seats to tour operators for these two routes, any potential price increases by the merged entity would lead to TUI, the tour operator vertically integrated with competitor ArkeFly, selling more package holidays to the detriment of its competitors, who largely depend on KLM and Martinair for the supply of airline seats for package holidays to Aruba and Curacao. The parties would therefore stand to lose significant sales, making price increases unprofitable.

The Commission also assessed the possible effects of the proposed merger on other routes where the parties' passenger operations overlap and in the cargo air transport sector. However, the Commission concluded that the proposed transaction was not likely to give rise to any competition concerns in these areas.

C — Summaries of decisions taken under Article 8(2)

Associated British Foods/GBI

On 23 September the Commission cleared the proposed acquisition of certain parts of GBI of the Netherlands by the UK-based company Associated British Foods (ABF), subject to conditions. Both companies produce dry, compressed and liquid baker's yeast. The Commission's in-depth market investigation, opened in April 2008, had indicated that the transaction, as originally notified, would have raised competition concerns in the markets for compressed baker's yeast in Spain and Portugal. To remedy the Commission's concerns, ABF offered to divest the GBI businesses in Spain and Portugal, while ensuring that these businesses will be linked to sufficient production capacity.

ABF is an international food, ingredients and retail group. Its activities include the production and sale of yeast, managed through the AB Mauri division, which has production plants worldwide, including four plants in the EU (UK, Ireland, Spain and Portugal). ABF also owns two bakery ingredients plants in the UK (Cereform) and distributes yeast from its plants across the EU and elsewhere in the world.

The core activity of the GBI assets being acquired was the production and sale of various types of yeast. The business comprises several European subsidiaries and assets of the GBI Group in Europe, except in the UK. The acquisition of GBI's business in the UK by Lesaffre was approved subject to conditions by the Commission in July 2008. GBI is ultimately controlled by the Dutch private equity house Gilde Buy-Out Partners.

Yeast is an essential ingredient in the production of bread and other bakery products, pizza, dough bases, beer, wine and other foodstuffs. The proposed transaction concerns liquid, compressed and dry yeast for the bakery sector only.

In its initial analysis, the Commission had serious concerns that the transaction, as originally notified, would have significantly impeded effective competition in the markets for compressed baker's yeast in Spain, Portugal and France. In these markets, the proposed transaction would have reduced the number of major competitors from three to two, with Lesaffre being the only remaining major competitor besides the merged entity. An in-depth analysis of market structures and conditions in Spain and Portugal led to the conclusion that the merger would have resulted in coordinated market behaviour between the remaining competitors in these two markets. As regards the compressed yeast market in France, no competition concerns were confirmed, essentially given the different market structure in place there.

With a view to removing the Commission's concerns, ABF committed to divest GBI's business in Portugal and Spain to a suitable buyer with sufficient production capacities to supply those businesses. To ensure that the acquirer will have the required production capacities, ABF committed to one of two alternative remedies: either the acquirer will have previously acquired GBI's former production plant in the UK or the parties will divest ABF's production plant in Portugal.

The Commission concluded that these commitments were sufficient to remedy its initial concerns.

Statoil Hydro/Jet Scandinavia

On 21 October the Commission gave its approval to the proposed acquisition of ConocoPhillips' network of Jet fuel stations in Scandinavia by StatoilHydro of Norway following an in-depth investigation opened in May 2008. To gain approval, StatoilHydro undertook to divest all 40 Jet fuel stations in Norway and a network of 158 fuel stations in Sweden operating under the Jet, Hydro and Uno-X brands. StatoilHydro is an integrated oil and gas company active in exploration for and production of crude oil and natural gas. The company also refines and sells motor fuels and other oil derivatives. StatoilHydro operates fuel station networks in Scandinavia under the Statoil, Hydro and Uno-X brands. Jet Scandinavia operates fuel station networks in Scandinavia under the Jet brand.

The Commission found that the proposed transaction — as originally notified — would have raised serious competition concerns in Norway and Sweden. In Norway, the proposed transaction would have reinforced the oligopolistic structure of the Norwegian market. Statoil Hydro's position as the largest provider of motor fuels in Norway would have been strengthened. In Sweden, StatoilHydro is already the market's largest supplier and, by acquiring one of its main competitors, the company would have obtained a market share more than double the share of the second largest competitor. The Commission had further concerns with regard to Jet's disappearance as the most efficient low-cost operator in both Norway and Sweden with a strong brand and a proven track record of undercutting competitors' prices in markets with high entry barriers.

To address the Commission's concerns, StatoilHydro offered to divest the entire Jet network in Norway and a 158-station network in Sweden, entirely made up of automated fuel stations. In view of this commitment, the Commission concluded that the transaction would no longer raise serious competition concerns in Norway and Sweden. Independently of the competition assessment, StatoilHydro decided to close a number of less efficient fuel stations in Sweden.

Arsenal Capital Partners/DSM Special Products

On 9 January the Commission cleared the proposed acquisition of chemical company DSM Special Products (DSP) of the Netherlands by Arsenal Capital Partners (Arsenal), a US private equity firm. Arsenal owns Velsicol, a chemical company active in the EEA through its Estonian plant. DSP is a chemical company with a single production plant, in Rotterdam. Both parties produce benzoic acid, a raw material used in the production of a variety of goods, including as an antimicrobial preservative in food and drinks, in plasticisers, pharmaceutical products and pet food. In August 2008, the Commission opened an in-depth investigation because of competition concerns. Arsenal made the commitment to divest the whole of its liquid and solid benzoic acid production, as well as sodium benzoate production in the European Economic Area (EEA). The Commission found that the proposed transaction would have raised serious competition concerns in the EEA market for solid benzoic acid, where the merged entity would have run the only two production plants in the EEA. The Commission also found that imports of benzoic acid into the EEA are very low and would not be capable of constraining the merged entity.

To address the Commission's concerns, Arsenal offered to divest the Velsicol production plant in Estonia and therefore its entire solid and liquid benzoic acid production. The proposed divestment also includes the production of sodium benzoate, a product derived from benzoic acid and used primarily as a preservative in food and soft drinks, to ensure the full viability of the divested business. In view of this commitment, the Commission concluded that the transaction would no longer raise serious competition concerns.

Campina/Friesland Foods

On 17 December the Commission cleared the proposed merger between Campina and Friesland Foods, both Dutch companies active in a range of dairy product markets, subject to conditions. The Commission's in-depth investigation, opened in July 2008, indicated that the transaction, as originally notified, would have raised competition concerns in the markets for the procurement of raw milk, fresh dairy products and cheese in the Netherlands and for long-life dairy drinks in the Netherlands, Belgium and Germany. To remedy the Commission's concerns, the merging parties offered to divest Friesland Foods' fresh dairy product business and part of Campina's cheese business and two Campina brands for long-life dairy drinks. They also offered remedies to ensure access to raw milk in the Netherlands.

Both Campina and Friesland Foods are dairy cooperatives active primarily in the Netherlands and other EU Member States. Their activities involve several markets along the dairy food product chain, from the procurement and processing of raw milk to the production of a variety of dairy and non-dairy products.

The Commission's investigation showed that the merger, as initially notified, would have resulted in a significant impediment to effective competition in the Dutch markets for the procurement of raw milk, fresh basic dairy products, value-added yoghurt and quark, fresh flavoured dairy drinks, fresh custard and porridge and cheese as well as in the market for long-life dairy drinks in the Netherlands, Belgium and Germany.

With a view to removing the Commission's concerns, the merging parties made the commitment to divest Friesland Foods' fresh dairy product business (including the transfer/licensing of brands and a plant in Nijkerk) and one of Campina's cheese plants, located in Bleskensgraaf. They also committed to divest two Campina brands for long-life dairy drinks.

Additionally, they offered remedies to ensure access to raw milk for the fresh dairy and cheese businesses to be divested by the parties as well as for their competitors in the fresh dairy and cheese markets in the Netherlands. These commitments include three elements. Both divested businesses would initially be able to source raw milk from the merged entity under a transitional supply agreement. Subsequently, a foundation (Dutch Milk Fund) would be set up to ensure access to a maximum yearly volume of 1.2 billion kg of raw milk for the divested businesses and other competitors. This Milk Fund would remain in place until more structural changes in the market for raw milk were achieved. The merged entity, FrieslandCampina, would reduce exit barriers for dairy farmers who might wish to leave the new cooperative. This third measure would aim to create a source of Dutch raw milk that was independent from FrieslandCampina and would thus provide a long-term structural solution. The Commission concluded that the commitments were sufficient to remedy its initial concerns.

D — Abandoned cases

BHP Billiton/Rio Tinto

On 26 November the Commission announced that it intended to close its investigation into BHP Billiton's proposed acquisition of Rio Tinto following BHP Billiton's announcement that it had abandoned the deal and had withdrawn its notification. The Commission is satisfied that the planned transaction has effectively been abandoned and will not proceed.

In a press release dated 25 November BHP Billiton announced that even if the Commission were to clear the proposed transaction unconditionally, BHP Billiton's directors intended to recommend that its shareholders vote against approving the transaction. The press release explained that given the continued deterioration of near-term global economic conditions the company's management believed that the acquisition of Rio Tinto was no longer in the best interests of BHP Billiton shareholders. On 26 November BHP Billiton decided to formally abandon their pre-conditional offer on Rio Tinto and withdrew their notification.

The Commission had opened an in-depth investigation of BHP Billiton's proposed acquisition of Rio Tinto on 4 July because the Commission's initial market investigation had indicated that the proposed takeover raised serious doubts as to its compatibility with the single market and could have resulted in higher prices and reduced choice for these companies' customers.

Fuel for thought — StatoilHydro/ConocoPhillips (Jet)

Jérôme Cloarec, Dag Johansson, Philippe Redondo, Daniel Donath, Elzbieta Glowicka and Cyril Hariton ([1])

Introduction

When faced with a proposed merger, antitrust authorities have to assess the likelihood and the magnitude of anticompetitive effects that may occur following the removal of one of the merging parties as an independent force in the various markets affected by the transaction. These possible anticompetitive effects must then be weighed against potential efficiency gains. To enable it to complete this task in the limited amount of time provided by the legislators, the Commission collects and contrasts information from different sources. The notifying party's compulsory notification (Form CO) is the initial source of such information and contains a description of the industry along with more specific details regarding the affected markets. In addition, to ensure that it has a complete understanding of the competitive landscape in each of the affected markets, the Commission supplements this information with the views of other market participants such as the merging parties' suppliers, competitors and customers. ([2])

Competitors are usually well informed about the market conditions in the affected markets and the competitive pressure that each merging party exerts on its counterpart in the transaction. However, competitors' views may be biased by their own interests. For example, a competitor can welcome a transaction that removes a very competitive market player. In such cases, competitors' replies to the Commission's market investigation may support their strategic views of the deal rather than provide an objective assessment of the transaction. Customers, on the other hand, are less likely to have strategic interests in the transaction and are therefore less likely to provide biased responses. This is particularly the case when there are numerous customers of modest size. Unfortunately, as a result, such customers are also less likely to have the necessary resources or access to the requisite information to respond meaningfully to the Commission's questionnaires. An extreme case occurs when customers are individuals, as it is virtually impossible to access such customers with standard questionnaires, although each individual may have a private (and sometimes informed and documented) view of the likely effects of a merger.

This was the case for the Norwegian oil company StatoilHydro's acquisition of Jet petrol stations in Scandinavia (67 in Denmark, 40 in Norway and 163 in Sweden), owned by ConocoPhillips of the US (case COMP/M.4919 — *StatoilHydro/ConocoPhillips*), which was subject to an in-depth investigation by the Commission. ([3]) Therefore, in addition to the standard market investigation that also included gathering evidence from *internal documents*, the Commission structured its market investigation around two pillars. First, several *econometric studies* that were based on an extensive request for data relating to the daily running of the fuel retail businesses were carried out to gauge the extent to which the two merging parties exerted competitive constraint on each other. Second, a *customer survey* was conducted in selected countries to obtain insights into customers' views regarding the main questions posed during the assessment of the transaction. ([4])

This article is divided into six sections. The next two sections describe the Swedish and Norwegian retail fuel markets and discuss the role that Jet played in those markets. ([5]) The econometric and customer survey analyses are described in the fourth and fifth sections. The last section offers some general conclusions and, in addition, makes some important points as to the data demands that are associated with analysing mergers where the merging firms' customers are widely dispersed.

Sweden

StatoilHydro was the largest retail supplier of motor fuels in Sweden, with a total of more than 1 000 fuel stations at the end of 2007 and accounting for more

([1]) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

([2]) From time to time, experts are directly appointed by the Commission to examine certain (usually technical or economic) aspects of a transaction. The Directorate-General for Competition also often benefits from the technical expertise of other Directorates-General.

([3]) Relevant documents issued by the European Commission regarding this case, including the non-confidential version of the final decision, can be downloaded at http://ec.europa.eu/competition/mergers/cases/index/m98.html#m_4919

([4]) The opinions of some customers' associations were also solicited.

([5]) The Commission's final decision found that the transaction would not lead to competition concerns in Denmark.

than 30% of total sales. (6) Jet was the country's sixth largest supplier of retail motor fuels: it accounted for more than 10% of total sales in 2007 and had by far the highest average throughput of all fuel station networks in Sweden. Following the transaction, the merged firm's largest competitor, OK-Q8, would have had a market share less than half that of the combined entity. The second and third largest competitors, Shell and Preem respectively, would be even smaller with market shares of [10-20]% each. (7) By acquiring Jet, StatoilHydro would thus further consolidate its position as the leading service-station chain in the Swedish market, in which substantial "green-field" entry of a new competitor is unlikely due to considerable entry barriers. (8)

The Jet business model is specific. First, it exclusively operates company-owned and company-operated stations only in densely populated areas under the unique Jet brand. (9) Second, Jet stations are all unmanned, with a limited range of services compared to traditional manned (or full-service) stations. Third, contrary to most of its competitors, which offer a wide range of fidelity and corporate cards that allow customers to obtain price reductions such as volume rebates, Jet has built a strong brand position based on a transparent net pricing policy that advertises net prices directly on the pump. The company furthermore applied a price differential with respect to competing full-service station networks of SEK 0.25 per litre. The combination of these elements resulted in Jet becoming the most efficient retail fuel supplier in Sweden, which allowed Jet to defend the SEK 0.25 per litre differential if challenged by competitors. (10) Jet's strategy has been highly successful: while it operates only 4.5% of all fuel stations in Sweden, its market share amounts to [10-20]%.

The success of Jet's strategy has also been recognised by its competitors. In particular, the Swedish retail motor fuel market has witnessed an expansion of the number of automated stations that today represent more than half of all fuel stations, and certain market players have shifted their pricing strategy from high fuel prices at full-service stations and volume-based rebate schemes towards "net pricing" schemes without rebates. (11) Related to such strategic repositioning, Shell initiated a nation-wide price war in April 2005 in order to establish its Shell Express brand of automated stations by applying the same price differential for *petrol* in relation to full-service stations and other automated stations that Jet (and some other smaller automated networks) applied. While this price war ended in August 2006 when all automated chains started to apply the same SEK 0.25 differential to full-service stations as Jet, it was soon followed by a second price war that started in April 2007 for *both petrol and diesel*. (12) The second price war was initiated by StatoilHydro, which sought to reduce the differential between full-service stations and unmanned stations from SEK 0.25 per litre to SEK 0.15 per litre. Jet (and other competitors) however resisted StatoilHydro's initiative and sought to maintain the SEK 0.25 per litre differential.

The important role of Jet as an independent competitor was also confirmed by the respondents to the market investigation and StatoilHydro's internal documents. Several respondents to the market investigation emphasised the fact that fierce competition between the Statoil network, Jet and Shell had decreased the margins and eroded the profitability of smaller and weaker networks that were viewed as too small to influence price levels in a manner similar to Jet. StatoilHydro's internal documents suggested that (i) Jet has a very strong brand image, and consumers perceive Jet as the cheapest supplier, and (ii) StatoilHydro views Jet as its most efficient competitor.

(6) StatoilHydro operated full-service fuel stations under the Statoil and Hydro brands and automated fuel stations under the 1-2-3, Hydro and Uno-X brands. Statoil's own network consists of 562 fuel stations: 478 full-service stations and 84 automated fuel stations branded "Statoil" or "1-2-3". StatoilHydro also owns Hydro's fuel station network, which comprised 426 stations at the end of 2007: 376 automated fuel stations branded "Hydro" or "Uno-X", 45 full-service stations under the Hydro brand and 5 unbranded stations ("white pumps").

(7) In addition, there are a number of smaller competitors operating brands such as Tanka, Din-X, Pump, Gulf, Q-star, St1 and ICA-Tapp.

(8) The availability of suitable sites that can be used for building fuel stations as well as the need to obtain permits are crucial factors for assessing barriers to entry (as well as barriers to expansion) in the fuel retail markets. In addition, green-field entry involves building forecourts, installing pumps and tanks, negotiating fuel supplies and establishing a brand by investing in promotion and advertising. The costs and the time required for such a strategy are substantial.

