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Editors:
Inge Bernaerts
Kevin Coates
Thomas Deisenhofer

Address:
European Commission,
J-70, 04/136
Brussel B-1049 Bruxelles
E-mail:
infocomp@ec.europa.eu

World Wide Web:
http://ec.europa.eu/
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EUROPEAN COMMISSION

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The design of competition policy institutions for the 21st century — the experience of the European Commission and DG Competition ([1])

by Philip LOWE ([2])

I. Introduction

All competition policy and enforcement systems consist of essentially two components: the legal instruments ('rules') governing both substance, competences and procedure, and the administrative structures and processes through which the legal instruments are implemented. Each of these is necessary for the success of the system as a whole. Good rules remain a dead letter if there is no efficiently run organisation with the processes to implement them. Conversely an efficiently managed authority cannot compensate for fundamental flaws in the rules which it is to implement.

The analysis and design of these components are also interdependent. The management of the processes within the organisation has to be adapted to the rules which it has to apply. And the rules must be shaped in a way that they can be implemented within the real world constraints to which the organisation is subject — such as limited resources.

Academic attention focuses mainly on the legal instruments and not so much on the organisational side. One reason for this is probably that competition policy and enforcement is still mainly a subject for lawyers. Another reason could be that it is not easy for outsiders to obtain detailed and comprehensive information about the interior workings of a competition authority. Finally, it is perhaps assumed that the management of a competition authority does not pose any different challenge than the management of other public or private institutions with a comparable mission and size.

Before starting I need to make a preliminary point that will be obvious to many, but which is none the less important. The competition authority in the European Union is not DG Competition, but the European Commission. The European Commission is a collegiate institution composed of 27 Commissioners from the 27 Member States of the European Union. It is this College of Commissioners that, on a proposal of the Commissioner for Competition, adopts final decisions in individual competition cases as well as on policy documents such as guidelines and notices, and legislative proposals to the Council. On the basis of a delegation of powers from the College (so-called empowerment), the Commissioner for Competition can herself directly adopt certain preparatory or intermediary acts such as a Statement of Objections, as well as final decisions in less important cases, such as a merger dealt with under 'simplified' procedure. The decisions taken by the College and the Commissioner are prepared and implemented by one of the departments of the Commission, in the case of competition, the Directorate General for Competition, which currently has around 800 staff.

I do not intend in the remaining sections of this article to give further attention to the classical institutional issue of the degree of independence of a competition authority, and in particular of the Commission as a competition authority. However some remarks on our general approach to this question may be useful.

The European Commission finds itself in a substantially different position to a national authority. In the first place, its institutional independence should not be in question. As reflected in the EU treaties, its independence from national and political interests is fundamental to its mission of promoting the 'common interest' of the European Union as a whole.

Secondly, the Commission has delegated fully its powers to investigate a case, and manage the due process, to DG Competition. The Commissioner for Competition is in addition empowered to take decisions on cases and problems which raise no significant policy issue. These arrangements offer a solid guarantee of the integrity and impartiality of investigations and their conclusions, while reserving all key decisions on cases and policy for the college of Commissioners as a whole.

Thirdly, a competition authority certainly needs to be independent and impartial. But it should not be isolated or uninformed. It needs to be fully aware of the market and regulatory environment around competition law enforcement. And it needs to be in a position to influence legislators and regula-

([1]) This is an abridged version of an article to be published in Competition Policy in the EU: Fifty Years On from the Treaty of Rome. Editor: Professor Xavier Vives. Oxford University Press, Forthcoming 2009

([2]) Director General of the Directorate-General for Competition at the European Commission. The views expressed are personal to the author and do not necessarily reflect those of the European Commission.

tors, particularly when competition problems can be better addressed by new or amended regulation. This only underlines the advantage for EU competition policy of having the work of the Competition Commissioner and DG Competition fully embedded within the Commission. Finally it is worth underlining again that the Commission as an institution, and not just DG Competition, retains the role of Europe's competition authority.

II. How to design a modern competition policy and enforcement system

Independently of whether we speak about merger control, antitrust or State aid control, a competition authority should ideally intervene at the right time, on the right markets, in relation to the right problems and with the correct remedies. At the same time, its intervention should be predictable, correct, and have a measurable positive impact.

In the real world, however, external constraints — resulting from limited resources and the institutional context — often disrupt this ideal. No competition authority has the resources to do all possible cases. Some form of prioritisation is necessary.

Moreover, there are inevitable trade-offs, for example, there may be a need to resolve a competition problem in a given market quickly to bring some form of anti-competitive conduct to an end. But there is obviously a parallel pressure to achieve correct (no error) outcomes in each and every case. Similarly, hard and fast per se rules provide a higher degree of predictability of outcomes, but can lead to more type 1 or type 2 errors when compared to effects-based rules.

Against this background what should a modern competition authority try to achieve? I see several basic requirements:

(1) Policy, rules and individual enforcement actions must be based on <u>sound law, economics and market knowledge</u>. Legally, enforcement must be — and be seen to be — subject to the rule of law, due process requirements, and effective judicial control. As to economics, the long-term legitimacy of any competition enforcement system rests on the economic story which it tells in each case. Any competition enforcer should be able to explain why and how its enforcement actions contribute to the wider public interest, and in particular to consumer welfare, whether in the short or longer term. As regards market knowledge, the authority must have effective investigative powers to gather relevant data and to set priorities and focus its use of its legal instruments accordingly.

(2) The enforcement system must be designed in a way that guarantees <u>coherence and predictability for business</u>: coherence ensures equal treatment. Predictability allows firms to plan for compliance. To achieve this, ex-ante rules and individual enforcement decisions should be based on a common methodology, clear and publicised enforcement objectives and an in-depth knowledge of how markets function. Again, there is a certain trade-off between predictability and the need to deal with each case on its merits. Based on empirical evidence, some structures or conducts have almost always produced outcomes which are harmful to competition and to consumers. As a result it may be possible to establish some clear ex-ante rules which offer a high level of predictability. However, where past evidence is mixed, the most that can be done to provide a degree of predictability is to indicate what assessment methodology will be used. Usually, an effective enforcement system will be based on a mix of ex-ante (per se) rules and an analytical framework for a case-by-case effects-based analysis.