(9) For example, as stated in footnote 6, StatoilHydro operated full-service fuel stations under the Statoil and Hydro brands and automated fuel stations under the 1-2-3, Hydro and Uno-X brands. In addition, stations may be operated by a third party for a given company, or even be only associated with a company through a marketing venture (essentially using the company's name along with its supply of fuel).

(10) It is, however, important to note that Jet was not a mere "price follower", as Jet's chosen differential varied over time, and competing networks had to consider the possibility that Jet might seek to change this differential over time.

(11) In addition, operators are also restructuring their networks to improve efficiency, for example by closing stations with low throughputs.

(12) Diesel sales have been rapidly gaining ground at the expense of petrol in Sweden. Although there were relatively few diesel cars in Sweden, they accounted for 35% of new cars sold in Sweden in 2007 (compared to 20% in 2006). Following the introduction of a more favourable tax regime for diesel cars in 2007, diesel sales are expected to grow further.

This evidence thus indicated that Jet is an important competitive force in the Swedish retail fuel market and that the transaction would remove an important and well-established low-cost operator.

Norway

The Norwegian market is highly concentrated. The four main players account for more than 90% of the total sales. StatoilHydro is the largest competitor, with a [30-40]% market share. Jet is the fifth largest fuel station network present in Norway, with a market share of [0-5]%. Jet's retail outlets are located only in the south-east of Norway, where the company's market share is higher, at [5-10]%. (13) The confinement to the south-eastern region of Norway is related to logistics hurdles that Jet faces. (14) Unlike the other four competitors, Jet has no storage depots or terminals in Norway and instead operates a depot in Strömstad, Sweden, situated close to the Norwegian border. It is noteworthy that while the four main market participants have granted mutual access to each other's depots to limit fuel logistics costs throughout the country, Jet has been unable to conclude similar agreements.

Despite these logistics constraints, Jet's purely automated fuel network enabled the company to compete aggressively on price, in particular compared to the full-service fuel stations of its competitors. Jet promoted a net pricing policy that was associated with a price differential in relation to rivals' manned stations and was the most efficient competitor in terms of average throughput, with an average fuel volume per site twice as high as the national average. Jet was therefore an important competitive force in the Norwegian market, as was also confirmed by the market investigation and in particular by internal StatoilHydro documents. These internal documents (i) confirmed that Jet was viewed by consumers as the cheapest of the automated networks and (ii) showed Jet's capability to react to price changes introduced by competitors. The other Norwegian competitors to the merging parties also confirmed that Jet exerted a strong competitive constraint in the Norwegian market and in particular in the south-east of Norway. Jet's role in the Norwegian market was also confirmed by PFC Energy's report for Norway (October 2007, page 50): "*Jet is still the main driver of gasoline price wars, due to its 'low-cost' strategy, and has been marketing diesel at its Norwegian outlets, which rapidly brought down prices in the diesel segment. Jet's presence being limited to the southeast of Norway confines much of the fierce competition to this area.*"

These elements indicated that the other market players had different incentives from those of Jet, potentially even including a joint interest to prevent Jet from expanding, and that Jet was an important competitive constraint, in particular in south-east Norway. Therefore, the transaction would remove an independent and well-established low-cost operator competing in Norway.

Econometric analysis

An interesting feature of the retail fuel market in this case was the way Statoil fuel station managers (15) set pump prices. On the one hand, Statoil's headquarters would set national recommended prices, issue payment cards and undertake advertising and promotional campaigns at national level in each country (Denmark, Norway and Sweden). On the other hand, individual fuel station managers could deviate from these national recommended prices after monitoring the prices of their local competitors located in each station's primary catchment area (the so-called cluster). There is therefore a tension between national and local aspects of the geographic market definition. (16) Accordingly, as in its previous decisions, the Commission defined the geographic market as at most national although it left open the possibility of having smaller local markets. (17)

The local characteristics of the market were, however, fully taken into account in the competitive assessment of the merger, as they lend themselves particularly well to examining the extent of the competitive constraint that Jet placed on StatoilHydro's fuel stations. If Jet's fuel stations put competitive pressure on StatoilHydro, one would expect to find that

(13) There are some counties in south-east Norway in which Jet's market share is as high as [10-20]%.

(14) Jet's logistical constraints, in particular access to depots, indicate that barriers to entry are high in Norway. No fuel retailer entered the Norwegian market after Jet's entry in 1992.

(15) At the time the transaction was notified, Statoil and Hydro had just themselves merged (see case COMP/M.4545 — *Statoil/Hydro*, documents available at http://ec.europa.eu/competition/mergers/cases/index/m90.html#m_4545) and their networks were still run separately to some extent.

(16) It is often argued that with each station having a different catchment area, eventually the overlapping of these catchment areas would result in a chain of substitution that would spread change of price in one place to another that is indirectly connected through a chain of overlapping catchment areas.

(17) The definition of the relevant product markets for motor fuel retail has also attracted some attention in recent years. However, this transaction does not allow these issues to be meaningfully discussed. For example, it was not assessed whether on-motorway and off-motorway stations belong to the same relevant market, as Jet hardly operates any on-motorway stations. Neither does this transaction make it possible to assess whether products such as LPG should be considered as belonging to the same product market as petrol and diesel for reasons related to supply-side common distribution, as Jet does not distribute LPG.

StatoilHydro's prices would be systematically lower whenever Jet is in the vicinity of StatoilHydro's fuel stations. Alternatively, if StatoilHydro's prices do not systematically differ with Jet's presence, this would imply that Jet does not pose a significant competitive constraint on StatoilHydro.

To test this empirically, it was thus necessary to *at least* collect data on pump prices at StatoilHydro's fuel stations and information on the location of Jet's fuel stations relative to StatoilHydro's fuel stations. However, other factors may influence pump prices. For example, full-service stations may charge higher prices than unmanned stations to cover labour costs. On the other hand, fuel stations located in densely populated urban areas may face more competition due to the presence of other fuel providers than fuel stations in isolated urban areas and thus are more likely to charge lower prices. If all of these factors are not correctly accounted for, it is impossible to correctly model the way that the managers at StatoilHydro's fuel stations set the pump prices and thus to capture the "Jet effect" on StatoilHydro's pricing.

The Commission therefore undertook an extensive data gathering exercise. Daily prices of diesel and 95 octane petrol at StatoilHydro stations were collected for the period from 1 June 2005 to the end of May 2008. In addition, it was possible to collect information on the total number of fuel stations and to identify each competitor situated in the vicinity of each StatoilHydro station. ([18]) StatoilHydro also submitted an extensive data set with station characteristics (e.g. whether the stations were manned or unmanned or whether they had a convenience store or a car wash on their premises).

The Commission used pooled cross-sectional multiple regression analysis to model the relationship between pump prices at StatoilHydro's fuel stations, Jet's presence and any other factors that could have had an effect on the pump prices. ([19]) In particular, the log of monthly pump prices at each StatoilHydro fuel station (i.e. the so-called dependent variable) was modelled as being dependent on (i) the presence of Jet, (ii) the presence of other competitors such as OK-Q8, Preem and Shell in Sweden or Shell, Esso and YX in Norway, (iii) transport costs from StatoilHydro fuel depots to StatoilHydro fuel stations to correct for differences in operating costs across the different clusters, (iv) an indicator variable that captured whether the station is manned or unmanned, (v) the total number of stations in the cluster to account for the general level of competition, and (vi) the Rotterdam price index for diesel and 95 octane petrol to account for the general movement of fuel prices over time. ([20])

The regression models were estimated for both Norway and Sweden for diesel and 95 octane petrol separately, as both products were subject to different market dynamics. For example in Sweden, the 95 octane petrol market was the subject of two price wars, while the diesel market was only subject to a single price war. On average, the results suggested that both StatoilHydro's petrol and diesel prices in Sweden were systematically lower by [0-5]% whenever a Jet fuel station was located in the vicinity of a StatoilHydro fuel station. The same was true for Norway. It is important to note that, in total, three different regression specifications were estimated for each country and each product to ensure that the regression results were sufficiently robust. The econometric analysis therefore indicated that Jet appeared to place an important competitive constraint on StatoilHydro's pricing in both Sweden and Norway.

Customer survey

Another method of gauging the role that Jet played in the Norwegian and Swedish retail fuel markets was a survey, which is particularly useful when customers are individuals such as in cases of retail and service markets. A customer survey takes into account the views of individual customers by carefully choosing a sample of customers that is representative of the whole population and asking them questions regarding a specific issue. The replies of the respondents can then be aggregated to approximate the views of the whole population of customers. The use of customer surveys in merger analysis started only recently: *Ryanair/Aer Lingus* was the first merger case where a customer survey of this type was conducted. ([21]) In this case, the resulting answers from the survey helped to assess the degree of substitutability between the two airlines.

([18]) To aid fuel station managers' monitoring of local competitive conditions, StatoilHydro defined clusters, which contained a list of stations in the surrounding area of each StatoilHydro station.

([19]) Ordinary cross-sectional regression analysis compares prices at Statoil's stations that faced Jet as a competitor with prices at Statoil's stations that did not face Jet as a competitor at a given point in time. Pooled cross-sectional regression analysis pools across different points in time. In this instance, as the daily price data was aggregated to monthly levels, the regressions were pooled across the different months.

([20]) The presence of Jet was captured by a dummy variable that equalled one whenever Jet was present in a cluster and zero otherwise. The same technique was also used for the other competitors such as Shell. Similarly, the indicator variable that captured the manned status of the fuel station equalled one when the station was manned and zero otherwise.

([21]) See case COMP/M.4439 — *Ryanair/Aer Lingus*, documents available at http://ec.europa.eu/competition/mergers/cases/index/m88.html#m_4439, and in particular Annex I to the final decision, which describes the survey, provides an analysis of the answers and addresses methodological issues.

Two key issues need to be addressed when designing a customer survey. (22) First, it is important to carefully select the pool of respondents to ensure that the sample of respondents is representative of the whole population in order to be able to substitute the views of the respondents from the sample for the views of the population. This is usually accomplished by surveying a sufficiently large group of *random* respondents, as the larger the surveyed group the more likely it is that it will contain all the different views that are present in the population. For example, for the purposes of this case, 1 250 Swedish and 1 001 Norwegian motor fuels consumers were interviewed by telephone or over the internet in June and July 2008.

The second key issue are the actual questions to be asked in the survey. One of the main difficulties was to identify a limited number of core issues to be tested in a single one-shot survey. Thus, after drafting an initial set of questions, the Commission discussed them with the notifying party to ensure that the questions were sufficiently clear and effective in assessing the effects of this merger. The questions focused on key issues raised during the assessment of the case, including the reasons why consumers fill up their cars at a particular fuel station, customers' specific brand preferences and their perceptions of Jet *vis-à-vis* its competitors. For example, to understand consumers' fuel purchasing behaviour, respondents were asked to rank the following three factors in deciding whether to fill up at a particular fuel station: (i) price of fuel, (ii) distance from home or work, and (iii) the availability of convenience shopping for food, tobacco and other products. They were also asked what price differential per litre would prompt them to change stations and were given six choices. To gauge the effect of Jet as well as the effect of the merger, respondents were asked (i) how they rated Jet's fuel prices compared to competitors' prices, and (ii) what impact the acquisition of Jet by StatoilHydro would have on competition between the remaining fuel station chains in Norway and Sweden.

Given that different consumer groups can be expected to behave differently, it is important to ask an additional set of control questions to identify possible customer segmentation. While all respondents were members of households with a car at their disposal, the control questions allowed the Commission to differentiate between those driving a lot and those driving little, between different types of fuel used (petrol, diesel, ethanol, other) or the type of fuel card used, if any. For Norway, given that Jet was only located in the south-eastern region of the country, it was also important to differentiate the respondents depending on the area that they live in. Of the 1 001 customers in the sample, 506 (or 50.5%) were from south-east Norway, which roughly corresponds to the proportion of the total Norwegian population living in that part of the country.

The customer survey showed that in both countries Jet was perceived as a low-price supplier of motor fuel. In Sweden, 40% of respondents who expressed an opinion stated that Jet always charged lower prices and 29% indicated that Jet sometimes charged lower prices. (23) The survey also revealed that consumers were price-sensitive: 54% in Sweden and 78% in Norway ranked price as the most important factor when deciding where to fill up. (24) It confirmed that customers found it easier to compare prices when net pricing schemes instead of rebate cards were applied by fuel selling stations: 61% of Norwegian respondents found that net pricing schemes facilitated comparison of prices "to a very large extent" or "to a relatively large extent". (25) Finally, as many as 54% of Norwegian customers and 50% of Swedish customers believed that the proposed merger, along with the disappearance of the Jet brand, was likely to reduce competition in the retail fuels market, while only 10% of Norwegian customers and 14% of Swedish customers thought that that merger would have a positive impact on competition. (26) This is consistent with customers' view that Jet played a specific role in driving price competition.

It should be noted that the answers differed between the total population in Norway and the population in south-east Norway. For example regarding Jet's prices compared to competitors' pump prices, while 40% of the overall sample considered that Jet was always or sometimes offering lower prices and 46% had no opinion, the perception of Jet being always or sometimes cheaper increased to 64% and the number of respondents without an opinion decreased to 22% when only respondents located in south-east Norway were considered. This divergence in views provides further evidence that regional aspects of retail fuel markets must be taken into account in addition to national market considerations.

(22) It is also important to note that the survey must be outsourced to professional research companies that have the know-how and experience to access a representative group of respondents in a timely manner to ensure that the survey is completed within the short time span of merger proceedings.

(23) 32% of the respondents did not know how Jet's fuel prices compared with competitors' pump prices. Unless otherwise specified, the remainder of this section displays percentages of respondents among those who expressed an opinion.

(24) 1% of the Norwegian respondents and 8% of the Swedish respondents had no opinion.

(25) 11% of the Norwegian respondents had no opinion.

(26) 16% of the Norwegian respondents and 10% of the Swedish respondents had no opinion.

Conclusion

The acquisition by StatoilHydro of ConocoPhillips' Scandinavian retail fuel businesses (Jet) required the Commission to assess the effects of the transaction without having access to the customers of the merging parties. This is because the customers in this instance are individuals, and it is thus virtually impossible to reach them using standard questionnaires. In addition to the standard market investigation that also included gathering evidence from internal documents, the Commission therefore based its market investigation on econometric studies and customer surveys. By doing so, the Commission was in a position to assess the relevance and likelihood of alternative possible theories of harm, as well as their likely effects, and came to the conclusion that, in the Swedish and Norwegian markets for retail sales of motor fuels, the transaction would raise serious doubts as to its compatibility with the common market and the EEA agreement.

To alleviate the Commission's concerns in Sweden, StatoilHydro proposed to divest a network consisting of 158 unmanned stations, including 118 of the most efficient stations currently operated by Norsk Hydro and 40 Jet stations. This "remedy fuel station network" would have the third highest average throughput among all competitors in Sweden. The remedy network would have a geographic coverage throughout Sweden, with a strong presence in the south. This network also covered the vast majority of the clusters affected by the transaction. In addition, StatoilHydro offered to divest the entire Jet network in Norway to remove the Commission's concerns in that country.

The investigation of this transaction nicely demonstrates that the absence of sizeable customers does not prevent the Commission from collecting relevant information necessary to reach an appropriate and carefully balanced outcome. Customer surveys and econometric studies are useful tools that can effectively supplement the Commission's standard market investigation. Performing customer surveys in the course of merger proceedings is inherently constrained, among others things by (i) the limited number of questions that can be addressed by a survey, (ii) the methodological hurdle related to avoiding insidious questions or questions subject to broad interpretation, and (iii) the procedural time constraints. The econometric analysis usually requires highly reliable data and proper care must be taken when modelling the competitive interactions between the merging parties and their competitors to ensure that the resulting econometric results are sufficiently robust. To ensure that the results from both the survey as well as the econometric analysis can be considered meaningful, it is thus important that the Commission and the notifying party engage in a dialogue as early as possible in the notification process (preferably at the pre-notification stage), to discuss data and timing issues as well as the analyses that can be undertaken.

EdF/BE: Yin and Yang — why complementarity can be problematic

Miriam Driessen Reilly, Polyvios Panayides and Raphaël De Coninck (1)

I. Introduction

On 24 September 2008, following ongoing talks with British Energy, EdF announced that it had agreed a takeover of the company for the sum of £12.5 billion. On 3 November 2008, given that the transaction had a Community dimension within the meaning of the Merger Regulation, EdF notified to the Commission its intention to take sole control of the company, having made a public offer to purchase its entire issued share capital.