(3) The system should allow the competition authority to <u>concentrate its limited resources on specific priorities</u>. The authority must be able to determine those priorities on the basis of the expected direct and indirect effects of its action. The system should make it possible to concentrate resources on the potentially most harmful conducts and on precedent-setting cases. This depends crucially on knowledge of markets and the capacity to focus on key issues without the need for repetitive indepth investigations on individual cases.

    Notification thresholds, block exemptions, *de minimis* rules and graduated decision-making procedures must allow the authority to deal quickly, and with limited resources, with unimportant and simple cases.

(4) As to the length of investigation procedures, any effective competition system must enable a public agency to take <u>decisions in a timeframe which is relevant to the problem it is supposed to remedy</u>. Being well-informed on market developments before cases arise is again important here. Precedents must also be set at a moment when they still have the intended wider policy impact. This means that

procedural rules and internal best practices should ensure timely investigation and rapid internal decision making.

(5) Last but certainly not least, enforcement must always go hand-in-hand with an effective communication of its benefits, for consumers and for business. Public intervention cannot depend on some abstract rule or unsubstantiated theory of problems, but must explain why and how it contributes to the wider public interest.

III. Modernisation of the Legal instruments

Although the fundamentals of competition law set out in the Treaty of Rome have essentially remained the same for the past fifty years, the legal instruments implementing them have been continually reassessed and amended.

III.1. Antitrust

The substantive antitrust rules have been progressively reviewed in order to reflect developments in economic thinking, reduce the regulatory burden on companies and improve the speed and efficiency of enforcement. In addition to legislative rules, the Commission has adopted various non-regulatory documents such as notices and guidelines, explaining in more detail the policy of the Commission on a number of issues and interpreting legislative antitrust rules.

On 1 May 2004, a new enforcement system for Articles 81 and 82 EC of the Treaty entered into force, abolishing the notification system and empowering national competition authorities and courts to participate fully in the application of Articles 81 and 82 EC. It also introduced new and more effective ways of addressing competition problems, such as the possibility for the Commission to make commitments binding on undertakings, when such commitments meet the concerns expressed by the Commission in antitrust proceedings. Regulation 1/2003 also gave the Commission wider investigative powers by expanding its inspection rights.

As a complement to Regulation 1/2003, the Commission adopted the 'modernisation package' consisting of a new Regulation on details of its antitrust procedures and six Notices aimed at providing guidance on a range of issues. In parallel, the Commission increased the transparency of competition procedures and expressed its commitment to due process and the parties' rights of defence. In 2001 it strengthened the role of the Hearing Officer by attaching it directly to the Competition Commissioner and by making its report available to the parties and publishing it in the Official Journal of the EU. In 2005, it revised its rules for access to the Commission's files by parties involved in its merger and antitrust cases by updating its previous notice from 1997. The revised Notice also increased procedural efficiency by confirming that access to the file can be granted either electronically or on paper.

Evaluating procedural and substantive rules is, and should be, a permanent task.

For example, the Commission has earlier this year introduced a form of direct settlements for cartels through which companies that acknowledge their responsibility in a cartel infringement can benefit from a shorter administrative procedure and receive a reduction in the amount of fines. This settlement procedure opens up the prospect of more rapid prosecution of cartels and a more effective use of scarce enforcement resources.

Similarly, facilitating private enforcement would help ensure that those damaged by infringements of EC competition law can exercise their right to compensation, as well as adding to overall sanctions and deterrence, as a complement to public enforcement. As a follow-up to its Green Paper of 2005, the Commission published a White Paper on antitrust damages actions.

Finally, work is ongoing on the review of Article 82 EC with the dual aim of strengthening the legal and economic underpinning of unilateral conduct cases as well as providing greater policy coherence and predictability.

III.2. Merger control

The Merger Regulation, first adopted in 1989, created a one-stop shop where companies apply for regulatory clearance for mergers and acquisitions above certain worldwide and European turnover thresholds. The recast Merger Regulation, adopted in 2004, introduced some flexibility into the investigation timeframes, while retaining a much praised degree of predictability. It reinforced the 'one-stop shop' concept, and clarified the substantive test so that the Commission now has the power to investigate all types of harmful scenarios in a merger, from dominance by a single firm to coordinated and non-coordinated effects in oligopolistic markets

The 2004 Regulation also introduced a new streamlined referral system in order to put in place a more rational corrective mechanism of case allocation between the Commission and Member States. It ensured that the authority or authorities best placed to carry out a particular merger investigation should deal with the case. Amendments to the referral system have been complemented by a new Notice on the principles, criteria and methodology upon which referral decisions should be based.

Furthermore, a set of best practices were adopted on the conduct of merger investigations to provide guidance for interested parties on the day-to-day conduct of EC merger control proceedings. These best practices were designed to streamline and make more transparent the investigation and decision-making process, ranging from issues of economic indicators to rights of the defence.

The 2004 Merger Regulation was complemented by Guidelines on the assessment of horizontal mergers. These Guidelines set out the analytical approach the Commission takes in assessing the likely competitive impact of mergers and reflect the re-wording of the substantive test for the competitive assessment of mergers in the 2004 Merger Regulation. The objective was to provide guidance to companies and the legal community alike as to which mergers may be challenged.

In addition, with the aim of providing guidance to undertakings, a 2001 Notice on remedies describes the main types of commitments that have been accepted by the Commission, the specific requirements which proposals of commitments need to fulfil in both phases of the procedure, and the main requirements for the implementation of commitments. A revised Remedies Notice has been adopted recently that adapts the 2001 Notice in the light of an extensive study undertaken by the Commission into the implementation and effectiveness of remedies, recent judgments of the European Courts and the 2004 Merger Regulation.

In 2007 the Commission also approved Guidelines for the assessment of mergers between companies that are in a so-called vertical or conglomerate relationship. The Guidelines provide examples, based on established economic principles, of where vertical and conglomerate mergers may significantly impede effective competition in the markets concerned, but also provide 'safe harbours', in terms of market share and concentration levels below which competition concerns are unlikely to be identified.

III.3. State aid control

Following reforms of legal and interpretative instruments in the field of antitrust and mergers, the Commission engaged in the first comprehensive modernisation of both substantive and procedural rules in the area of State aid control. The State Aid Action Plan (SAAP), launched in 2005, aims at an increased efficiency of State aid control. It is based on four guiding principles: i) less and better targeted State aid, ii) a refined economic approach, iii) more effective procedures, better enforcement, higher predictability and enhanced transparency and iv) shared responsibility between the Commission and Member States.