The parties' activities would overlap in several areas of the British electricity markets. The deal would also strengthen the vertical integration of the combined post-merger entity. On examination, it was found that even though the combined shares of the two companies were not extremely high, there were some aspects of concern specific to the electricity markets under investigation. These concerns were to a large extent linked to the fact that the combined post-merger entity would in many respects be highly complementary. In particular it would combine EdF's flexible UK fossil fuel plants with British Energy's almost exclusively nuclear fleet, a source for baseload electricity, leading to concerns about a possible withdrawal strategy. Secondly, the deal would combine two strong players on the British wholesale electricity market, one with a "short" position and the other with a "long" one, thereby potentially facilitating a reduction in liquidity on the wholesale market. Finally, the deal would give EdF access not only to nuclear capacity but also to a high proportion of sites most likely to be suitable for a first wave of new nuclear build with the consequence of removing many possibilities for competitors to acquire such sites.

Following a substantive analysis including an in-depth first-phase market investigation and cooperation with the UK regulator for gas and electricity (Ofgem), the Commission decided to clear the case, subject to substantial remedies.

II. The parties and the transaction

Electricité de France (EdF) is a mainly state-owned French energy company listed in Paris. While based in France, EdF and its subsidiaries are active globally in all segments of the electricity markets: generation and wholesale trading, transmission, distribution and retail supply of electricity to all groups of customers. (2) In particular, EdF prides itself on being the world's leading nuclear power utility, operating a French nuclear fleet consisting of 58 reactors across 19 different sites. Within the UK, however, in terms of generation of electricity, prior to the transaction EdF UK had no nuclear assets. Rather its generation portfolio was comprised of gas and coal fossil fuel plants.

British Energy is a plc limited by shares, incorporated under the laws of Scotland and listed on the London Stock Exchange. It was established in 1995 to operate the eight most modern nuclear power plants in the UK (3) and privatised in 1996. Operating exclusively in the UK, it is active in the British markets for generation and wholesale trading of electricity and retail supply of electricity to industrial and commercial customers.

The company had been in financial difficulties for some time in 2002, when it first approached the British Government for financial aid. In the run-up to the takeover, notwithstanding financial assistance, British Energy faced challenges due, among other things, to its plants' ageing technology and scheduled closures of its AGR fleet. In the context of the HM Government White Paper on New Nuclear Build, the company took the decision to seek a business partner. The British Government supported this and consequently the decision by the Board of British Energy to recommend British Energy shareholders to approve a takeover by EdF.

III. Market definition

The parties' activities were found to overlap on the markets for generation and wholesale supply of electricity, retail supply of electricity to industrial and commercial customers, sites for new nuclear build, carbon trading, procurement of nuclear fuel and financial electricity trading. No particular issues were found to exist in relation to carbon trading,

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) EdF is also active in other energy-related activities.

(3) Taking two AGRs from Scottish Nuclear and five AGRs and a PWR from Nuclear Electric. The Magnox assets of these two companies were transferred to Magnox Electric, which later became part of British Nuclear Fuels.

procurement of nuclear fuel or financial electricity trading.

Wholesale electricity markets

Both parties were active in the wholesale electricity markets in Great Britain. The parties agreed with the approach taken by the Commission in previous cases, according to which there is a single product market for both electricity generation and wholesale supply. Furthermore, in line with the Iberdrola/Scottish Power ([4]) decision, no distinction was made between the different sources of electric energy ([5]) within the wholesale electricity market for the purpose of market definition. ([6]) However, the Commission did investigate whether the various sub-segments of the wholesale market (non-standard non-brokered, OTC brokered, Power Exchange and Balancing Mechanism) could comprise separate markets. It also examined whether, within the OTC brokered segment, the various products traded (such as baseload and peakload) constitute separate markets. This was not supported by the market investigation. ([7])

Geographically, the Commission, as supported by the market investigation, considered that the relevant market comprises the whole of Great Britain. This area is regulated by BETTA ([8]) and therefore subject to similar conditions of competition.

Retail supply of electricity to industrial and commercial customers

In the past, the Commission had identified separate product markets for large and small industrial customers. In relation to the British market, it had differentiated between customers on the basis of kW demand. However, following liberalisation of the electricity markets, there were findings that the retail electricity market could be subdivided between three categories: domestic customers, smaller industrial and commercial customers (SMEs) which do *not* use "half hourly rates" and large industrial and commercial ("I&C") customers which *do* use half hourly rates. ([9])

In this case, the parties submitted that the relevant product market is the broader market for the supply of electricity to all industrial and commercial ("I&C") customers, encompassing supply at both half hourly (HH) and non-half hourly (nHH) rates. This was not supported by the market investigation, which clearly favoured the subdivision of the retail electricity market into the three categories mentioned above. ([10])

As for the wholesale market, the Commission found the relevant geographic market to be Great Britain (England, Scotland and Wales, excluding Northern Ireland). ([11])

Sites for new nuclear build

The definition of a market for sites for new nuclear build is set against a background of the need for the UK to address the renewal of the large number of power stations due to close over the next 15 years and the adoption of policies on energy and climate change, which support the building of new nuclear power stations. ([12]) In particular, there is an ongoing Strategic Siting Assessment (SSA) procedure which is to establish a list of suitable sites to be included in the National Policy Statement (NPS), expected to be published in early 2010.

The Commission made no distinction between the different sources of electric energy for the wholesale market. However, it considered in the light of the particularities of the ongoing SSA and of the special characteristics of such sites ([13]) that there is a separate product market akin to a real estate market for sites considered suitable for building new nuclear power stations. At least in the first wave of new nuclear development, expected over the next ten to fifteen years, this market can be expected to include a limited number of sites. According to the 2008 White Paper ([14]) these are expected to be in the vicinity of existing nuclear facilities. This position was strongly supported by the results of the market investigation.

([4]) Case M.4517 — *Iberdrola/Scottish Power.*

([5]) Gas fired, coal fired, nuclear, hydroelectric power stations, wind farms or others.

([6]) The technology portfolio of each generator played a central role in the competitive assessment, however, as detailed in section IV.

([7]) Rather, the market investigation favoured the retention of the definition of one wholesale electricity market comprised of different segments. This can also be said for the various products sold (weekday, weekend, baseload, peak hours, etc). The majority of respondents indicated that splitting these products into separate markets would not be appropriate, as different products simply represent different groupings of the same basic trading units, which are half-hourly quantities.

([8]) British Electricity Trading and Transmission Arrangements.

([9]) Half-hourly rates are used for consumers whose consumption can effectively be metered on a half-hourly basis.

([10]) Market division also supported by the market investigation in case M.2890 — *EdF/Seeboard.*

([11]) This is in line with the market definition in case M.4517 — *Iberdrola/Scottish Power.*

([12]) The 2008 White Paper on Nuclear Power states that new nuclear stations should have a role to play in the country's future energy mix alongside other low carbon sources.

([13]) See the Jackson Report.

([14]) Meeting the Energy Challenge: A White Paper on Nuclear Power, January 2008 CM 7296; see pages 127-129.

In relation to the geographic market for new nuclear build, the Commission decided to leave the scope of the market open. ([15])

IV. Competitive effects of the merger

As mentioned above, even though the combined shares of the two companies were not extremely high, the case raised issues quite specific to the electricity markets under investigation.

Withholding in the wholesale market

The parties' market shares on the UK wholesale electricity market were not particularly high, and would not necessarily appear, at first sight, to constitute a serious source of concern. The transaction would lead to a combined market share in the UK wholesale electricity market lower than 30%, with an increment of less than 10%, while the parties face a number of competitors in the UK, including E.ON, SSE, RWE, Iberdrola/Scottish Power, International Power, Drax and Centrica, each of them having a market share between 5% and 15%. ([16]) Yet the Commission found that the transaction, as initially notified, would lead to significant competition concerns on the wholesale electricity market. This finding followed a detailed economic analysis of the effects of the transaction.

Given the specific characteristics of electricity markets, market shares only constitute a very crude indicator of the likely effect of a merger between electricity generators. For example, one essential characteristic of electricity is that it cannot be stored. In addition, demand for electricity is inelastic and is characterised by a high degree of variation. ([17]) Given these specificities, a mix of generation technologies is usually used so that supply can meet demand at any point and market imbalance or rationing is avoided. Technologies with a low marginal cost of production, also known as baseload technologies, tend to be used most of the time, while other, more expensive, technologies may be used only when demand is high.

([15]) In the first instance, nuclear power plants supply the wholesale market and as such it was considered that it could not be larger than national. The SSA is also theoretically national. On the other hand, the Scottish authorities do not support new nuclear build and can prohibit it in Scottish territory. Therefore it was left open whether as a minimum the market should be defined to include only potential sites in England and Wales or whether it would be national further to the issuance of the National Policy Statement.

([16]) Figures on market shares are valid both for installed capacity and for effective production.

([17]) Part of this variation is predictable well in advance (as it relates for example to differences between weekends/weekdays, seasons, time of the day), but part of it is not (as e.g. it relates to weather conditions).

Beyond market shares, the impact of such a transaction therefore critically depends, among other things, on the generation portfolio of the parties and their competitors. In this respect, the merger of EdF and British Energy could be seen as a textbook example of a situation in which combining generators with complementary technology portfolios could lead to higher prices through capacity withholding. The proposed transaction would bring under common control British Energy's mostly baseload and predominantly nuclear capacity with EdF's flexible capacity (coal and gas). This led to the potential concern that the merged entity would have an incentive to withhold flexible capacity in order to increase the market price that it would receive on its infra-marginal units. This effect is a direct consequence of the merger since, post-merger, the combined entity could benefit from price increases on a larger production base and have more opportunities to withhold flexible capacity.

Ultimately however, the extent to which the proposed operation would be likely to lead to anticompetitive effects is an empirical question. In particular, the effect of the merger on prices would depend, among other things, on the slope of the supply curve, the ranking of each plant in the merit order and the level of demand, which typically varies hour by hour. In order to estimate the likely impact of the transaction, the parties submitted a model incorporating the assumption that prices are set on the basis of the marginal cost of the most expensive plant on the merit curve that is called into production, and based on which the impact of different withdrawal strategies was considered.

The Commission carried out a substantive sensitivity analysis of the model provided by the parties. In order to reflect more accurately the technical constraints faced by the plant operator if it were to engage in a withdrawal strategy, the Commission also considered a wide range of possible withdrawal strategies, defined as the minimum period during which a plant could be withdrawn, and incorporated in the model an estimate of the cost of withdrawal for each plant. On the basis of this detailed empirical analysis, the Commission found that the results of the model provided by the parties were very sensitive to assumptions concerning demand, capacity and other variables, such as the marginal cost of certain plants, ([18]) and that the transaction would lead to significant price increases under a number of plausible assumptions.

([18]) The Large Combustion Plants Directive (LCPD) restricts the running hours for opted-out coal plants to 20 000 between 2008 and 2015 (8 years) before they must be retired. The marginal cost of the opted-out plants was increased in order to take this constraint into account in the model.

In addition to the quantitative analysis, a number of qualitative arguments were considered since the UK market differs in many ways from this simplified model representation. In particular, the UK market structure is prominently characterised by bilateral and forward trading and a correspondingly small spot market. However, the Commission concluded that this specificity of the UK wholesale electricity market does not imply that the merged entity would lack the ability to increase prices. In fact, post-merger, the merged entity could reflect its ability to withhold capacity in the price of its forward contract sales independently of whether it actually withholds capacity in the short term.

The discussion above only sketches some of the main findings of the very detailed analysis carried out by the Commission in this case, from both a qualitative and a quantitative standpoint. The Commission's investigation relied not only on a very detailed empirical analysis, but also on a full consideration of the market's specific characteristics, which included, among other things, the position of each market player by technology, the marginal cost of production for each plant, the hourly variation of demand, the relationship between spot and forward prices, the presence of long-term contracts or the companies' specific hedging strategies. Despite the relatively limited market shares of the merging parties, the Commission concluded on the basis of this comprehensive economic analysis that the transaction could lead to anticompetitive effects on the wholesale electricity market.

Impact on liquidity: effects in the wholesale and supply markets

Another concern that was raised during the market investigation is that the merger, as initially notified, could lead to a reduction of liquidity in the wholesale electricity market. British Energy has a long generation position as it produces more electricity than it supplies to its final customers, while the opposite is true for EdF, which buys part of the electricity it supplies to its final customers on the wholesale market. Respondents to the market investigation were concerned that the merger could lead to increased internal use of electricity that would otherwise have been sold to the market.

Market test respondents indicated that there is currently, and independently of the merger under review, a concern in the UK about relatively low levels of liquidity. Lower levels of liquidity may increase the cost of trading on the wholesale market and may possibly create barriers to entry on the retail market and/or wholesale market. Although further investigation would be necessary to establish whether the proposed transaction would effectively lead to customer harm as a result of reduced liquidity (taking into account the efficiencies brought by vertical integration), the Commission's first-phase investigation established serious concerns with respect to the ability and incentive for the merged entity to internalise trades and thereby affect trading possibilities of competitors, including new entrants. In addition, the Commission estimated the possible reduction of liquidity that could result from the merger on the basis of a series of market characteristics and assumptions (such as e.g. the merged entity's future hedging strategies, the availability of power plant, the type of product traded or the existence of long-term contracts), which was necessary to assess the likely impact of the remedies proposed by the parties.

Retail supply of electricity to industrial and commercial customers

The parties' activities overlapped for industrial and commercial customers on both half hourly (I&C HH) and non-half hourly (I&C nHH) rates. For customers on nHH rates, the increment of market share was found to be very minor and the market investigation did not identify any serious doubts for this market. As regards I&C HH, the transaction would lead to a combined market share of [30-40]% by volume, with an increment of [10-20]%. As a result of the deal, the combined entity would therefore become the undisputed market leader in this market. The investigation therefore focused on this segment of the retail market.

During its analysis, the Commission took into account data which indicated that there are sub-segments within the I&C markets with differing customer characteristics based on expenditure, consumption and number of sites within a portfolio. However, the market investigation did not identify these segments as separate product markets.

The Commission found that the parties compete to a large extent on different segments of the customer market. In particular it found that while EdF focuses on multi-site customers consuming lower volumes, British Energy focuses on very large high volume-consuming single-site customers. Although both companies are active in the same market, they focus to a large extent on different types of customer, and are therefore unlikely to exert a particularly strong competitive constraint on each other.

The Commission also examined the substitutability of the products offered by the parties. Feedback from the market test indicated that the parties' products were not considered close substitutes but that the products offered by EdF are similar to those offered by its main competitors. In this regard the Commission considered that the merged entity's incentive to raise prices is more likely to be constrained when rival firms produce close substitutes to its products, as was the case at hand.

As a consequence, while the combined entity would be a market leader in the supply of electricity to I&C HH customers, the Commission considered that EdF and British Energy are not particularly close competitors. Remaining competitors active in the market, particularly E.ON, RWE and SSE, would be sufficient to ensure that competition is maintained. Therefore the transaction did not give rise to serious doubts on this market.

Market for sites for new nuclear build

Another concern raised during the market investigation related to the fact that the merger, as initially notified, would lead to a high concentration in the ownership of sites most likely to be suitable for a first wave of new nuclear build. The merged entity would hold or have some influence on the development of seven out of nine (or seven out of ten) such sites. This was of particular significance to the transaction given that the British Government had recently adopted new policies on energy and climate change which clearly support investments in nuclear new build as part of the UK's electricity mix. ([19])

The market investigation carried out by the Commission identified nine to ten sites that are most likely to be part of the National Policy Statement (NPS) and thus suitable for a first wave of new nuclear build in the foreseeable future. At the time of the Commission's market investigation, out of these potential sites for a first wave of new nuclear build, five belonged to British Energy while three belonged to the Nuclear Decommissioning Authority (NDA) and land at one site belonged partly to the NDA and partly to British Energy. EdF had furthermore already purchased land next to the NDA's land at Wylfa and British Energy's Hinkley site. Therefore, the merger, as initially notified, increased the control by the combined entity over the market for sites most likely to be used for a first wave of new nuclear build.

Most of the respondents to the market investigation voiced concerns in relation to the potential dominance of the merged entity in the market for new build nuclear sites. On the other hand, the Commission also took into account the Sites Undertaking which EdF had entered into with the British Government, as well as the Simultaneous Marketing Agreement (SMA) signed by EdF with the NDA, both of which could make available to competitors of the merged entity a number of potentially suitable new build sites. ([20])

Third parties pointed out to the Commission that as a result of the merger and because of the conditions contained in the Sites Undertaking for the release of sites by EdF, new entrants could be put at a time disadvantage and face higher risks. In particular, the conditions contained in the Sites Undertaking could delay the development of the Bradwell and Dungeness/Heysham sites as the release of land by EdF was contingent on EdF obtaining the necessary consents and planning permission on other developments. It was argued that this could clearly have the effect of preventing or delaying entry by other parties.

In terms of the counterfactual (absent the merger), considering the high number of sites in the hands of British Energy and given the fact that it lacked the resources to develop at least a majority of these sites on its own, it was likely that British Energy would have opted for a joint venture approach to develop its sites jointly with competitors. As a consequence the market for sites for new nuclear build could be significantly altered by the merger in so far as it removed many possibilities for competitors of the merged entity to acquire such sites.

Additionally, as the market investigation indicated, the inherent uncertainty about the scope and timing of the release of sites (and which sites would be finally released following the Sites Undertaking) could act as a disincentive for competitors to invest in the considerable up-front planning work involved.

Finally, it was also considered relevant that the parties to the transaction appeared to be in a very good position to compete with each other in new nuclear build in the UK in the absence of the merger. EdF had already acquired land potentially suitable for nuclear generation in the UK at Wylfa and at Hinkley; it already held connection agreements which could support a nuclear reactor at each of these two sites and is an experienced nuclear operator.

On the basis of the above considerations, the Commission expressed serious doubts as to the compatibility of the transaction, as initially notified, with the common market.

([19]) See the UK Government's January 2008 White Paper on Nuclear Power.

([20]) The Sites Undertaking required EdF, in certain circumstances, to dispose of specified areas of land adjacent to or near existing nuclear sites, including land currently owned by BE. EdF had furthermore entered into a marketing agreement with the NDA, under which the NDA will offer through a competitive auction land at Bradwell, Oldbury and Wylfa and at the same time EdF will offer its own land at Wylfa.

Overlap in connection agreements

A further concern related to the number of connection agreements held by EdF and British Energy respectively, at specific locations, which could potentially foreclose the opportunity for competitors to connect new power plants to the grid. It was specifically claimed by third parties that the combined entity would hold a large portfolio of connection agreements for gaining access to the transmission network, which could hinder other generators' ability to develop new power plants. With respect to the merger-specific elements regarding connection agreements, the Commission identified an overlap between EdF and British Energy at Hinkley, allowing the merged entity to hold connections for three nuclear reactors at that location, when in fact the intention of the merged entity was to only develop two nuclear reactors at that location.

V. Remedies

In order to address the serious doubts identified by the Commission, EdF submitted a remedy package consisting in (a) the unconditional divestment of the Eggborough Power Plant and an auction of baseload electricity, (b) the unconditional divestment of a site at either Heysham or Dungeness and (c) the termination of one of the combined entity's grid connections at Hinkley Point. Following a relatively negative market test, EdF submitted a revised proposal, which was found to address the serious doubts identified by the Commission in relation to (a) withholding, (b) liquidity reduction, (c) access to nuclear new build sites and (d) potential barriers to entry caused by the holding of grid connections.

Whereas in line with the Notice on Remedies the Commission clearly favours structural remedies, in exceptional circumstances it may also consider behavioural promises. In this case, in order to fully address the problems identified for liquidity in the wholesale market, behavioural remedies were accepted in addition to the plant divestitures.

The remedies, as described below, form an integral and conditional part of the decision.

Withholding

In order to address the withholding concerns identified by the Commission, the parties proposed to divest one coal-fired plant from British Energy (Eggborough) and one gas-fired plant from EdF (Sutton Bridge).

The Commission concluded that the merger, considered together with this remedy package, does not bring any significant additional scope for withholding. This is for several reasons. First, the transaction would then lead to a relatively limited increment (one coal-fired plant) in flexible technology for the merged entity compared to British Energy's pre-merger portfolio. Second, the baseload production that would mostly benefit from a price associated with a withholding strategy is unaffected by the merger. Third, the merged entity would incur a similar marginal cost for withdrawing flexible plants to that currently incurred by British Energy, since both the merged entity and pre-merger British Energy only have coal-fired plants to withhold. This conclusion was also confirmed by the Commission's calculations on the basis of the model presented above.

Impact on liquidity: effects in the wholesale and supply markets

In order to address the serious doubts raised by the Commission with respect to liquidity, the parties first proposed to commit to sell determined quantities through auctions. The results of the market test with respect to this proposal were in general rather negative. Not only were the proposed volumes generally considered insufficient, but concerns were also raised with respect to the auction mechanism itself. ([21]) The parties subsequently revised their initial commitment, and instead committed to sell significantly higher volumes in the same way as the parties currently sell electricity on the wholesale market, i.e. through OTC trades and/or structured trades agreements. The revised commitments also include provisions to ensure that the volumes are not purchased back by the merged entity. ([22])

Considered in conjunction with the power plant divestitures, the proposed remedies significantly reduce the ability of the merged entity to internalise British Energy's long position and consequently any possible negative impact on liquidity in the wholesale market.

Commitments for access to sites for new nuclear build

In order to address the serious doubts established by the Commission regarding access to nuclear sites most likely to be used for a first wave of new nuclear build, EdF offered to dispose of land owned by British Energy either at Dungeness or at Heysham to an independent operator on terms of sale approved by the Commission. The purchaser must elect which land to acquire within a specific period

([21]) Some market respondents indicated that the proposed auction mechanism, and in particular the proposed liquidity test and the reserve price for the auction, could distort trading incentives and limit the effectiveness of the remedy.

([22]) The traded amounts will be assigned to a separate trading book under the supervision of a trustee.

of time from the date of the conclusion of the sale and purchase agreement. This commitment for the unconditional release of land at either Heysham or Dungeness did not affect the obligations of EdF to sell certain sites, subject to conditions, following the Sites Undertaking and the SMA agreed with the UK Government. ([23])

The Commission considered that Heysham and Dungeness can be regarded as viable options for new nuclear build. It took the view that the envisaged ability of the successful purchaser to elect which land to acquire within a set period of time as part of this commitment brought a significant advantage as this can allow the successful bidder to undertake the necessary verifications before deciding which site to acquire. This ability can be considered as being highly advantageous given the lack of absolute certainty for developing any site potentially suitable for new nuclear build. The Commission also found that the commitment offered by EdF for an unconditional divestiture of land at either Heysham or Dungeness ensures that at least one of the merged entity's sites will be divested unconditionally.

Taking into account the land release obligations which EdF is to abide by in view of the SMA and the Sites Undertaking with the UK Government, the Commission concluded that the commitment offered by EdF regarding sites for a first wave of new nuclear build constituted a clear-cut remedy that directly and fully addressed the serious doubts identified by the Commission with regard to the market for nuclear new build sites.

Commitment to terminate one grid connection agreement at Hinkley Point

EdF also offered a commitment to terminate one of the three connection agreements between National Grid on the one hand and EdF or British Energy on the other hand at Hinkley Point. The Commission considered that this commitment removed any overlaps identified regarding connection agreements in the hands of the merged entity.

V. Conclusion

Despite the relatively limited market shares of the merging parties, the Commission concluded on the basis of a comprehensive economic analysis that the transaction was likely to lead to anticompetitive effects on the wholesale electricity market. The Commission's first-phase investigation also established serious concerns with respect to the ability and incentive for the merged entity to internalise trades, with consequent implications for a reduction in liquidity on the wholesale market. In addition, the Commission had doubts in relation to the market for sites for new nuclear build.

This was a complicated case, which could have gone to a second-phase review were it not for the fact that the parties were prepared to submit adequate remedies for each of these issues. It illustrates that while the combination of complementary opposites may be strategically good from a business perspective, it may, in specific circumstances, also raise issues from a regulatory point of view.

([23]) Under the Sites Undertaking and the SMA, following the satisfaction of the relevant conditions, EdF's land at Wylfa, British Energy's land at Bradwell and any land acquired by the merged entity at the Bradwell NDA auction can also be made available to competitors.

Friesland Foods/Campina: a merger between two Dutch dairy cooperatives approved with a set of comprehensive remedies

Miguel de la Mano, Patrick D'Souza, Gregor Langus, Martine Lissens, Szabolcs Lorincz,
Jean-Christophe Mauger, Fabio Polverino, Axel Specker

Introduction

The *Friesland Foods/Campina* case (M.5046), which concerned a full legal merger between the two leading Dutch dairy producers, covered the entire production chain of dairy products starting from raw milk and including everyday consumer products such as milk, cheese, butter or cream, as well as intermediate products used in the food industry such as emulsions, and lactose, an ingredient employed in the pharmaceutical industry.

The transaction not only involved a large number of affected markets, but also had vertical aspects since both cooperatives, Friesland Foods and Campina, are obliged to buy all the raw milk produced by their member-farmers and the member-farmers have to sell their entire production to the cooperatives. Given the fact that Friesland Foods and Campina have a combined market share of [70-80%] on the market for the procurement of raw milk in the Netherlands and similar shares on several markets for dairy products, the Commission was only able to clear the case, on 17 December 2008, subject to commitments which take into account not only the position of the parties on different dairy product markets, but also the need for access to the raw milk market as a necessary condition for the effectiveness and viability of divestments — leading to a comprehensive set of conditions and obligations.

The Commission's in-depth investigation used the usual investigative techniques such as questionnaires addressed to market participants and telephone interviews. In addition the Commission's Chief Economist Team conducted an intensive analysis of the parties' internal pricing data as well as scanner data covering several product categories in the fresh dairy segment. This data (time series of volumes and values) was used as the basis for a set of econometric calculations to supplement the traditional analysis with respect to closeness of competition and product market definition.

The parties and the transaction

Friesland Foods and Campina, the two largest dairy cooperatives in the Netherlands, both collect raw milk and process it into consumer and industrial dairy products. Campina had in 2007 6 885 member-farmers and activities in fresh dairy products, cheese, butter, fresh and long-life flavoured drinks, and emulsions in various countries in Europe, North and South America and Asia. Friesland Foods counted 9 417 members (2007) with sales of consumer dairy products in Europe, the Middle East, Asia and Africa as well as sales of dairy ingredients for professional and industrial customers worldwide.

The transaction involved a full legal merger between the two cooperatives, leading to the establishment of a single cooperative, FrieslandCampina.

Friesland Foods and Campina are vertically integrated in the purchase of raw milk from member-farmers and sales of downstream dairy products processed from this raw milk. However, as both companies are cooperatives, this vertical integration is atypical in the sense that the link between a cooperative and its member is stronger than a mere economic relationship and also because conditions of supply are more stringent for both parties.

First, member-farmers are the owners of their cooperatives. Consequently, they are involved in the governance of the cooperative through various representative bodies. Elected farmers appoint the Board of the cooperative (the decision–making body) and have the right to approve or veto certain decisions of the Board.

With respect to conditions of supply, member-farmers are obliged to deliver all their raw milk to the cooperatives while the latter are in turn obliged to buy 100% of members' production, irrespective of market conditions. The result of this reciprocal obligation is that there is a continuous flow of raw milk from farmers to dairy plants. This system remains in place after the merger.

All member-farmers of the new cooperative FrieslandCampina receive a base price for their supplies, namely the guaranteed milk price, which consists of a weighted average of the raw milk price paid by dairy companies in Denmark, Germany, Belgium and the Netherlands (excluding the parties). In addition to the guaranteed price, they also receive a share of the overall profits of the cooperative. This so-called "performance payment" equals 25% of the net profits, while 75% of these profits are added to the reserves of the company, either directly (60%) or through the issuance of bonds to members (15%).

On top of the milk price, farmers are granted member bonds and member certificates, which are financing instruments awarded to member-farmers on the basis of the quantity of milk delivered by them in a given year. The compensation or interest rate payable on such instruments for financing the company is independent of the quantities of milk that such investors deliver to the company. Therefore, members are remunerated for financing the company through annual interest on bonds. They also have the option of cashing the value of these bonds upon termination.

It follows that part of the remuneration paid to farmers (the performance payment and, less directly, member bonds) depends on the business results of the new entity in the downstream dairy markets where it is active. This method of determination of the milk price creates a strong link between the downstream markets for processed dairy products and the price paid to farmers by cooperatives for raw material, which therefore cannot be compared to a "normal" market price that would be solely influenced by raw milk supply and demand factors.

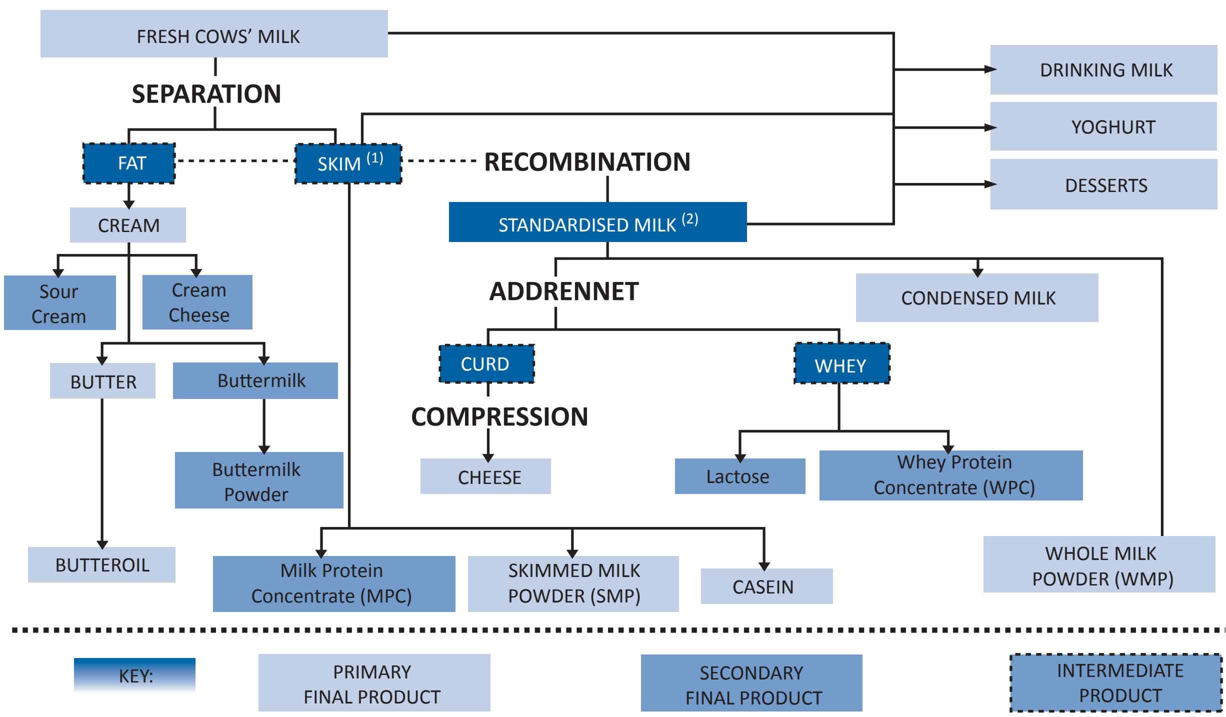
Furthermore, in that kind of cooperative structure, member-farmers have limited incentives to leave the cooperative. First, the supply arrangements give them security of outlets, which is critical for a perishable product such as raw milk produced on a daily basis. Secondly, farmers who have invested in the cooperative can only get back the value of their past investment in the cooperative if they stay as members, since they lose their entitlement to the profits of the cooperative upon termination of their membership. This structure limits farmers' incentives to leave the merged entity and, by extension, influences the decisions of independent farmers or members of competing cooperatives. This can be expected to have an impact on access to raw milk for competitors.

The dairy sector

The dairy sector comprises a series of interrelated product markets, reflecting the wide variety of milk-based end products. The typical business model for dairy companies, notably dairy cooperatives, is to process the raw milk collected from farmers into a wide variety of higher-value added dairy products. The common raw material — raw milk — means that prices of dairy products follow similar trends.

Raw milk consists of several nutritional components: fat, proteins, lactose (milk sugar) and minerals. For some dairy products, only the non-fat components (such as proteins and lactose) are used. Other products, notably butter and cream, are made from the milk fat. Many key products such as cheese and drinking milk contain a mix of fat and non-fat components. Some products — in particular cream, buttermilk and whey — are, in essence, by-products resulting from the production of the primary dairy products such as drinking milk and cheese. The diagram below shows how the fat and non-fat components of raw milk can be used for different applications.

Figure 1: The different applications of milk's components. ©Trevor Smith, dairy industry consultant



(1) SKIM = protein + other solids (lactose, minerals) + water
(2) STANDARDISED MILK = of a fat content adjusted by the addition of skim or cream

Competitive effects of the merger

The activities of Friesland Foods and Campina overlap in many dairy product markets, starting with the procurement of raw milk, the entire range of fresh dairy products (milk, yoghurt, buttermilk, custard, porridge, desserts, quark, flavoured drinks), cheese, butter, cream, long-life milk, coffee whiteners, long-life dairy drinks, emulsions and lactose.

A thorough investigation of the structure and the functioning of the dairy markets concerned by the merger was carried out. As a result, it was found that the merger, in its initial form, would have led to a significant impediment of effective competition in the markets for the procurement of raw milk, fresh basic dairy products (i.e. fresh milk, fresh buttermilk and plain yoghurt), cheese, value added yoghurt and quark (sometimes also called curd cheese), fresh flavoured dairy drinks, long-life dairy drinks and fresh custard and porridge. ([1])

The competition concerns on the long-life dairy drinks market were solved through brand divestitures, and the remedies for fresh dairy products and cheese involved "classical" business/plant divestitures. The focus in the next paragraphs is on the markets for raw milk procurement, for which the remedy package represents a number of innovations.