Since 2005 a number of legislative and interpretative instruments have been adopted that reflect the new approach to State aid policy, including a package on Services of General Economic Interest, guidelines for Regional aid, Risk Capital, R&D, Innovation aid short-term export-credit insurance.

A General Block Exemption Regulation has been adopted with the aim to simplify and consolidate into one text five existing block exemptions for aid to SMEs, research and development aid in favour of SMEs, aid for employment, training aid and regional aid. The new Regulation also allows the block exemption of three new types of aid: environmental aid, aid in the form of risk capital and R&D aid also in favour of large enterprises. This comprehensive review of the substantive rules will be accompanied by improvements in the way the Commission deals with the State aid notification procedures. Procedural reforms should aim at shortening procedures, improving transparency, ensuring that State aid is duly notified or recovered if implemented illegally and improving administrative efficiency, among others, by allowing an easier collection of relevant sectoral information.

IV. Resource and change management inside DG Competition

In parallel to the reforms of the legal instruments, over the last years DG Competition has changed its mission, internal structures and processes to align it more closely with the requirements of a modern framework for competition policy.

IV.1. Past culture and traditions

For the years up to around 2000, the mission of DG Competition was essentially defined as 'promoting competition, thereby promoting an efficient allocation of resources'. Enforcement was necessarily reactive, as it was driven largely by notifications and complaints. This was also reflected in the internal structures and processes of the DG.

Work was focused on the development of the various legal instruments, with lower priority given to economic analysis and market knowledge. With the exception of the Merger Task Force, resources were mostly allocated on a unit by unit basis within each directorate, often resulting in ring-fencing of staff within the boundaries of both the legal instrument and the market sector concerned. There were very few examples of a case-handler in the telecoms antitrust unit working on either a telecoms merger case, or a media antitrust case.

In addition, there was limited priority-setting or planning of cases and other initiatives. Negative priorities — Drucker's 'posteriorities' — were almost non-existent. Without positive and negative priorities, it was difficult to deploy resources effectively. This led to some very lengthy anti-trust and State aid investigations which stretched out well after the moment at which the final decision on the case would have had most impact.

DG Competition also had a reputation for a rather inward-looking culture vis-à-vis the rest of the Commission and national competition authorities. Although a high value was placed on professionalism, intellectual rigour and integrity, there was at least a perceived tendency towards a monopoly of the truth in external relationships. The DG rarely involved itself in an analysis of competition issues in the work of other Commission departments.

Around 2002 there were signs that the platform on which DG Competition was operating needed to be stabilised. A series of merger prohibitions were reversed by the Court of First Instance for inadequate legal reasoning and economic analysis by the Commission and procedural errors. Outside criticism targeted the DG's formalistic approach, as well as the lack of transparency and long delays in State aid control.

IV.2. Change management

There are a number of general success parameters that are key to managing change effectively in any organization such as DG Competition (be it a public body or a private undertaking).

Most importantly, there is the need to establish objectives. The role, mission and core values of the organization need to be clearly defined. Competition authorities should not shy away from regularly re-assessing their role as a public institution and from redefining their mission in light of changes to the environment. Debate about the mission also helps to devise a clear strategy. Multi-annual forward looking strategic planning is essential to the success of the organization and the system as a whole. The strategy, in turn, should translate into operational objectives together with planning and monitoring of results to be achieved. Strategic goals have to be broken down into operational objectives that can be planned in advance, monitored during their execution, and evaluated afterwards.

Secondly the organizational structure should target resources towards these objectives. Such structure should reflect the core values of the organization and help mobilize resources to achieve the objectives.

Thirdly the organization needs people with the right skills and experience. The biggest asset of a competition policy institution is its staff. An efficient management and development of people is fundamental.

Fourthly, an organizational culture must be created which promotes values crucial to the success of the organization such as ethical standards, integrity, intellectual rigour, objectivity, public- and client-service culture, and results-orientation.

Finally, within every organizational structure there is a need to establish the right processes which help make things happen. These can include, for example, decision-making procedures, 'liturgies' of meetings or IT systems.

IV.3. Defining objectives

IV.3.1. A new mission: making markets work better

If competition policy is to make a significant contribution to a policy of sustainable economic growth, a narrow law enforcement and instrument-based approach which focuses only on the preservation of existing competition is not sufficient.

Competition policy must therefore act on a number of fronts at the same time. First, it must enforce competition law whenever there are harmful effects on Europe's citizens or businesses. But second, it must also ensure that the regulatory environment fosters competitive markets. It needs to screen proposed and existing legislation. Thirdly, it must help shape global economic governance through promoting the convergence of substantive competition rules, strengthening cooperation with other jurisdictions and promoting a shift of emphasis from trade regulation to competition regulation in the WTO. Finally, it must develop a competition culture in the society in which it operates. This is in itself one of the principal elements which can guarantee the competitiveness of an economy in the longer term.

Ultimately competition policy must make markets work better for consumer and businesses in Europe.

IV.3.2. Consumer and social welfare objectives

Competition policy institutions must also make clear, in economic terms, whose interest they are there to protect.

In the Commission's view, the ultimate objective of its intervention in the area of antitrust and merger control should be the promotion of consumer welfare. Under EU antitrust and merger control the aim is to ensure that consumers are not harmed by anti-competitive agreements, exclusionary and exploitative conduct by one or more dominant undertakings, or by mergers that significantly impede effective competition. A good example is the Commission's prohibition decision in the *Ryanair/Aer Lingus* merger case, which prevented a reduction in choice and, most likely, higher prices for more than 14 million EU passengers using one of the 35 routes operated by both parties.

However, a consumer welfare standard cannot be transposed directly to the world of State aid. In fact, beyond any justification it may have in terms of allocative efficiency, State aid can be justified on the basis of non-economic grounds such as reducing social disparities which consumer welfare does not measure. Whether the rationale for State aid is efficiency or equity, the correct welfare standard for State aid policy — expressed in economic terms — would seem to be the social welfare of the European Union, which is equivalent to the notion of common interest found in Article 87(3) of the Treaty.

The concept of consumer welfare should also be interpreted dynamically in the sense of the effects of any structure or conduct on price, choice, quality and innovation in the short and long term. Sometimes these effects are immediate and measurable. However, often the effects are difficult to quantify and the only way to protect consumer welfare in the longer term is by safeguarding the process or dynamic of competition on the markets. In this sense, there is convergence between the German and Anglo-Saxon antitrust traditions.

Most theories of harm do not require sophisticated econometric or simulation modelling. Usually the economic 'story' behind a case is simple to explain and simple to test against the evidence drawn from a market investigation. It is also sometimes impossible to carry out indepth analysis within the confines of the legal deadlines of a merger investigation. However, in some cases, detailed econometric tests have been applied with success.

IV.3.3. A more economic and effects-based approach

Following the legislative and policy changes described in more detail above, the Commission now uses an 'effects-based approach' both in merger control and in antitrust, which focuses on the actual and likely effects on consumer welfare. This means that a framework is needed to establish a theory of consumer harm, and this framework should also come up with hypotheses which can be tested. For example in the *Oracle/PeopleSoft* merger case in 2004, we examined with econometrics the extent to which Oracle's bidding behaviour was affected by the specific identity of the rival bidders in the final rounds of a given bidding contest.

In line with the State aid Action Plan, the Commission is also moving towards a more economic approach in State aid policy. Assessing the compatibility of State aid is fundamentally about balancing the negative effects of aid on competition and trade with its positive effects in terms of the 'common interest'. However, economic analysis in State aid cases is more challenging than in antitrust and mergers: first it is not just concerned with competition between firms, but also with negative effects of an aid on trade within the EU Single Market, or location decisions and secondly equity considerations (jobs, benefits for the environment) need to be balanced against efficiency considerations.

IV.3.4. Focusing limited resources on the most harmful practices in key sectors

The objective of making markets work better requires, in the first place, carefully selected priority sectors. DG Competition's action therefore focuses on sectors that are key for the functioning of the internal market and for the Lisbon agenda for growth and jobs. For example, public monopolies established to provide telecommunications, post, energy and transport services have not always proved efficient and able to satisfy consumers' needs in the best possible way. Gradually opening up these markets to competition and making sure that they remain open not only allows consumers to benefit from new, cheaper and more efficient services but also reduces significant input costs for companies. The Commission's antitrust decisions against *Deutsche Telecom* and *Wanadoo* in 2003, against *Telefónica* in 2007 and its ongoing investigations following the sector inquiry into the gas and electricity sector are but a few examples of this focus.

The more harmful anti-competitive practices for the European economy and consumers are, the greater the need there is for competition policy to intervene. As cartels are clearly the most harmful restrictions of competition, high priority is given to the prevention and deterrence of cartels, as evidenced by the imposition of fines in excess of €3.3 billion in 2007. Similarly, abuses of dominant position with a clear negative effect on consumer welfare must remain in the spotlight of enforcement. Finally, erecting barriers to market entry through special or exclusive rights, granting distortive State aid or restricting take-overs of national companies often result in serious restrictions of the competitive process and therefore also warrant priority.

There may also be alternative ways or remedying a market failure. Proper priority setting should be based on a 'competition obstacle' approach. This approach is based on identifying the main competition problems in a sector and subsequently selecting the most effective instrument(s) to tackle those problems. These instruments may be i) competition enforcement by the Commission, by national competition authorities or by both, ii) the adoption, modification or abolition of legislation at the Community level, at the national level or at both levels, iii) action by a sectoral regulator, iv) self-regulation by the industry or v) a combination of these. The way the Commission has been challenging unjustified public obstacles to takeovers, for example in the *E.On/Endesa* case, jointly through its competition and internal market rules is a good example of this 'competition obstacle' approach.

IV.4. Reforming the structures

IV.4.1. Two major reorganizations of DG Competition in 2003 and 2007

Against this background of the progressive reorientation of EU competition policy, there have been two major reorganizations of the structure of DG Competition, complemented by a number of other incremental changes in between.

In 2003/2004 we created for the first time a matrix structure by integrating Merger Units with antitrust units in directorates dedicated to enforcement action in key sectors of the EU economy such as energy, telecoms, transport, financial services and information technology. The 2007 reorganisation goes one step further and integrates State aid units with antitrust and merger teams in five 'market and cases' directorates.

The advantages of this more sectoral organization are evident. It pools and increases market knowledge so that investigations are more informed and effective. It allows for more flexible use of staff across the policy instruments (antitrust, mergers, State aids) and helps spread best practices. It establishes closer links between competition policy and other EU sectoral policies and allows for more effective competition advocacy. It also makes sector enquiries easier to organise and run. Finally it helps the dialogue with other DGs within the Commission and with national competition authorities and national regulators both within and outside the EU.

On the other hand, there are areas where market knowledge is not as important as instrument knowledge and where therefore an instrument based organization is more effective. The Cartel Directorate, created in 2005 and specifically dedicated to the enforcement and development of competition policy in relation to cartels, remains instrument based. This structure brings economies of scale and consolidates the Commission's cartel expertise in one directorate. Similarly, the content and procedures of horizontal state aid work, such as regional aid or aid for R&D&I, are more difficult to integrate into sectoral directorates and warrant an instrument-based directorate.

IV.4.2. Creation of a Chief Competition Economist function

In line with the objective of strengthening the economic assessment of cases and new policy initiatives, a Chief Competition Economist function was created in 2003. The Chief Competition Economist reports directly to the Director General and is assisted by a team of 20 PhD economists. First of all he provides guidance on the economic methodology in competition investigations. Secondly, he also gives guidance in individual competition cases from their early stages. Thirdly, he provides detailed guidance in key competition cases involving complex economic issues, in particular those requiring sophisticated quantitative analysis. Fourthly, he contributes to the development of general policy instruments.

In addition, the creation of the Chief Competition Economist function has contributed to the wider dissemination of economic expertise in DG Competition. He acts as a focus for economic debate within DG Competition, in liaison with other Commission services and in association with the academic world. Members of his team organise training sessions on economic issues and give advice on studies of a general economic nature, as well as on market monitoring.

IV.4.3. Project-based allocation of resources

Setting priorities has no meaning unless priorities determine the use of scarce staff resources. Resources need to be flexibly allocated to cases or other projects. But the Commission's administrative structure (Directorate General composed of directorates which are themselves composed of units) can create rigidities. So it has become standard practice in DG Competition to allow for '*décloisonnement*' of staff to be assigned to any priority project with a 'case manager', reporting directly to a Director, who may come from any unit within a directorate. In addition, case teams can be created by bringing together staff from different directorates but who are skilled in antitrust merger or state aid investigations. It is also becoming general practice to assign to a case team a secretary who is specialized in the type of investigation concerned (mergers, antitrust or State aids), who is given overall responsibility for the case's administrative aspects of the case.