Procurement of raw milk

At the level of product market definition, a distinction was made in this case between procurement of conventional raw milk and procurement of organic raw milk. As no competition concerns were identified in the latter case, the assessment focused on procurement of conventional raw milk.

The notifying parties, whose activities overlap only in the Netherlands, argued that procurement of conventional raw milk is sub-national in scope and fully coincides with the working area of the parties (Friesland Foods collects raw milk in the eastern and northern parts of the Netherlands whereas Campina collects raw milk in the southern and western parts of the Netherlands). The Commission's market investigation found, however, that the relevant market is national in scope. First, costs of procurement of raw milk are influenced by a number of factors besides distance, such as the size of the processing or production plants located in the area (large processing plants can benefit from economies of scale) and the size of the farms from which raw milk is sourced. Secondly, the parties' competitors collect conventional raw milk in areas which extend, in general, beyond the respective working areas of Friesland Foods and Campina and cover a substantial part of the Netherlands. Thirdly, competitors in the raw milk procurement market do not necessarily take the price paid out by Friesland Foods or Campina to their farmers as a benchmark to set their own purchase prices, and other cooperatives pay the same price to their farmers for raw milk, irrespective of the region where these farmers are located.

On the national market for the procurement of raw milk, the merged entity holds a very high market share, amounting to [70-80%]. Coupled with the fact that on the supply side, farmers supplying raw milk are highly fragmented, this provides a strong indication that the merged entity holds a dominant position in the procurement market for conventional raw milk. These market shares have been particularly stable in the past.

The Commission found that, because of the cooperative structure of the parties, their very strong position on the procurement market would not give them market power and the ability to reduce milk procurement prices, leading to lower output both of raw milk and in the downstream markets and thus harming consumer welfare. The new cooperative retains the current commitment to purchase the milk from its members post-merger. It is thus likely that the merged entity will have neither the ability nor the incentive to reduce the price paid for raw milk purchased from its members, leading to a reduction in input purchases and a consequent reduction of output and increased prices further downstream.

However, the new entity would without the proposed commitments have had the ability and the incentive to leverage its strong position in the procurement market for raw milk to foreclose existing or potential downstream rivals, by limiting or raising the costs of their access to raw milk. The following elements are relevant in this respect.

First, the market investigation showed that the merger would have significantly impeded competition in some national downstream markets for dairy products processed from raw milk, for instance fresh dairy products and cheese. As a result, the merged entity would have been able to exercise market power on these markets. The reduction of effective competition in these markets would have enabled the parties to charge higher prices, and secure higher margins, in the fresh dairy products and cheese markets. This would have led to an increase in the overall profits of the merged entity.

The increase in profits linked to downstream market power could have been redistributed to farmers, by means of higher pay-out prices, since part of the

([1]) In contrast, no competition concerns were found in markets such as long-life milk, organic fresh basic dairy products, bulk and packet butter, liquid and spray cream, liquid coffee whiteners, SDEs, food grade lactose, pharmaceutical and DPI lactose.

price paid to farmers for raw milk is directly linked to the profits of the new entity in downstream markets. If the parties were to pay higher prices for raw milk to farmers than their competitors while offering the same kind of cooperative solution to which Dutch farmers are attached (stability of income, commitment to collect all the raw milk produced, long-standing relationships), it is likely that more farmers would apply to join the new entity. Any increase in the pay-out price for raw milk would also make members of the post-merger entity less likely to switch to other purchasers of raw milk. Through both means, the merged entity's position on the market for procurement of raw milk would therefore have been further reinforced.

With regard to the downstream markets, the market investigation showed that alternative suppliers on the Dutch fresh dairy product and cheese markets need access to Dutch raw milk on a large scale. In a situation where the merged entity would have had the possibility of increasing its already very large farmer base, these competitors would find it more difficult to gain access to Dutch raw milk. The transaction would therefore have further reduced their ability to compete effectively in their respective Dutch downstream dairy markets by raising barriers to entry or expansion and would have strengthened the market power of the notifying parties in these markets.

In summary, the merger brought together the two main purchasers of raw milk in the Netherlands, which control roughly [70-80%] of the market. The market power that they would have had post-merger on downstream markets would have enabled them to generate additional profits and therefore pay higher prices to farmers. Consequently, the merged entity would have been in a position to attract more farmers and maintain and/or strengthen its farmer base. This situation would have increased barriers to entry and/or to expansion on the primary downstream markets for fresh dairy products and cheese where Dutch raw milk is needed to compete effectively.

Fresh dairy products

For fresh dairy products, the market investigation in this case led to the definition of numerous product markets.

The notion of fresh dairy products includes fresh basic dairy products (i.e. fresh milk, fresh buttermilk and plain yoghurt), value added yoghurt and quark, fresh flavoured dairy drinks, fresh custard and porridge. Fresh basic dairy products can be divided into organic and non-organic, and within each of these categories separate product markets for fresh milk, fresh buttermilk and plain yoghurt can be distinguished. It was concluded that in these markets, private label and branded products belong to the same product market upstream. A possible distinction, with regard to the distribution channel, between retail/Out of Home ("OOH"), is left open for non-organic fresh basic dairy, while in organic fresh basic dairy OOH and retail belong to the same market. The upstream market for (organic and non-organic) fresh milk, fresh buttermilk and plain yoghurt was considered national in scope.

For value added yoghurt and quark, separate markets are defined according to distribution channels. A separation into value added yoghurt on the one hand and quark on the other, and a separation into health/indulgence as well as into private label and branded products was left open as such a distinction did not affect the competitive assessment. The relevant geographic market is national in scope for the upstream market in the supply of value added yoghurt and quark to OOH wholesalers and wider than national for the upstream market in the supply of value added yoghurt and quark to retailers.

There are also separate relevant product markets for health-related fresh flavoured dairy drinks and non-health related fresh flavoured dairy drinks, which can be further separated into the supply of branded and private label products and according to the distribution channel (retail/OOH). As the merger did not lead to an impediment of effective competition in the market for health-related fresh flavoured dairy drinks and the private label market was not affected, the competitive assessment focussed on the branded non-health related market for fresh flavoured dairy drinks. The upstream market for non-health related fresh flavoured dairy drinks is national in scope.

Separate product markets also exist for fresh custard, porridge and portion pack desserts. For custard a separation between private label and branded products is left open. Whether the market has to be further separated according to the distribution channel was also left open as such a distinction did not affect the competitive assessment. The markets for custard and porridge were considered national in scope.

The market investigation found that the transaction as proposed in its initial form would have significantly impeded effective competition as a result of the creation of a dominant position on the markets for non-organic fresh milk, fresh buttermilk and plain yoghurt in the Netherlands, regardless of a further segmentation of these markets according to distribution channels. This conclusion was based, inter alia, on the parties' high combined market share, on the fact that they were regarded as each other's closest competitor, on the difficulty for customers to switch to alternative suppliers and on the difficulty for competitors to expand production in the event of a price increase.

Similarly, the notified concentration would have significantly impeded effective competition on the market for value added yoghurt and quark in the Netherlands supplied to the OOH segment and on the market for branded non-health fresh flavoured dairy drinks in the Netherlands, separated according to the distribution channel into retail and OOH.

In the markets for fresh desserts, the notified concentration would have significantly impeded effective competition on the market for fresh custard in the Netherlands and the market for porridge in the Netherlands, regardless of whether these markets need to be further segmented according to the distribution channel. As in the other markets described above, the conclusion was based, inter alia, on the parties' market position, on the fact that they were regarded as the closest competitors and that it was thus difficult for customers to switch to alternative suppliers.

Cheese

The cheese supply chain in the Netherlands has many specific features. The market investigation revealed that Dutch-type cheese (i.e. Gouda, Maasdam, Edam and varieties) needs to be distinguished at the level of product market definition from other hard/semi-hard cheeses such as Emmenthal, Tilsit, etc. Dutch-type cheese is sold in the Netherlands either to specialised cheese wholesalers, who are active at an intermediate level between production and downstream distribution channels, or retailers and other downstream channels. Dutch-type cheese can be either mature cheese (i.e. naturally matured cheese) or rindless cheese (i.e. cheese that is wrapped in a plastic foil when it is young and does not mature any further); mature cheese is often bought by specialised cheese wholesalers at the age of 15 days for the purpose of further ripening before it is sold to downstream distribution channels in the Netherlands. The market investigation led to a delineation of separate product markets for the sale of Dutch-type cheese to specialised cheese wholesalers on the one hand and to supermarkets and other modern types of retail on the other hand. Any further subdivision of the Dutch-type cheese market was left open as such a distinction was not material for the competitive assessment.

With respect to the relevant geographic market, the markets for the sale of Dutch-type cheese to specialised cheese wholesalers and modern types of retail (including all narrower segmentations except for rindless cheese) are national in scope while the markets for the sale of rindless Dutch-type cheese (including all narrower segmentations) to specialised cheese wholesalers and modern types of retail are wider than national and include at least the Netherlands and Germany.

The market investigation found that the transaction in its initial form would have significantly impeded effective competition on the markets for the sale of Dutch-type cheese to specialised cheese wholesalers (including narrower segmentations into mature, Gouda and 15 day-old cheese) and to modern types of retail (including narrower segmentations into mature and Gouda cheese) in the Netherlands.

As regards sales to specialised cheese wholesalers, this assessment is based, inter alia, on the high market shares of the parties, the closeness of competition between the parties, the limited abilities of specialised cheese wholesalers to switch to alternative domestic or foreign suppliers, the limited prospects for entry and expansion in the near future and the fact that all countervailing factors put forward by the parties (e.g. decreased demand and increase in re-imports/sales of cheese originally destined for exports in the event of price increases, alleged dependence on wholesalers' storage and ripening capacity) were found to be insufficient to prevent the merging parties from increasing prices.

Similarly, the assessment of the market for sales to modern types of retail is based, inter alia, on the high market shares of the parties, the closeness of competition between the parties, the limited degree of competition between the parties and specialised cheese wholesalers, the limited possibilities of modern types of retail to switch to alternative domestic or foreign suppliers, the limited prospects for entry and expansion in the near future and the fact that all countervailing factors put forward by the parties (e.g. buyer power, increase in re-imports/sales of cheese originally destined for exports and increased use of rindless cheese in the event of price increases) were found to be insufficient to prevent the merging parties from increasing prices.

Remedies

In order to remove the competition concerns described above, Friesland Foods and Campina committed to divest/grant:

- The entire fresh dairy business of Friesland Foods situated in Nijkerk (the Netherlands), covering the products fresh milk, fresh buttermilk, plain yoghurt, value added yoghurts and quark, fresh custard, porridge, fresh flavoured dairy drinks, fresh cream and organic fresh basic dairy products;
- An exclusive, renewable five-year licence to use the Friesche Vlag brand name in the Netherlands for the current Friesland Foods Fresh product portfolio, followed by a black-out period;
- The ownership of Campina's Melkunie brand and the ownership of all Friesche Vlag sub-

brand names and all brands that are specific to the products of Friesland Foods Fresh (with the exception of the Friesche Vlag brand itself); and

- Campina's Dutch-type cheese production facility at Bleskensgraaf (the Netherlands) and the carve-out of a sales team and other employees for R&D, planning and logistics and general support from the sales organisation of the merged entity.

As explained above, the merger would in its initial form also have led to a significant impediment of effective competition in the market for procurement of conventional raw milk by bringing together the two main purchasers of raw milk in the Netherlands, given the market power that they would have on downstream markets. These competition concerns in the market for procurement of conventional raw milk had therefore to be solved through commitments in the downstream markets and had to include access to raw milk for the divested businesses on a lasting basis. The parties have provided a set of commitments with respect to access to raw milk to eliminate the significant impediments of effective competition identified in the downstream and the upstream markets. In addition to transitional supply agreements for the buyers of the divestment businesses in fresh dairy products and cheese, the remedy package included the setting up of a "Milk Fund" and incentives for farmers to leave the merged entity.

The Dutch Milk Fund ("DMF")

The parties will grant drawing rights for a maximum volume of 1.2 billion kg of raw milk to plants of dairy companies in the Netherlands that produce fresh basic dairy products, Dutch-type mature cheese or one of these products in combination with other dairy products. These drawing rights will be guaranteed by an independent non-profit organisation DMF (in the form of a "*stichting*" or foundation under Dutch law) which will act as a mediator between FrieslandCampina and potential users of these drawing rights.

The volume of 1.2 billion kg will first cover the maximum capacity of both plants of the divested businesses and the remaining volume will allow purchasers of the divestment businesses to expand their business during the period of functioning of the DMF. It should also enable alternative players to source raw milk on competitive conditions to support further growth, thereby further contributing to the restoration of effective competition in the downstream markets for fresh basic dairy products and cheese in the Netherlands.

The price for raw milk will correspond to the guaranteed price that the merged entity will offer to its member-farmers minus 1% for the first five years from the date on which this remedy becomes effective (which corresponds to the date when the DMF becomes operational) and thereafter will correspond to the guaranteed milk price without reduction.

Both divestment businesses will have preferential drawing rights up to the volume representing the total production capacity of those businesses. This arrangement was considered necessary to ensure that these divestment businesses will be able to compete with the parties on a lasting basis.

The DMF will remain in operation until the volume of raw milk to be made available by FrieslandCampina through the DMF has been reduced to zero following the application of the incentive to leave described below. The volume of raw milk available under the DMF commitment will be reduced every year by the volume of raw milk for which applications have been made under the incentives to leave scheme. Therefore the DMF will remain in place until newcomers in the downstream markets have been able to constitute their own supply platform.

Incentive to leave

The parties have also undertaken to reduce the exit barriers for members of the merged entity by granting to existing members of FrieslandCampina in the Netherlands a financial incentive to leave FrieslandCampina (the "Start Up Payment") and to enter into a supply arrangement of any kind with a certain minimum duration with a buyer of raw milk in the Netherlands. The amount of the Start Up Payment is 5 EUR per 100 kg raw milk delivered in the year immediately preceding the year in which the application for the Start Up Payment is made. Any member of FrieslandCampina may apply for the Start Up Payment provided it becomes a supplier to any buyer of raw milk in the Netherlands for a period of three years. Whenever a member terminates his membership with FrieslandCampina, the raw milk volume for which the Start Up Payment has been paid is withdrawn from the volume to be made available by FrieslandCampina through the DMF.

These incentives should provide access for the purchasers of the fresh dairy and cheese divestment businesses to the original sources of milk (farmers). These purchasers should be in a position to contact members of the cooperative societies and to offer alternative terms and conditions. This commitment provides for a more structural solution which enables the purchasers of the divestment businesses to secure their own supply base.

Members that have exited FrieslandCampina may rejoin FrieslandCampina as a member. However, if a member re-accedes to FrieslandCampina within three years from the date he ceases supplying raw milk to FrieslandCampina or definitely stops supplying raw milk altogether, he will have to repay the exit fee on a pro rata basis. This specific arrangement, which gives the farmer the opportunity to rejoin as a member should he decide to apply for the scheme, is essential to secure the success of the incentives to leave scheme. Otherwise, the prospect of not being able to return will function as an additional deterrent to leave and make the incentives less attractive.

Conclusion

In view of these substantial remedies offered by the parties, which are designed to keep the markets at issue competitive and to ensure that consumers will not be harmed by the merger, the Commission was able to approve this significant concentration in the Dutch dairy sector. The Commission's decision is conditional upon full compliance with the commitments.

ABF/GBI Business: coordinated effects baked again

Andrea Amelio, Pablo Asbo, Miguel de la Mano, Ruben Maximiano and Viktor Porubsky (1)

1. Introduction

Just a few months after the Court of Justice gave a key ruling in *Sony/BMG v Impala* (2), the Commission adopted its decision in the *ABF/GBI Business* case (3). This was the first case since *Airtours* in which the Commission intervened solely on the basis of coordinated effects. The case raised several interesting issues and may well help to pave the way for another era of Commission coordinated effects cases, in line with the latest case-law from the Court of Justice.

The case essentially concerned the acquisition of GBI's yeast business in continental Europe (GBI was one of the main European yeast producers, owned by the Dutch private equity firm Gilde) by Associated British Foods (ABF). ABF is a diversified food company and one of the two worldwide leaders in the yeast industry. Gilde, the seller, was disposing of its yeast operations worldwide and, in another transaction, sold the remaining part of GBI (i.e. except operations in continental Europe, but including the UK activities) to the other leading yeast producer — the French company Lesaffre. This other transaction was notified under case No M.5020 — *Lesaffre/GBI UK* and cleared subject to commitments in the first phase, and will not be dealt with in detail in this article.

The *ABF/GBI Business* case did not have a Community dimension and thus arrived at the Commission after a post-notification referral from Spain, Portugal and France. Under the Article 22 referrals procedure (4), the Commission examines the impact of the concentration in place of the requesting Member States and analyses the effects of the merger within the territory of those Member States.