So project-based resource allocation is used both within a Directorate (each member of the Cartel Directorate can work for different case-managers under the single authority of a Director) and across Directorates (a member of a merger unit can work with colleagues from a merger unit from another Directorate within the 'Merger Network'). This project-based approach is applied not only for case work, but also for policy projects requiring the participation of staff having different sector- or instrument-specific expertise.

IV.5. Reforming the processes

IV.5.1. Introducing a two-stage procedure in antitrust

Following the entry into force of Regulation 1/2003 and as a part of the efforts to streamline and increase the efficiency of the working methods in the field of antitrust, in 2005 we introduced a two-stage procedure. The goal of this procedure is to allow the Commission to discriminate quickly and effectively between those few cases that deserve an in-depth investigation and to which resources should be allocated and the other cases that are not a priority and that should be closed as soon as possible and with the least use of resources. The procedure is also designed to properly plan investigations in order to achieve results within specific target deadlines.

As a result, all antitrust cases now start with a first-phase investigation of usually no more than 4 months, after which a decision is taken as to the theory of harm identified and whether there are reasons to regard the case as a priority for the Commission. If the case is considered a priority, in principle a Commission decision to initiate proceedings is adopted and an in-depth investigation is carried out.

The theory of harm on which an eventual investigation is based must be robust and there must be *prima facie,* facts-based indications of the alleged infringement. This solid foundation reduces the risk of subsequent delays in the procedure.

The criteria on the basis of which it is decided whether there are sufficient grounds to carry out an in-depth investigation include, among others, the extent and likelihood of consumer harm, the strategic nature of the policy area or the sector concerned, the significance of the impact on the functioning of competition in the internal market, the extent or complexity of the investigation required, the possibility for bringing the case before a national court in a Member State and whether the potential infringement investigated has terminated or is still ongoing.

IV.5.2. Focus on investigative techniques

Given the increased focus on effects, investigations are becoming more fact-intensive and case files are growing bigger. This requires new approaches and skills in the handling of antitrust, merger and State aid cases. DG Competition is constantly trying to improve its practices in collecting evidence and presenting facts in decisions.

Efficient investigative techniques (i.e. how to best gather reliable evidence) are essential for the success of any antitrust procedures. bettering order to focus investigations and reduce case handling time, we try to plan the details of the investigation at an early stage of the proceedings, i.e. i) the quality and quantity of evidence needed to prove the case, ii) the identification of possible sources where the evidence is located, and iii) the resources to be assigned to this task.

Best practices in drafting (i.e. how to best present evidence to construct a sound decision) are another important tool. In order to discharge the burden of proof imposed on the Commission, case teams must thoroughly and accurately incorporate the results of the investigation into the final decision, demonstrating that the standards of proof are met. The final decision must address all the relevant issues the Commission investigated during the proceedings, incorporate all the relevant evidence gathered during the investigation, and lay down the reasoning of the Commission in a clear and consistent fashion.

IV.5.3. Organising Peer Review Panels

In order to ensure the quality of its interventions, DG Competition applies a particular form of scrutiny for major antitrust, merger or State aid cases, from their factual basis through the legal reasoning to economic analysis. It consists of organizing a Peer Review Panel at key points during the investigation, e.g. after the sending of the Statement of Objections and the hearing, where a peer review team looks at all aspects of a case with a 'fresh pair of eyes'.

The primary objective of this exercise is to provide assistance to the case team in particularly complex cases with a view to ensuring that the foundations of the case are robust. The Peer Review Panel may identify areas where further work is necessary to sustain an objection and how this might be carried out.

IV.5.4. Advocacy and competition screening of legislative proposals by other Commission departments

As a result of internal advocacy and communication efforts competition policy and our objective of making markets work better for the benefits of consumers and businesses play an increasing role in Commission overall economic policy.

A competition test was included in the Commission's revised Impact Assessment Guidelines of 2005. All legislative and policy initiatives included in the Commission's annual work program must pass this test.

The basic 'competition test' applied in the context of competition policy screening involves asking two fundamental questions at the outset. First: what restrictions of competition may directly or indirectly result from the proposal (does it place restrictions on market entry, does it affect business conduct, etc.)? Second: are less restrictive means available to achieve the policy objective in question? This screening exercise may result in the choice of less restrictive regulatory or market-based methods to achieve certain policy objectives, thereby helps avoid unnecessary or disproportionate restrictions of competition.

V. Current management challenges

V.1. Measuring performance and impact

It is impossible to know whether objectives are correctly set, whether the institutional structures and processes are well defined and ultimately whether the actions of a competition authority produce the desired outcome if the performance of the institution is not measured in one way or another.

Working back from the overall objective of making markets work better for the benefit of consumers and business, we intend to use for the measurement of our performance the following three performance dimensions:

Productivity: this dimension tries to measure the efficiency of the organisation; it indicates whether we are successful in coping with the incoming workload, in minimising inputs and in maximising output. For that purpose we compare on a regular basis on the one hand workload (incoming cases) and inputs (resources,…) with, on the other hand, outputs (decisions, texts adopted,…)

Quality: for a competition enforcer such as DG COMP to achieve its public interest objectives, the quality of its output is arguably at least as important as productivity. There are different sub-dimensions to that. We look at (a) the legal and economic soundness of our enforcement, (b) the timeliness of our procedures, (c) compliance with due process, and (d) how well we communicate on our enforcement.

Impact: in order to really know whether we achieve our ultimate objective of making markets work better, we need to measure the impact of our decisions on those markets. For that purpose we intend to distinguish between the measurement of the direct impact of our action on markets and on the different stakeholders (consumers, competitors…) and of the indirect effects (precedent effect, deterrence …).

As a first step, a Unit dedicated to the ex post evaluation of DG Competition's enforcement activity was set up in 2007 as a part of the Policy and Strategy Directorate of DG Competition.

V.2. Demonstrating the added value to citizens

Closely linked with measuring performance is the challenge of demonstrating the added value of competition policy to ordinary people. It is not sufficient to know what the impact of competition policy action is: the benefits need to be communicated effectively.

We have recognized that communication is core business. Communicating effectively about our work has a preventive effect. We can explain the law and highlight the penalties for not respecting the law. In addition, explaining what DG Competition, entrusted with public resources and powers, does, ensures its accountability. Communication is also about good policy making. Through dialogue, DG Competition can learn to re-evaluate the things it is communicating about. Finally, external communication on concrete actions of competition policy can demonstrate a Europe of results.

These simple principles are the core of our proactive communication strategy for which we have also recently created a dedicated Communications Policy unit.

V.3. Resources

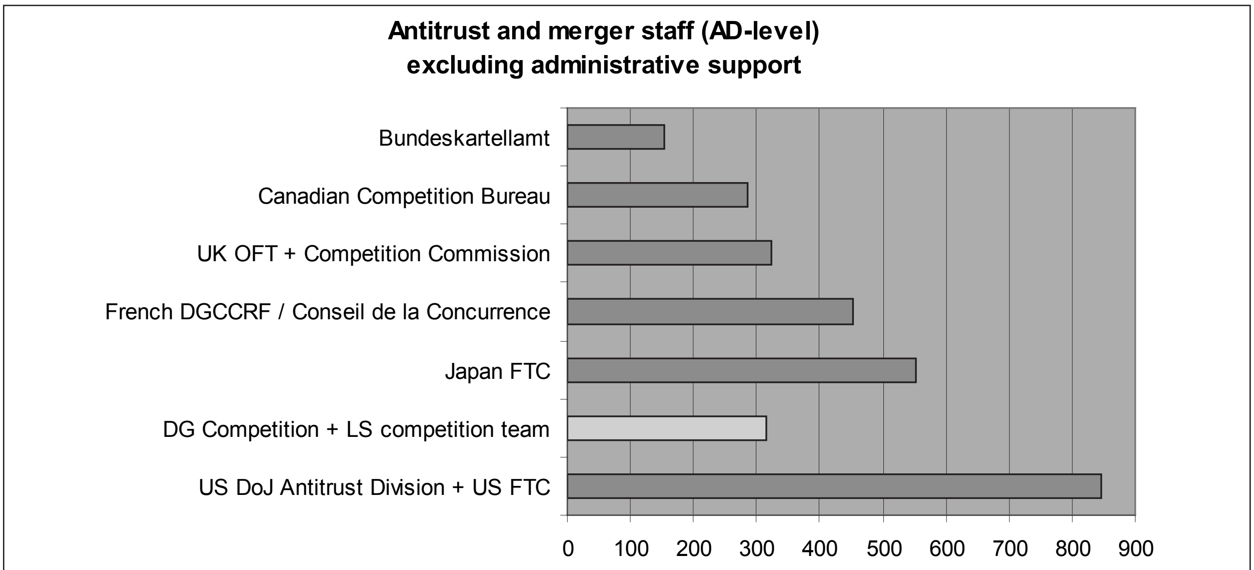
V.3.1. The COMP 2010 project

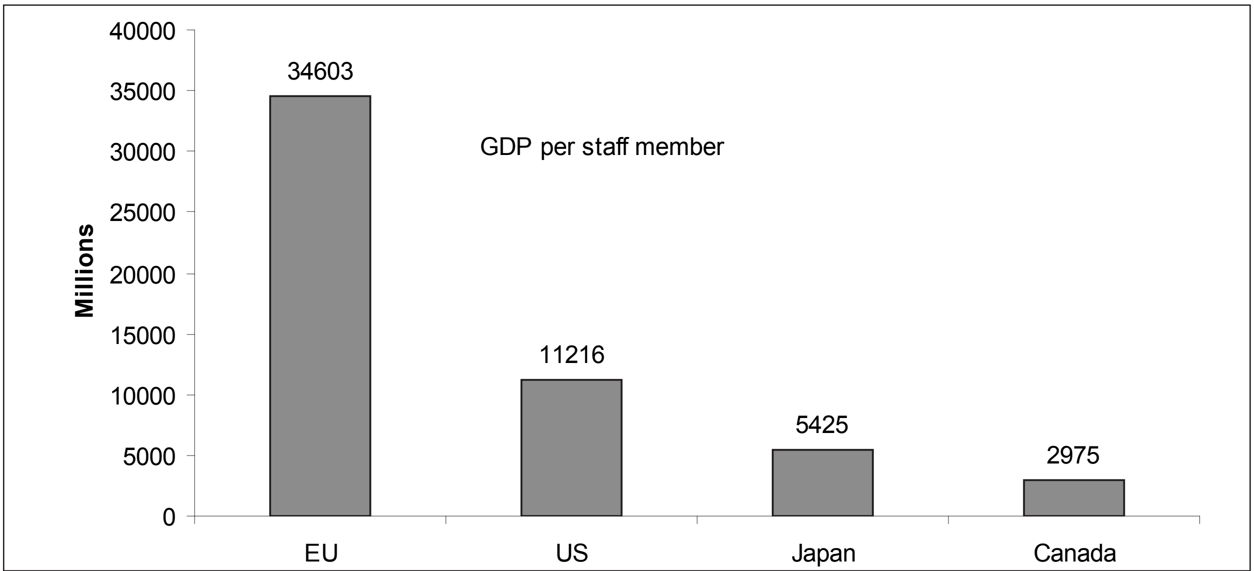
In 2006 Commissioner Kroes and I set up an internal working group to take stock of where the Commission's competition policy, as well as DG Competition's organization and resources stand now, and where they should go in the medium term, i.e. until 2010. The working group produced a report which (i) provided the Commissioner and the management of the DG with a detailed picture of current work and output, (ii) identified relevant trends for the next years, (iii) determined the likely impact of those trends on work and output and (iv) discussed options how the challenges can be addressed.

The working group found that the enforcement architecture and internal organization stemming from the 2003 and 2007 reforms produce reasonably good results in terms of focusing resources where DG Competition can bring the greatest added value.

However, based on the analysis of expected trends that influence competition policy and on comparisons with other competition agencies, it identified a resource gap between what DG Competition should, and will have to, do in the future and what it is able to do on the basis of its current resources.

One of the main findings is that DG Competition is understaffed when compared to other competition authorities, such as the US Department of Justice and Fair Trade Commission or the Japan Fair Trade Commission. The understaffing is even more evident if account is taken of DG Competition's responsibility for State aid issues.