After an in-depth investigation, the Commission identified competition concerns on the Spanish and Portuguese national markets for compressed yeast. The decision concludes that there would have been coordinated effects on these two markets, but it cleared the transaction after having accepted appropriate remedies offered by the parties. The products concerned are quite familiar: yeast is an essential ingredient in the production of bread and other bakery products, basically enabling the dough to rise. While three separate product markets for yeast were identified (dry, liquid and compressed yeast), the focus of the investigation was on compressed yeast. Compressed yeast is perishable with a 3-4 week life time when refrigerated and is used in Spain and Portugal primarily by artisan bakers. The in-depth investigation supported the conclusion that the markets for compressed yeast are national in scope for the countries analysed.

The basic market structure was found to be as follows: in Spain, pre-merger ABF held about a 30-40% market share on the compressed yeast market, while GBI had 10-20% and the remaining big player Lesaffre 40-50%. In Portugal, GBI was the traditional leader with 40-50%, ABF 20-30% and Lesaffre 20-30%. Fringe players existed on both markets but their presence was very limited.

2. Where are we now with coordinated effects in Europe?

2.1. The economics of tacit collusion

The goal of merger control is to prevent the build-up, through mergers and acquisitions, of excessive market power which would give firms the discretion to raise prices above the competitive level with a negative impact on consumer welfare in the absence of any relevant efficiencies. Economic theory shows that mergers may reduce consumer welfare also by facilitating collusion (*coordinated behaviour*) in oligopolistic markets, in essence as the companies in the market reach a tacit (or explicit) understanding of how to coordinate their actions so as to eliminate or reduce the competitive pressure that they exert on each other.

Collusive arrangements may, however, be difficult to enforce given that explicit cartelisation by means of legally enforceable contracts is prohibited. In addition, the participating firms face a dilemma between adherence to the terms of coordination, thus collectively maximising profits, and deviation, which entails reaping high individual short-term profits at the expense of the others but obtaining less profits in future periods as a result of targeted punishment

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) Case C-413/06 P *Bertelsmann and Sony Corporation of America v Impala*, not yet reported; OJ C 223, 30.8.2008, p. 7.

(3) Commission Decision of 23 September 2008, case M.4980 — *ABF/GBI Business*.

(4) See paragraph 50 of the Commission Notice on Case Referral in respect of concentrations, OJ C 56, 5.3.2005, p. 2.

by other firms or simply the breakdown of the coordination. A large body of literature on the necessary and sufficient conditions for rational collusive firm behaviour has developed in industrial economics. The more the post-merger situation presents these characteristics, the greater the likelihood of a post-merger equilibrium where the companies will engage in tacit collusion. However, the focus should not be on the feasibility of tacit collusion, but rather on the merger-specific influence on the potential for tacit collusion to arise.

2.2. How collective dominance grew into coordinated effects

In earlier years, the Commission dealt with the potential collusive effects of mergers in narrow oligopolies by drawing on the notion of a dominant position "by one or more undertakings". In the *Nestlé/Perrier* case in 1992, the Commission concluded with the finding that Nestlé and BSN would acquire a *collective dominant position* on the market for bottled spring water in France. The Commission referred to a number of theoretically relevant factors such as high post-merger market shares, capacities, limited reaction of outsiders and increased dependencies of wholesalers and retailers on the parties. Despite this first successful application of the concept, major uncertainties remained. In the *Kali+Salz/MDK/Treuhand* case in late 1993, the Commission, relying mainly on the existence of structural links, found the transaction would create a dominant duopoly between the parties. In the *Gencor/Lonrho* case in 1996, the Commission found that the parties would have acquired a dominant duopoly position in the worldwide markets for platinum and rhodium. In this decision the Commission mainly relied on the concept of homogeneity of products, high transparency and increased symmetry in the absence of structural links, which were deemed not necessary. The next two important steps in the applicability of the concept of collective dominance were the judgment by the Court of Justice in *France v Commission* in 1998 and, one year later, the CFI's *Gencor* judgment confirming and upholding the Commission's decision.

A substantial development in the assessment of tacit collusion took place when, in a second landmark judgment in 2002, the CFI in *Airtours v Commission* annulled for the first time a prohibition decision under the ECMR. In 1999, the Commission in *Airtours/First Choice* prohibited the merger of two UK suppliers of foreign package holidays, because it expected that the transaction would result in the creation of a collective dominant position. On this occasion the CFI clarified the standard for finding collective dominance by rejecting the routine application of a "checklist" approach (analysing the market characteristics conducive to coordination) and rather set out three cumulative conditions, reflecting a more dynamic approach and looking at the sustainability mechanism of tacit collusion. First, the market must be transparent enough to allow monitoring of other firms' market conduct. Secondly, coordination must be sustainable, which means that the participants must be deterred from defection by fear of retaliation. Thirdly, the benefits of coordination must not be jeopardised by the actions of current or future competitors or customers. The CFI also made it clear that these conditions require a "prospective analysis" of the specific circumstances.

This landmark decision prompted the adoption of the Horizontal Merger Guidelines, where the Commission opted for a more economic approach. The Guidelines indicate that to assess the likelihood of coordinated effects it is first necessary to identify a plausible mechanism for coordination. Four cumulative elements are considered necessary for coordination to emerge and be sustainable, namely, the ability to reach an understanding on the terms of coordination, the ability to monitor deviations, the existence of deterrent mechanisms and the absence of any ability or incentive for outsiders to destabilise the coordination. The mechanical application of the checklist was thus put aside and the facilitating factors would have to be discussed in the context of a sound story based on the abovementioned four building blocks. That paved the way for the most important first steps from collective dominance toward the concept of coordinated effects.

2.3. Implications of the ECJ's Impala judgment: coordinated effects as a matter of degree

When the CFI in *Impala v Commission* annulled the Commission's *Sony/BMG* decision, this was a remarkable and somewhat surprising development for many. The core of the judgment is a detailed review of the Commission's assessment of the strengthening of an existing collective dominant position by the major record companies. On 10 July 2008, the CFI judgment was overturned by the ECJ. In the context of this judgment the ECJ fully endorsed the economic model of tacit coordination, elaborating on its most important aspects.

The ECJ's *Impala* judgment highlights several elements that the Commission should look at in detail and analyse consistently. The ECJ recognises that by its very nature and in contrast to cartel agreements, tacit coordination can rarely be proven by relying on hard evidence. By its very nature, tacit coordination can be difficult to prove. Price-fixing or market-sharing agreements in violation of Article 81 EC Treaty can generally be proven by way of hard evidence (generally written documents). In contrast, tacit coordination, as indicated by the Court of Justice, "*is likely to emerge if competitors can easily arrive at a common perception as to how the coordination should work*" ([5]). Tacit coordination can thus only be inferred indirectly from observing and adequately interpreting the actual conduct of market players in light of existing market conditions, affecting their ability and incentives to tacitly coordinate their actions.

Reaching an agreement, however, is not sufficient. The agreement should be sustainable over time: "*having regard to the temptation which may exist for each participant in a tacit coordination to depart from it in order to increase its short-term profit, it is necessary to determine whether such coordination is sustainable*" ([6]). The ECJ also refers to the need to identify a sufficient degree of sustainability. Monitoring to a sufficient degree, a credible deterrence mechanism and limited reaction of outsiders are the elements that the ECJ points to: "*the coordinating undertakings must be able to monitor to a sufficient degree whether the terms of the coordination are being adhered to ... Furthermore, discipline requires that there be some form of credible deterrent mechanism that can come into play if deviation is detected. ... the reactions of outsiders, such as current or future competitors, and also the reactions of customers, should not be such as to jeopardise the results expected from the coordination.*"

The ECJ also requires the Commission to link these aspects to the effect that the merger brings about. Thus, after having analysed these aspects, the Commission should further show, on the basis of a prospective analysis, the extent to which the "*the alteration in the [relevant market] structure that the transaction would entail, significantly impedes effective competition by making coordination easier, more stable or more effective for the three firms concerned either by making the coordination more robust or by permitting firms to coordinate on even higher prices*" ([7]).

It is precisely the change towards more likely, more stable or more effective coordination which lies at the very heart of merger control. What economic analysis has shown is that the concern should focus on the *coordinated effects* of the merger-specific change in the structure and dynamics of a market rather than solving the more prosaic dilemma of whether a merger is the triggering point for coordination (or collective dominance) which did not exist pre-merger, or whether it strengthens already existing collective dominance. The economic reality is more colourful: between black (coordination) and white (competition) there is something that could be called a sliding scale of coordination. When a market exhibits a certain degree of coordination, no matter whether this could already be described as collective dominance or not, the critical part of a merger analysis is to determine whether a merger creates a situation in which the coordination moves up the scale, to a higher degree. This has been clearly made possible with the introduction of the new Merger Regulation, as for its parallel, the so-called unilateral "gap cases" where no dominant position has to be created to justify an intervention. The new substantive standard of the 2004 Merger Regulation solves the dilemma by effectively shifting the focus towards the significant impediment of competition test, much closer to the economic analysis and the real world, to all intents and purposes getting more under the skin of a market.

The *ABF/GBI Business* case is the first example of this shift, embracing the change in the Merger Regulation and the very clear recent guidance from the ECJ on how to assess the coordinated effects arising through a merger.

3. The yeast story

3.1. Two in one: some background

The background to the transaction at issue is particular, so it is useful to understand it before placing the case in the context of the coordinated effects analysed by the Commission. GBI Holding was owned from 2005 by a private equity fund, Gilde, which acquired it from a strategic player, Gist-Brocades. Evidence suggested that Gilde bought GBI with a view to re-selling the company in the very short term, seeing an opportunity to act as an arbitrageur in a situation where the previous owner wanted to sell the whole of the GBI company into one set of hands. As a buyer, it had a big advantage over the main established players in the industry such as ABF and Lesaffre, as it would be unlikely to run into merger control concerns buying the whole package. After less than two years of Gilde's ownership of the company, negotiations both with Lesaffre and with ABF were initiated and the final agreements led Gilde to the effective split-up of the GBI assets and businesses throughout the world. Lesaffre would purchase the yeast businesses in South America and the United Kingdom, areas where it had a weaker market position than ABF, while ABF agreed to acquire the other European assets and businesses, increasing its position in Lesaffre's traditional stronghold of continental Europe. The end result of the two deals was a significantly more sym-

([5]) Paragraph 123 of the judgment in Case C-413/06 P *Bertelsmann and Sony Corporation of America v Impala*, not yet reported; OJ C 223, 30.8.2008, p. 7.

([6]) Paragraph 123 of the judgment in Case C-413/06 P *Bertelsmann and Sony Corporation of America v Impala*, not yet reported; OJ C 223, 30.8.2008, p. 7.

([7]) Case T-342/99 *Airtours/First Choice* [2002] ECR II-2585, paragraph 61.

metric presence in the various regions in the world of the two main players in the yeast industry.

3.2. Yeast: a good mix of "collusion-facilitating" ingredients

As mentioned above, economic literature on coordinated effects (based primarily on non-cooperative game theory), as well as the Commission's Horizontal Merger Guidelines and the Community Courts, suggest looking at some key market characteristics that are conducive to firms colluding. In *ABF/GBI Business*, these structural features of the Spanish and Portuguese compressed yeast markets strikingly hinted at the finding that the basic "coordination-friendly" ingredients were indeed present.

Consider the following market mix: a small number of active competitors (essentially three, which were reduced to two post-merger), with a high frequency of repeated interaction and without any large or bulky orders (predominantly weekly or twice-weekly orders of relatively small amounts of yeast via distributors to artisan bakers). These two/three firms are interacting on a relatively stable or slightly declining market which is very mature and shows a low risk of leap-frog innovation, while demand elasticity is low and the product is quite homogenous (a couple of brands of yeast in standard packaging for each competitor). There is a high degree of market transparency in competitors' prices, volumes and capacity. The markets in question are protected from outside reactions by high barriers to entry or to expansion of fringe competitors (as fringe competitors have no local distribution networks, which tend to be very traditional and hard to establish; they are located relatively far away from the region and have little spare capacity and very limited incentives to enter/expand in Spain and Portugal) and, on the other hand, by the relatively low buyer power of customers (being typically smaller local distributors of bakery products for artisan bakers). To all this, add extensive multi-market contacts between the companies involved, who meet on a number of neighbouring product and geographic markets. With these market features revealed or confirmed by the investigation, it would be difficult not to take coordinated effects seriously.

3.3. How the cake is baked

On top of analysing the "checklist" of individual market features, the Commission went further and sought to understand how coordination would actually work in practice. That meant understanding the mechanism and variables on which the colluding partners would (tacitly) agree, the mechanism for detecting deviations and the means to punish them. The essence of the investigation in this case was to understand the dynamics of the industry — not only at the level of the yeast market but also further downstream where distributors sell the yeast to bakers. To this end, the Commission conducted extensive interviews with competitors, and notably with a number of local distributors, which proved very fruitful. Information was also gathered at an industry trade show where all major market participants are usually present. It is perhaps interesting to note that extensive econometric evidence was not necessary to arrive at a robust standard of proof, even though transaction data were indeed analysed and served to supplement the qualitative findings in many instances. To step into the shoes of the main players, it was very useful to review their internal documents. A number of interviews and internal documents uncovered a great deal of market transparency and showed how competitors would be able to arrive at a common perception of each other's behaviour. For example, some documents showed how price increases of competitors would be anticipated.

Price — and more precisely price increases applied more or less simultaneously — was indeed found to be the core focal point of the likely (tacit) collusion between the oligopoly members. This was also in line with some past cases of alleged cartel behaviour in the yeast industry. Holding significant excess capacity, all three main players would likely be in a position to react timely enough to punish deviations from the collusive behaviour. What turned out to be a very important element in implementing and monitoring the collusive mechanism were the local distributors.

3.4. How yeast is delivered: role of distributors

In both Portugal and Spain the compressed yeast market is essentially made up of artisan bakers — that is to say that most of the final customers of the compressed yeast producers are small, traditional, family enterprises and are many in number. These businesses are in some cases so small that it is not economic for them to own their own refrigeration systems to keep the compressed yeast in a usable condition for any significant period of time. So they have to be served on a nearly continuous basis by local/regional distributors operating refrigerated transport. These factors mean that over the years the producers actively selling in Portugal and Spain rely on a capillary network of distributors to make the rounds to serve these customers. One of the surprising aspects revealed by the investigation was the importance of the interpersonal relationship between the distributors and their customers, in certain cases extending over more than one generation.

It is therefore very clear that distributors play a fundamental role in the market.

Significant loyalty between the yeast producers and the distributors themselves also exists, as the stability of relationships over the years clearly shows. This was confirmed by the analysis of some written contracts (in Portugal in particular), many dating back many years or even decades. This stability is explained by the arrangements that are in place: distributors proved in the vast majority of cases to be either de facto or de jure exclusive for one supplier and for a given "allocated" region. This makes the whole distribution system a relatively simple one, with few changes possible as all the relevant producers are already "taken" in all regions in both Portugal and Spain.

What was also revealed during the interviews and by analysis of the contracts was that distributors have another important role in the Bakers Play: acting as collectors of information for the suppliers. They collect information about the market at their level, regularly reporting this information back to their relevant supplier of yeast. In some instances, distributors' contracts with their supplier include a full reporting obligation.

Therefore the investigation showed that the way the distribution system is set up also enhances to a very significant extent transparency in both the Portuguese and Spanish markets for compressed yeast ([8]), thus making it easier for Lesaffre, ABF and GBI to monitor any deviation in prices or conditions, and facilitating the sustainability of tacit coordination.

3.5. Cake assortment: multimarket contacts

ABF, Lesaffre and GBI were the main worldwide players in the yeast production sector. They also had a significant presence in all three of the Member States subject to the Commission's scrutiny, and in a number of other markets in Europe. Meeting across a multitude of different product and/or geographic markets may serve to increase the sustainability of coordination across markets, for example by adding another market on which retaliation can take place or by inducing coordination on a market closely linked with a neighbouring market on which coordination may take place. These multi-market contacts may also serve to decrease asymmetries between the market participants. Overall, the presence of competitors on multiple markets enhances the interaction and the mutual interdependence of the oligopoly members.

([8]) There were other factors leading to the finding that the markets in question were to a significant extent transparent, such as product homogeneity.

An interesting feature which the investigation revealed in this context was the interplay between the Portuguese and Spanish compressed yeast markets. While the investigation concluded that they are still distinct geographic markets, in particular given the importance of demand factors, there are a number of links on the supply side between Spain and Portugal that would mutually enhance the likelihood of coordination. Despite highly asymmetric market shares in Portugal, the Commission identified coordinated effects on that market, taking the form of collusive price leadership (where one firm would lead the market and the other follow). When looking at the behaviour of the firms concerned, it was considered that any highly competitive action of the smaller player in Portugal (which was nevertheless much more strongly present in Spain) on this relatively small neighbouring market could lead to an undesired response of its rival in the geographically close and much larger Spanish market. In other words, there could be more to lose than to gain from such action. This may likely be an additional factor to incentivise the smaller player in Portugal to align its behaviour on that market with the local leader instead of taking a more competitive stance, in order to prevent tougher competition in Spain.