V.3.2. Human Resource Strategy

The issue of resources is not only about mechanically increasing staff numbers. It is more and more challenging to attract, improve and keep talent.

DG Competition is focusing on very specific staff, i.e. lawyers specializing in competition law and economists specializing in industrial organisation. For both of these categories, DG Competition is competing on the labour market with law firms and economic consultancies which are offering salary packages much higher than the Commission can do. Organising Commission competitions for higher entry level grades could somewhat reduce this salary gap, at least during the first years of the career. Organising Commission competitions specifically addressed to candidates having the right profile (i.e. not lawyers or economists in general, but having a specific competition background) could also improve recruitment. Accelerating recruitment procedures is a further challenge.

It is essential to ensure that staff recruited continues to have the skills and competences required to meet DG Competition's quality standards. This is guaranteed by a training programme adapted to real needs. Knowledge areas that are strategically relevant for DG Competition and hence should be the focus of training programmes are law and procedures, economics and accountancy, sectoral knowledge, investigative techniques, drafting, communication, languages and IT. The process of training, the internal training offers of DG Competition and the use of external resources must continue to be improved.

Finally, keeping talent is only possible through a transparent and motivating career development system. Within the constraints of Commission-wide staff regulations, we currently plan to introduce additional systems of recognition of expertise (through, for example, job titles for experienced case handlers and assistants), to activate a Career Guidance Function within DG Competition to give factual information to staff on career opportunities and to facilitate the identification and building of career paths. It is particularly challenging to find a correct balance between promoting staff mobility to sustain motivation and the needs of DG Competition to guarantee the stability and continuity of its activities.

V.3.3. Managing knowledge better

One of the key assets of DG Competition is its accumulated knowledge of the markets as well as its expertise in applying the legal instruments at its disposal. Managing knowledge, so as to keep it up to date and accessible to all those who need it, is a major challenge for the DG. This will be of key importance if DG Competition is to better contribute its market knowledge to policies developed in other DGs within the Commission.

The organizational structure which has been described earlier is instrumental in fostering exchange of knowledge between colleagues. However, further action will be required to improve the management of in-house knowledge through updating the existing document management systems and case management applications.

VI. Conclusion

The growing number of competition policy institutions in the world reflects the need for public institutions to safeguard and promote competition in an economy that is becoming increasingly global. In order to fulfil their role effectively these institutions must constantly assess and re-assess their mission, objectives, structures, processes and performance. It is only through realising and adapting to changes in their environment and through carrying out the corresponding improvements that their competences, powers, budget and ultimately existence can be justified before a wider public.

The General Block Exemption Regulation (GBER): bigger, simpler and more economic

Harold NYSSENS (1)

1. Introduction

One of the main objectives of the reform of state aid policy, as set out in the 'State Aid Action Plan' (SAAP) adopted by the Commission in 2005 (2), is to create a simple, user-friendly and coherent set of legislative rules applying to those types of aid which can be considered as passing the compatibility test outlined in Article 87(3) of the EC Treaty. With this in view, the Commission has in the last two years adopted a series of guidelines and frameworks setting out the principles and precise criteria which it applies when assessing, upon notification, aid measures proposed by Member States: most notably the regional aid guidelines (3), the R&D&I framework (2006) (4), the risk capital guidelines (2006) (5) and the environmental guidelines (2008) (6). As part of the SAAP exercise, the Commission also announced that in order to enhance readability and allow for better prioritisation of cases within the Commission, it would simplify the existing block exemption regulations (BERs) (7) and consolidate them into a single instrument: the general block exemption regulation (GBER) (8).

BERs are Commission regulations providing that all state aid measures fulfilling the applicable substantive and procedural conditions are both considered as compatible with Article 87(3) EC Treaty and exempted from the prior notification obligation laid down in Article 88(3) of the Treaty. Such BERs consequently reduce the administrative costs of handling the aid measures in question for the beneficiary of the aid, the Member State concerned and the Commission.

The Commission has in recent years begun to systematically monitor implementation of the BERs. The fact that such monitoring will continue to take place is explicitly stated in Article 10 GBER.

As the GBER constitutes one of the cornerstones of the future state aid architecture, the Commission has sought to strike the right balance between two objectives: the necessity to simplify the assessment of straightforward cases and the need to ensure that effects on competition are reduced to the minimum. A similar balancing act has also been performed in the context of the different guidelines and frameworks adopted under the SAAP and mentioned above. The provisions of the GBER are therefore largely based on the pre-existing horizontal instruments. However, because the GBER is a regulation with 'direct effect' — whereas other horizontal instruments are still applied by the Commission when assessing specific aid measures — its provisions must be absolutely straightforward. This explains the differences which appear, here and there, between the GBER and horizontal instruments. The most obvious difference is in the area of environmental investment aid. Here, the GBER provides for a simplified methodology for calculating eligible costs as compared to the more traditional one contained in the environmental guidelines (9). Another example is that only public participation in profit-driven private equity investment funds have been included in the GBER (10), whereas the standard assessment section of the risk capital guidelines covers other types of aid favouring venture capital, such as tax measures.

Beyond achieving simplification, the main policy objective of the GBER is to encourage Member States to redirect existing aid budgets towards those types of aid which are considered essential for realising the revamped Lisbon objectives (11).

A first draft of the GBER was presented and discussed with Member States in April 2007. At the same time, this draft was published on the Commission's website for stakeholder comments.

(1) Directorate-General for Competition, unit H-4. 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) See http://ec.europa.eu/comm/competition/state_aid/reform/reform.html.
(3) Guidelines on national regional aid for 2007-2013, OJ C 54, 4.3.2006, p. 13.
(4) Community framework for state aid for research and development and innovation, OJ C 323, 30.12.2006, p. 1.
(5) Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises, OJ C 194, 18.8.2006, p. 2.
(6) Community guidelines on state aid for environmental protection, OJ C 82, 1.4.2008, p. 1.
(7) For an overview of the BERs predating the GBER, see http://ec.europa.eu/comm/competition/state_aid/legislation/block.cfm.
(8) See point 35 of the State Aid Action Plan.
(9) Article 18(5) GBER.
(10) Article 29(2) GBER.
(11) See IP/08/1110.

In September 2007, the Commission adopted a revised draft which was published in the Official Journal for a second, more formal, stakeholder consultation ([12]). After a second formal discussion with Member States, the GBER (Regulation No 800/2008 ([13])) was adopted on 6 August 2008 and entered into force on 29 August 2008. All comments from stakeholders are available online ([14]).