3.6. When a merger makes things worse

It is necessary to further show that the change in the relevant market structure that the transaction would entail constitutes a significant impediment to effective competition. While the investigation indicated that a certain degree of coordinated behaviour was already observable pre-merger on the markets concerned, the key to the analysis was to identify why and how the merger would make the coordination more effective or more stable. The Commission's analysis showed that the merger of ABF and GBI Business would likely trigger a significant change towards more efficient and more stable coordination.

A merger from three to two main yeast suppliers would significantly change the market picture. For each of the remaining duopoly members, there would only be one competitor to (tacitly) agree on the terms of coordination. Transparency would be enhanced significantly, meaning that each firm would face only one competitor to be monitored and hence discovering the deviator would be much easier. Also punishing deviations would be much more effective, whereas there would be no doubt as to who should be the one taking the retaliatory measures compared with three players on the market. The fact of having only two players instead of three would also reduce the incentives to deviate, as there would be proportionally less to gain.

The investigation also showed that by removing GBI from the market, a potentially destabilising factor in the collusive game would be eliminated. GBI showed a number of asymmetries in comparison with the two other suppliers, which the merger would remove. Contrary to ABF and Lesaffre, who had local production plants in the region, GBI was serving Spain and Portugal from a greater distance, from its Italian facility. The different size of the Italian plant and its different location meant not only comparably higher transport costs, but may have prompted GBI to react differently to, for example, unanticipated supply developments in Italy or demand changes in all the other regions that it was serving. Also, by eliminating GBI from the game, spare capacities would become extremely symmetric between the two remaining players, making coordination between them much more sustainable. An aspect which weakened the retaliation potential against GBI (and hence increased GBI's potential incentives to deviate) was that GBI was not present on some related product markets in Spain and Portugal (liquid yeast), where retaliation could effectively occur. GBI would thus be immune from counter-attacks on that related market, whereas the two remaining players were also the only ones active there. All in all, the merger would change the market structure in such a way as to reinforce the basic criteria favourable for more likely, effective and sustainable coordination in each of the basic building blocks of the collusive mechanism: in reaching a (tacit) agreement, in monitoring deviations and in the threat of retaliation.

4. Conclusion

The *ABF/GBI Business* case is a first example of how the new Merger Regulation together with the guidance from the ECJ in its *Impala* ruling is transposed into a coordinated effects case. The case encouragingly shows that in the context of the analytical framework set by the ECJ and applied by the Commission, a robust coordinated effects case can be arrived at with a common-sense approach: by examining how the merger would change the market structure and whether it would enhance the building blocks of a sustainable collusive mechanism.

Commission and Germany agree on better control for the use of State aid in the broadcasting sector

Lukas Repa and Nóra Tosics (1)

On 18 December 2008, Germany's 16 *Länder* signed a new inter-state treaty on broadcasting, which implements a set of appropriate measures under the terms of a Commission Decision of April 2007. The case is an important precedent for the Commission's approach to State aid control in the area of public service broadcasting. It also highlights the value of constructive cooperation between the Commission and Member States during the implementation of appropriate measures for modifying an existing aid scheme.

In a joint press statement dated 18 December 2008 Commissioner Kroes and the *Ministerpräsidenten* of Germany welcomed the fact that from now on the public funding of Germany's broadcasters ARD, ZDF and Deutschlandradio for new audiovisual media services will be in line with the EC State aid rules. (2) The signature of the 12th Inter-State Treaty on broadcasting concluded a long-standing discussion between the Commission and Germany's 16 *Länder* which raised no less important questions than whether EC State aid rules apply to the audiovisual media sector at all.

Controlling the use of State aid at national level: the "Drei Stufen Test"

Germany's *Länder* and the Commission agreed in April 2007 on a set of appropriate measures which should bring the public financing of ARD, ZDF and Deutschlandradio into line with the EC State aid rules. These measures addressed in particular the financing of "new media services", including offers on the internet. The Commission considered that State aid authorisation for offering new media services could only be warranted based on a clear definition of the public service mission and a proper entrustment process.

To address this concern, Germany proposed that new media offers of public service broadcasters must contribute to "editorial competition". Establishing whether this requirement is met involves analysing the contribution new offers will make to opinion shaping while also taking into account already existing offers on the market. Germany also pledged to give private operators an opportunity to comment on the expected market impact of the envisaged new offers.

This evaluation process is today referred to as the "*Drei Stufen Test*" in Germany as it consists of three steps, (3) with the second step of the test addressing the potential market impact of a new offer. The BBC have already since 2006 been operating a similar test, which they refer to as a "Public Value Test". (4) Smaller Member States such as Ireland and Belgium are in the process of implementing similar tests too. (5)

Problems resulting from a long implementation period

The 2007 Decision provides for an unusually long implementation period of two years, contrary to other comparable State aid cases in this sector. (6)

This long implementation period was deemed proportionate for several reasons. First, media policy is a matter of regional competency under Germany's federal constitution. Hence, the revision of the existing Inter-State Treaty on public service broadcasting requires coordination between the 16 *Länder*. Second, the implementation process was made more complex by the need for public broadcasters to adopt a series of side-measures which were to spell out and supplement the provisions of the Inter-State Treaty.

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) Commission Decision of 24 April 2007, E 3/2005 (IP 07/543). The Decision was adopted under Articles 17 and 8 of Council Regulation (EC) No 659/1999 of 22 March 1999, OJ L 83, 27.3.1999, p. 1. See Competition Policy Newsletter 2007 No 2, p. 67.

(3) The three steps of the *Drei Stufen Test* require each public service broadcaster in Germany to evaluate whether a new and significant offer (1) serves the democratic, social and cultural needs of German society and (2) contributes in a qualitative way to "editorial competition" (*publizistischer Wettbewerb*) and (3) to specify the financial impact of such offers.

(4) http://www.bbc.co.uk/bbctrust/framework/public_value_test/index.html

(5) See Competition Policy Newsletter 2008 No 3, p. 81 on the Irish and Belgian cases.

(6) The Decision of February 2008 on the Irish public broadcasting system requires Ireland to notify the Commission of the entry into force of the new Broadcasting Act and to submit the final law to the Commission no later than December 2008 (see Commission Decision of 27 February 2008 in case E 4/2005, at para. 189).

Due to this situation, Germany could not base its proposal for appropriate measures on one all-encompassing bill of law. Rather, the appropriate measures it offered were set out in broad terms which inevitably necessitated further refinements in the implementation process. ([7])

However, during the long implementation period Germany's public service broadcasters continued to develop their media offers on all platforms. ([8]) This increasingly threatened to undermine the very effectiveness of the appropriate measures envisaged by the *Drei Stufen Test* for all "new" or "significantly modified" offers. "Existing services" merely have to be enumerated in a "*Gesamtkonzept*" but not tested with respect to their value for citizens and the impact on the market. ([9])

Half-way through the implementation process, Germany's *Länder* could no longer sufficiently distinguish pre-existing services from new offers. To address that difficulty, Germany's *Länder* in the end decided to apply the test to all internet offers which should still be on the market at the end of the implementation period in April 2009. ([10])

The wider importance of a balancing test for new media offers

The *Drei Stufen Test* — and similar forms of ex ante assessment — are important mechanisms to safeguard the principles of the Amsterdam Protocol at national level. The Amsterdam Protocol interprets Article 86(2) EC in an authentic and binding manner. It has two parts. First, the Protocol clarifies that Member States have full freedom to define the public service remit (i.e. the SGEI) in the broadcasting sector with reference to "the democratic, social and cultural needs" of their societies. Second, the Protocol obliges Member States to prevent State funding affecting trading conditions and competition in the Community to an extent which would be contrary to the common interest, "while the realisation of the remit of that public service shall be taken into account".

The assessment of new media in a balancing test replicates these two elements of the Amsterdam Protocol and hence it is also called the "Amsterdam test". One crucial aspect of the test is that citizens and market participants (e.g. private broadcasters or newspaper publishers) are granted the opportunity to give their views within a public consultation on the value and the potential market impact of a planned offer *before* irreparable harm is caused and public funds are spent. The views of this public consultation should be taken into account in balancing — at the national level — the pros and cons of using State aid for financing a new media activity. If the outcome of that balancing exercise is negative, the service should only be provided on market terms without using State funds.

The Commission's review of the 2001 Broadcasting Communication, which ended in July 2009, consolidates its practice in more than 20 decisions including the German, Irish and Belgian cases. Upon entry into force, the revised Communication will also consolidate the "Amsterdam test" at the national level ([11]).

How to ensure the effectiveness of the balancing test

The Commission's implementation discussions with Germany's *Länder* soon focused on how the *Drei Stufen Test* is implemented both in the Inter-State Treaty and in the guidelines adopted by ARD and ZDF. The appropriate measures leave Germany discretion to entrust the test to the *Rundfunkräte* of ARD and the *Fernsehrat* of ZDF ([12]) rather than to a public authority. ([13]) When Germany's *Länder* made use of this possibility, the Commission insisted on accompanying measures to prevent any possible conflict of interest in order to safeguard the effec-

([7]) Thanks to effective coordination between Germany's 16 *Länder*, which were headed by a group of four *Länder*, the implementation talks between the Commission and Germany took no longer than four months, starting in September and ending in December 2008. However, the preceding internal discussion in Germany actually took more than a year.

([8]) ARD and ZDF had already put some of their new digital channels on the market prior to the adoption of the Decision and further developed those channels during the implementation period. Moreover, during the implementation period, both ARD and ZDF started "*Mediatheken*", large on-line portals which offer viewers the possibility to download TV and radio programmes for free. ARD's portal alone contains approximately 15 000 TV and radio programmes.

([9]) Commission Decision of 24 April 2007 in case E 3/2005, at paras 328 and 333.

([10]) ARD and ZDF are currently in the process of preparing this first and rather voluminous test for existing internet services. The test is generally considered as a test case for the effectiveness of the new control mechanism.

([11]) http://ec.europa.eu/competition/state_aid/legislation/specific_rules.html#broadcasting; see paragraph 88 of the revised Broadcasting Communication.

([12]) Both the *Rundfunkräte* and the *Fernsehrat* are control bodies composed of politicians and representatives of diverse social and cultural groups in Germany whose role is to supervise the management of the public broadcasters.

([13]) This compromise was due to the specific constitutional situation in Germany. For historical reasons the constitutional Court in Karlsruhe interprets the principle of editorial freedom of the media very widely to deter any kind of governmental intervention. Freedom of expression is also protected under Article 11 of the Charter of Fundamental Rights of the European Union and Article 10 of the European Convention of Human Rights as a general principle of law the respect of which is ensured by the European Community Courts.

tiveness of the test, including measures to increase the transparency of the decision-making process and measures to enhance the factual capability of the decision makers to execute such a test.

Another question left open in the appropriate measures was the threshold for triggering the *Drei Stufen Test*. As a matter of general policy, the Commission requires State funding for any "new" and "significant" audiovisual media service to be assessed with respect to the criteria of the Amsterdam Protocol. However, in doing so, the Commission leaves Member States wide discretion to define by themselves what "new" and "significant" means. This is, amongst others, because the Commission does not wish to prejudge for Member States whether they want to test new services platform by platform (e.g. a possibility to offer downloads of TV films on the internet) (14) or rather *across* platforms (e.g. an offer under the same brand on TV, internet and radio).

For constitutional reasons (editorial freedom) (15) the German authorities again preferred ARD and ZDF to define the notions of "new" and "significant" rather than to lay down such definitions in a legislative act. Here, too, close deliberations between the Commission departments and Germany's *Länder*, including the public broadcasters, were required to reach a fully satisfactory solution.

As a consequence, ARD and ZDF have now published guidelines on the procedure and details of the *Drei Stufen Test* which among other things also define the terms "new" and "significant". (16)

Conclusions

Germany's public broadcasting system has today an effective dispute resolution mechanism at national level which should prevent the public funding of new audiovisual media services running counter to EC State aid law.

The advantages of this form of ex ante control include enhanced legal certainty, improved awareness of the value of public services in this sector and ultimately more value for taxpayer's money. This framework will allow public service broadcasters to offer high-quality and modern services, taking advantage of the opportunities technological development is offering to media companies. At the same time, this will happen in an environment where newspaper publishers, commercial broadcasters and other private media can also improve and diversify their offers without fearing to see their efforts frustrated by unfair competition that is financed with public money.

The experience with implementing the Decision in the German case also highlights the challenges resulting from a long implementation period requiring close coordination between several national bodies. It may be easier for Member States to propose appropriate measures already on the basis of a concrete bill of law. On the other hand, several issues in this case only surfaced during the implementation process. They concern details which could hardly have been foreseen in advance when the appropriate measures were put forward.

The positive solution that was found in Germany therefore speaks in favour of maintaining a close dialogue between the Commission departments and the national authorities concerned after the acceptance of appropriate measures in existing aid cases.

(14) The first *Drei Stufen Test* after the entry into force of the inter-State Treaty on 1 June 2009 concerns a joint ARD/ZDF internet portal "kikakaninchen.de" (see *epd Medien*, 6.12.2008, at p. 11).

(15) See footnote 12 above.

(16) See for instance in *epd Medien*, 17.12.2008, at p. 29. The definition of services that must be tested is based on a set of 4 positive and 7 negative criteria which must be taken together to conclude whether the test is needed.

The first final decision involving a detailed economic assessment of R&D aid: the ITP case

Almorò Rubin de Cervin (1)

On 21 October 2008, the Commission authorised, under the EC Treaty rules on state aid (Article 88(2)), €35 million of public funding granted by Spain to Industria de Turbo Propulsores (ITP) for the development of the low-pressure turbine for the Trent 1000 engine (2). The Trent 1000 engine is being developed by Rolls-Royce for the Boeing B787 Dreamliner. After an in-depth investigation, launched in March 2007, the Commission found that the project satisfied the requirements of the EU framework for state aid for research, development and innovation (3) (the R&D&I framework).

In particular, the Commission found that the project incites ITP to carry out additional research, that the public funding will be reimbursed according to the success of the project and that the relevant provisions on eligible costs and aid intensity have been respected. The Commission accordingly concluded that the aid does not threaten to distort competition in the single market and is therefore compatible with the EC Treaty (Article 87).

The five-year project (2005-2009) is focused on the low-pressure turbine of the Trent 1000 engine, which Rolls-Royce is developing with a number of partners in order to equip the Boeing B787.

The aid is granted by the Centro para el Desarrollo Tecnológico Industrial (CDTI), an agency of the Spanish Ministry of Industry, Commerce and Tourism, in the form of a €35 million loan. It is intended to reduce the risk linked to this type of project, where returns on investment are uncertain and slow. The project is carried out in Zamudio (Vizcaya, País Vasco), Ajalvir and San Fernando de Henares (Comunidad de Madrid), which are eligible for regional aid as areas with employment and living standards below the EU average.

The case is relevant as it is the first final decision taken on the basis of the detailed economic assessment provided for in Chapter 7 of the R&D&I framework.

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the author.

(2) Case C 9/2007 — *R&D aid to ITP for the Trent 1000 project*. Final decision adopted on 21 October 2008 and published in OJ L 66, 11.3.2009, p. 3.

(3) Community framework for state aid for research and development and innovation, OJ C 323, 30.12.2006, p. 1.

The investigation made it possible to clarify a number of factual circumstances:

- first, it clarified the circumstances that led the Spanish authorities to grant two tranches of aid to the same project. Spain recognised that it made a mistake in doing so, and in forgetting to mention the first tranche of aid in the initial notification of the second tranche of aid;
- second, the investigation clarified the granting process by the Spanish Government, including the transfer of competencies from a ministry to the public agency CDTI.

There are several aspects of the assessment that deserve to be highlighted:

The first aspect worth mentioning is that the assessment of the incentive effect was not based on a counterfactual project. A detailed analysis of the company's decision-making process, based among other things on internal documentation, showed that the potential alternative investments considered by the company were numerous; at the same time, the assessment also showed that these alternatives were only theoretical, as they depended ultimately on the negotiation with the leader of the project. The information supplied by Rolls-Royce during the procedure allowed a broader understanding of the project.

The second relevant aspect concerns the eligible costs, which were reduced and reclassified. On the eligibility of costs, the final decision states that eligible R&D costs are only those costs incurred by the company until the certification of the engine. This means that costs after the engine has been certified should be considered as not eligible for aid. Secondly, some costs were reclassified from industrial research to experimental development, as Spain recognised that they were specific to the project under development. The aid amount now corresponds to around 48% of the total eligible costs, in line with the aid intensity laid down in the R&D&I framework.

A third important aspect of the final decision is that the aid instrument has been changed compared to the measure notified in 2006. Spain has transformed the aid instrument into a repayable advance, i.e. a fully reimbursable loan, with the reimbursement depending on the success of the product. The reimbursement mechanism includes a success fee in case sales go beyond the forecasted level. The new instrument is fully in line with point 5.1.5 of the R&D&I framework.

Further, the Commission's investigation made it possible to ensure that the amount of aid was kept to the minimum, set at €35 million, somewhat lower than the sum of the initially notified amount of €27 million plus a first tranche of €9 million that Spain had not notified.

Another important aspect concerns bonuses, which have not been allowed. On the one hand, the R&D&I framework does not allow a regional bonus. On the other hand, the final decision found that the project was not entitled to receive a collaboration bonus: the project was entirely carried out by ITP in Spain, and the two companies involved (of which only ITP is an aid beneficiary) were not independent, since RR is a large shareholder of ITP.

The investigation also ruled out the presence of indirect aid to Rolls-Royce, the main developer of the Trent 1000 engine. In particular, the agreement between ITP and Rolls-Royce was made on commercial terms (similar to those available to other risk-sharing partners), the costs to be taken into account for the calculation of the aid amount are only those incurred by ITP in Spain and there is no transfer of state resources to Rolls-Royce itself.

Finally, concerning the impact on competition, the final decision takes note of the fact that no competitor or other third parties intervened during the proceedings to make observations. It further notes that ITP has a limited market share and that the impact of the aid on competition is limited.

To conclude, the final decision provides clarification on a number of aspects related to practice in the field of large amounts of R&D aid in the aerospace sector. It ensured that the aid was made fully reimbursable, on acceptable terms, and relative to a correct amount of eligible costs. The final decision also clarified a number of aspects related for instance to the application of bonuses and to the absence of indirect aid in case of commercial partnerships.

Organigram of the Competition Directorate-General (1 September 2009)

Position	Name	Phone +32 29…
Director- General	**Philip LOWE**	65040/54562
Deputy Director-General Operations	**Lowri EVANS**	65029
Principal Adviser	**Kirtikumar MEHTA**	57389/90183
Deputy Director-General Mergers and Antitrust	**Nadia CALVIÑO**	55067
Deputy Director-General State Aids	**Philip LOWE (acting)**	65040/54562
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Adviser: Consumer Liaison Officer	Juan RIVIERE Y MARTI	51146
Audit adviser	Rosalind BUFTON	64116
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03. State aid case support	Nicola PESARESI	92906/95033
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Adviser	Dietrich KLEEMANN	65031/54133
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3. Mergers	Flavio LAINA	69669/50658
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Documents

Speeches

From 1 September 2008 to 31 December 2008

This section lists recent speeches by the Commissioner for Competition and Commission officials. Full texts can be found on http://ec.europa.eu/competition/speeches. Documents marked with the reference "SPEECH/08/…" can also be found on http://europa.eu/rapid

By Neelie Kroes, European Commissioner for Competition

SPEECH/08/714, 17 December

State aid for financing the real economy, merger approvals and Slovak Post. Introductory remarks at press conference. Brussels

SPEECH/08/700, 10 December

Collective redress in Europe. Address at panel discussion organised by DHIK at the Representation of the Free State of Bavaria to the EU. Brussels

SPEECH/08/683, 8 December

The role of state aid in tackling the financial & economic crisis. Introductory remarks at press conference. Brussels

SPEECH/08/679, 5 December

EU state aid rules – part of the solution. EStALI conference. Luxembourg

MEMO/08/757, 2 December

State aid: Commissioner Kroes briefs Economics and Finance Ministers on financial crisis measures

SPEECH/08/659, 28 November

Antitrust: preliminary report of sector inquiry into pharmaceuticals. Opening remarks at press conference. Brussels

28 November

Preliminary report of sector inquiry into pharmaceuticals – public hearing. Brussels

SPEECH/08/658, 27 November

Achieving self-sustaining competition in telecommunications. 9th Annual ECTA Regulatory Conference. Brussels

SPEECH/08/634, 21 November

The State Aid Action Plan: a roadmap for reform and recovery. Conference on "The new approach to state aids - Recent reforms under the State Aid Action Plan and next steps". Brussels

SPEECH/08/625, 18 November

EU competition rules – part of the solution for Europe's economy. European Competition Day. Paris, France.

SPEECH/08/604, 12 November

Car Glass Cartel. Opening remarks at press conference. Brussels

SPEECH/08/588, 6 November

State aid decisions on Gdynia and Szczecin shipyards. Opening remarks at press conference. Brussels

SPEECH/08/563, 28 October

Preserving the competitiveness of European industry – the contribution of state aid policy. The Centre. Brussels

SPEECH/08/551, 21 October

Restructuring of Polish shipyards. Declaration by Commissioner Neelie Kroes at plenary session of European Parliament. Strasbourg, France

SPEECH/08/521, 13 October

In defence of competition policy. Opening remarks at conference "Competition policy, growth and consumer purchasing power". Brussels

SPEECH/08/498, 6 October

Dealing with the current financial crisis. Economic and Monetary Affairs Committee, European Parliament. Brussels

SPEECH/08/477, 1 October

Paraffin wax cartel and bank rescues. Opening remarks at press conference. Brussels

SPEECH/08/457, 25 September

Exclusionary abuses of dominance

the European Commission's enforcement priorities. Fordham University Symposium, New York, USA

SPEECH/08/445, 19 September

Settlements in cartel cases. 12th Annual Competition Conference. Fiesole, Italy

SPEECH/08/437, 17 September

Making online commerce a reality. Closing remarks at Online Commerce Roundtable. Brussels

11 September

How Malta can get the most out of competition policy. La Valletta, Malta European Commission

By the Competition Directorate-General staff

27 November

Herbert Ungerer: Public funding for broadband networks and EU State aid rules: Issues ahead. 9th ECTA Regulatory Conference. Brussels

22 November

Lowri Evans: Competition and respect of identity of social economy enterprises. European Conference on Social Economy. Strasbourg, France

7 November

Lowri Evans: State aid in perspective: Europe, UK and Wales - The European Perspective on State aid control. Welsh Assembly Government / Welsh Local Government Association / Law Society Office in Wales. Cardiff, UK

6 November

Herbert Ungerer: The new approach to State aids and its consequences for the Romanian business environment in the view of the newly adopted General Block Exemption regulation. European competition and competitiveness day. Bucharest, Romania

6 November

Philip Lowe: Can EU competition policy create competition in the energy sector? The Beesley Lectures. London, UK

30 October

Herbert Ungerer: European Forum on State Aid - opening speech. The Polish Office of Competition and Consumer Protection. Warsaw, Poland

24 October

Olivier Guersent: The Guidelines on Maritime Transport Services. European Maritime Law Organisation. Copenhagen, Denmark

26 September

Lowri Evans: The role of economics in modern competition policy. International League of Competition Law Congress 2008. Hamburg, Germany

26 September

Philip Lowe: Enforcers Roundtable - Independence and competition authorities. Fordham Competition Law Institute Annual Conference 2008. New York, USA

23 September

Philip Lowe: Innovation and the Regulation of Dominant Firms. Georgetown University Symposium 2008. Georgetown, USA

22 September

Herbert Ungerer: Competition and Web 2.0 Annual SCL Policy Forum. London, UK

17 October

Herbert Ungerer: The External Dimension of State Aid Control. Claes&Casteels Conferences. Brussels

3 September

Irmfried Schwimann: Payments: Commission and ECB support launch of Pan-European SEPA Direct Debit; provide guidance to industry. Brussels

Press releases and memos

From 1 September 2008 to 31 December 2008

All texts are available from the Commission's press release database RAPID http://europa.eu/rapid

Enter the code (e.g. IP/06/14) in the 'reference' input box on the research form to retrieve the text of a press release. Languages available vary for different press releases.

Antitrust

MEMO/08/809 - 29 December

Commission confirms sending Statement of Objections to EdF on French electricity market

MEMO/08/806 - 18 December

Commission welcomes European Court of Justice judgment in the French Beef case

MEMO/08/805 - 18 December

Commission welcomes Court of First Instance judgment in rubber chemicals cartel case

IP/08/1997 - 17 December

Commission opens infringement proceedings against Slovakia to ensure compliance with Commission hybrid mail decision

MEMO/08/783 - 11 December

Commission confirms sending Statement of Objections to alleged participants in power transformers cartel

MEMO/08/768 - 05 December

Commission market tests commitments proposed by RWE concerning German gas market

IP/08/1887 - 04 December

Commission consults on review of rules for assessing horizontal cooperation agreements

IP/08/1877 - 03 December

consumer welfare at heart of Commission fight against abuses by dominant undertakings

MEMO/08/761 - 03 December

Guidance on Commission enforcement priorities in applying Article 82 to exclusionary conduct by dominant firms – frequently asked questions

IP/08/1829 - 28 November

Preliminary report on pharmaceutical sector inquiry highlights cost of pharma companies' delaying tactics

MEMO/08/746 - 28 November

preliminary report of sector inquiry into pharmaceuticals – frequently asked questions

IP/08/1774 - 26 November

Commission opens German electricity market to competition

MEMO/08/734 - 25 November

Commission confirms unannounced inspections at pharmaceutical companies

MEMO/08/728 - 20 November

Commission welcomes Court ruling in Irish beef case

MEMO/08/706 - 13 November

Commission confirms unannounced inspections on biomedical analysis market

IP/08/1685 - 12 November

Commission fines car glass producers over €1.3 billion for market sharing cartel

MEMO/08/690 - 12 November

Commission action against cartels – Questions and answers

MEMO/08/676 - 05 November

Commission confirms unannounced inspections in the cement sector

MEMO/08/666 - 30 October

Commission inspection of incumbent telecom operator in Poland Telekomunikacja Polska S.A.

IP/08/1566 - 22 October

Commission opens consultations on review of block exemption for liner shipping consortia

MEMO/08/644 - 22 October

revision of the liner shipping consortia block exemption Regulation - frequently asked questions

IP/08/1509 - 15 October

Commission fines banana suppliers €60.3 million for running price cartel

MEMO/08/623 - 15 October

Competition: Commission action against cartels – Questions and answers

IP/08/1477 09 October

Competition: Commissioner Neelie Kroes hosts high-level conference on the benefits to the economy and consumers of competition policy

MEMO/08/610 - 08 October

Competition: Commission welcomes Court of First Instance judgments in carbon and graphite cartel case entirely confirming level of fines

IP/08/1467 - 07 October

Commission requests Slovakia to re-open competition in the hybrid mail sector

IP/08/1434 - 01 October

Commission fines wax producers €676 million for price fixing and market sharing cartel

MEMO/08/600 - 01 October

Competition: Commission action against cartels – Questions and answers

IP/08/1338 - 17 September

Competition: Commissioner Kroes hosts consumer and industry Roundtable on opportunities and barriers to online retailing and the European Single Market

MEMO/08/567 – 16 September

Antitrust: Commission welcomes Court decision on parallel trade in the pharmaceutical sector

IP/08/1290 - 04 September

Payments: Commission and ECB support launch of pan-European SEPA Direct Debit; provide guidance to industry

Merger control

IP/08/2027 - 18 December

Commission approves proposed acquisition of joint control over Taranto Container Terminal by Hutchison and Evergreen

IP/08/2014 - 18 December

Commission clears proposed acquisition of SSTL by EADS

IP/08/2012 - 18 December

Commission approves acquisition of Bradford & Bingley Assets by Banco Santander subsidiary Abbey

IP/08/2011 - 18 December

Commission approves joint venture between Sofinco and Banco Popolare in Italian consumer credit markets

IP/08/1938 - 10 December

Commission approves proposed acquisition of Hägglunds Drives by Robert Bosch

IP/08/1848 - 01 December

Commission approves proposed acquisition of Porterbrook Leasing Company by Deutsche Bank, Lloyds Bank and BNP Paribas

IP/08/1798 - 26 November

Commission closes investigation after BHP Billiton abandons proposed acquisition of Rio Tinto

IP/08/1770 - 26 November

Commission approves proposed joint venture between Ericsson and STMicroelectronics

MEMO/08/729 - 21 November

Commission closely monitoring Dutch State plans as regards Fortis Bank Nederland and ABN AMRO Bank Nederland

IP/08/1731 - 18 November

Commission approves proposed joint venture for breakbulk terminal services between DP World, Conti 7 and Rickmers at port of Antwerp

IP/08/1683 - 12 November

Commission clears proposed acquisition of Applied Biosystems by Invitrogen

IP/08/1671 - 10 November

Commission approves proposed acquisition of ILOG by IBM

IP/08/1616 - 31 October

Commission clears proposed acquisition of M-real's Graphic Paper Business by Sappi

IP/08/1615 - 31 October

Commission clears proposed acquisition of Cherry by ZF

IP/08/1613 - 31 October

Commission approves proposed acquisition of ExxonMobil's Iberian subsidiaries by GALP, subject to conditions

IP/08/1591 - 28 October

Commission opens consultations on review of Merger Regulation

IP/08/1584 - 24 October

Commission approves proposed acquisition of IKON by Ricoh

IP/08/1567 - 22 October

Commission revises Remedies Notice and amends Merger Implementing Regulation

IP/08/1556 - 21 October

Commission clears StatoilHydro's proposed acquisition of Jet Scandinavia, subject to conditions

IP/08/1494 - 14 October

Commission clears proposed acquisition of certain OSI Group Companies by Marfrig

IP/08/1493 - 14 October

Commission approves proposed acquisition of BAS by Capgemini

IP/08/1479 - 09 October

Commission approves proposed acquisition of sole control over German Metro-Group by Haniel

IP/08/1465 - 06 October

Commission approves proposed acquisition of Hercules by Ashland

IP/08/1452 - 02 October

Commission clears proposed acquisition of OTE by Deutsche Telekom

IP/08/1393 - 23 September

Mergers: Commission clears proposed acquisition of TNS by WPP, subject to conditions

IP/08/1376 - 18 September

Mergers: Commission approves proposed acquisition of Foodvest by Lion Capital

IP/08/1329 - 16 September

Mergers: Commission clears proposed acquisition of joint control over Italian energy supplier Enia Energia by Centrex, ZMB and Enia S.p.A.

IP/08/1328 - 16 September

Mergers: Commission approves acquisition of Kirchner by Strabag and refers review of local asphalt market to German competition authority

IP/08/1327 - 16 September

Mergers: Commission approves proposed acquisition of EPCOS by TDK

IP/08/1325 - 16 September

Mergers: Commission approves proposed acquisition of Alliance & Leicester by Banco Santander

IP/08/1322 - 15 September

Mergers: Commission approves proposed acquisition of Bertelsmann's 50% share in Sony BMG by Sony

IP/08/1300 - 08 September

Mergers: Commission opens in-depth investigation into proposed take-over of Martinair by KLM

State aid control

IP/08/2063 - 30 December

Commission approves first real economy crisis measures

IP/08/2059 - 23 December

Commission approves Italian recapitalisation scheme for financial institutions

IP/08/2057 - 23 December

Commission approves modifications to UK financial support measures to the banking industry

IP/08/2056 - 23 December

Commission approves German banking rescue aid for NordLB

IP/08/2055 - 23 December

Commission approves state support for IKB

IP/08/2054 - 23 December

Commission approves Latvian support scheme for banks

IP/08/2049 - 23 December

Commission approves Spanish guarantee scheme for credit institutions

IP/08/2037 - 19 December

Commission authorises €104 million Italian film production tax incentives

IP/08/2034 - 18 December

Commission approves state support for BayernLB

IP/08/2033 - 18 December

Commission approves recapitalisation of Belgian KBC Group

MEMO/08/804 - 18 December

Commission and German Länder render the activities of ARD and ZDF compatible with the Community rules while considering the interests of commercial operators - joint press statement

IP/08/1993 - 17 December

Commission adopts temporary framework for Member States to tackle effects of credit squeeze on real economy

MEMO/08/795 - 17 December

Commission adopts temporary framework for Member States to tackle effects of credit squeeze on real economy – frequently asked questions

IP/08/1977 - 16 December

Commission approves Swedish rescue aid for Carnegie Bank

IP/08/1966 - 12 December

Commission approves modifications to German financial rescue scheme

IP/08/1964 - 12 December

Commission approves Slovenian support scheme for credit institutions

IP/08/1952 - 11 December

Clearer rules on State aid to Motorways of the Sea

IP/08/1951 - 11 December

Commission approves Dutch authorities' recapitalisation of SNS REAAL

IP/08/1950 - 11 December

Commission consults on draft Best Practices Code on state aid proceedings

IP/08/1945 - 11 December

Commission authorises France to grant €54.5 million aid for Iseult-Inumac R&D programme

IP/08/1944 - 11 December

Commission endorses €28 million aid to Masdar for production of thin-film solar modules in Thüringen, Germany

IP/08/1941 - 11 December

Commission endorses €47 million aid to BVG in Poland

IP/08/1940 - 11 December

Commission authorises €212 million German film support scheme

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Address:

European Commission
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Communications Policy and Inter-Institutional Relations

1049 Bruxelles/Brussel
BELGIQUE / BELGIË

E-mail: comp-publications@ec.europa.eu

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