2. Overview of the content of the GBER

The GBER is subdivided into three main chapters ([15]). The first, horizontal, chapter deals largely with procedural matters. It applies to all types of aid covered by the GBER. The second, more substantive, chapter contains the detailed substantive conditions applying to each of the types of aid covered by the GBER. Chapter III essentially contains the transitional provisions. Annex I integrates the unchanged definition of what is to be considered as an 'SME' ([16]). Annex II contains the forms for providing information to the Commission on large regional and R&D projects. Annex III contains the summary information sheet which has to be sent to the Commission via the Commission SANI system for an aid measure to be covered by the GBER.

The first chapter (Articles 1 to 12) is aimed, in line with the Commission's 'Better Regulation' agenda, at harmonising horizontal and procedural aspects. It provides, for example, common definitions of standard concepts, common requirements for aid being classed as 'transparent' aid, common provisions on incentive effect, an overview of the sectoral exclusions applying to the different types of aid, and uniform requirements as regards transparency and monitoring.

The second chapter (Articles 13 to 42) contains the substantive conditions applying to the different types of aid. This chapter covers certain horizontal types of aid already contained in the pre-existing block exemption regulations: investment aid to SMEs ([17]), research and development aid for SMEs ([18]), aid for hiring disadvantaged and disabled workers ([19]), training aid ([20]) and regional aid ([21]). It also comprises types of aid not previously included in any existing BER: R&D aid for large enterprises, environmental aid, aid for the creation of new small enterprises in assisted regions, aid for the creation of new small enterprises by women entrepreneurs, innovation aid and aid in the form of risk capital.

The present article will focus on the main (new) features of Chapter I of the GBER, as Chapter II is largely based on pre-existing horizontal instruments which have already been described in earlier articles ([22]).

3. Main horizontal characteristics of the GBER

Sectoral and other 'per se' exclusions

All the pre-existing BERs and existing guidelines and frameworks contain specific provisions regarding sectoral scope. They exclude aid for activities related to some industrial sectors from their scope of application, either because more specific provisions are included in sectoral regulations or because there is overcapacity in the industry concerned or because that sector is subject to a common organisation of the market ([23]). Article 1(3) contains a consolidation and simplification of all these sectoral exceptions. Furthermore, as compared to the pre-existing texts, the exclusions are 'self-standing' in the sense that the reader does not need to consult any other Community instrument to determine their scope.

The GBER also excludes from its scope aid to undertakings which are subject to an outstanding 'Deggendorf' ([24]) recovery order from the Commission to recover incompatible state aid already granted. This approach continues the

([12]) OJ C 210, 8.9.2007, p. 14.
([13]) 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), OJ L 214, 9.8.2008, p. 3. See also MEMO/08/482, 7.7.2008, available at http://europa.eu/rapid/.
([14]) http://ec.europa.eu/comm/competition/state_aid/reform/reform.html.
([15]) For a Commission explanatory document regarding the GBER (more particularly its second draft), see http://ec.europa.eu/comm/competition/state_aid/reform/revised_final_memorandum_gber.pdf.
([16]) Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.5.2003, p. 36.
([17]) See BER 70/2001.
([18]) See Commission Regulation (EC) No 364/2004 of 25 February 2004 amending Regulation (EC) No 70/2001 as regards the extension of its scope to include aid for research and development, OJ L 63, 28.2.2004, p. 22.
([19]) See BER 2204/2002.
([20]) See BER 68/2001.
([21]) See BER 1628/2006.
([22]) 'The new Community framework for state aid for research and development and innovation' by T. Kleiner and Renate Repplinger-Hach, CPN, 2007, No 1, p. 3; 'New Guidelines on State aid promoting risk capital investments in SMEs' by B. Tranholm Schwarz, CPN, 2006, No 3, p. 19; 'Helping to combat climate change: new State aid guidelines for environmental protection' by A. Winterstein and B. Tranholm Schwarz, CPN, 2008, No 2, p. 12.
([23]) See, as regards the agricultural sector, recital 12 of the GBER.
([24]) Judgment of the ECJ of 15 May 1997 in Case C-355/95 P Deggendorf v Commission [1997], ECR I-2549.

line taken already in the regional BER [25] and in the *de minimis* regulation [26]. It excludes both a) individual ad hoc aid to such beneficiaries and b) *the full scheme* if it does not explicitly exclude such beneficiaries from its national scope of application. This approach is designed to avoid the GBER resulting in the circumvention of state aid rules [27].

Neither does the GBER apply to 'enterprises in difficulty' [28]. This is in line with the Commission's long-standing policy concerning enterprises in difficulty, as defined in the rescue and restructuring guidelines [29]. However, in order to avoid serious administrative difficulties in implementing this exclusion, the conditions have been simplified for SMEs, as compared to the complete set of conditions laid down in points 10 and 11 of the rescue and restructuring guidelines. This simplification is made purely for the purposes of the GBER and for SMEs and does not affect the classification of aid granted outside the scope of the GBER.

Finally, the GBER excludes all ad hoc aid to large enterprises. This is due to the fact that the incentive effect of these types of measures is often difficult to establish, as a series of training aid cases have shown [30]. The Commission thus considers that it must be in a position to examine the presence of such incentive effect upon notification.

The 'transparent' aid requirement

The GBER expands the 'transparent aid' requirement [31] already adopted in the regional BER and the *de minimis* regulation. This condition is justified by the fact that, in the context of a regulation with direct effect, it is only possible to calculate a gross grant equivalent easily with respect to transparent aid.

The discussions preceding the adoption of the GBER were, as regards this condition, largely centred on guarantees. Guarantees are essentially considered transparent if the methodology has been notified to and approved by the Commission under the GBER itself or under its predecessor, the regional BER. This approach is in line with the approach already decided in the context of the de minimis regulation. However, the GBER also explicitly stipulates that the 'safe harbour' provisions contained in sections 3.3 and 3.5 of the Commission Notice on guarantees may also be used as a basis to calculate the GGE in the context of the application of the GBER [32].

Increased and simplified notification ceilings

In the SAAP, the Commission announced that it wanted to concentrate its resources on the most distortive cases [33] and simplify the administrative treatment of aid which is clearly compatible with Article 87(3) of the EC Treaty. In this context, individual aid covered by the GBER should be subject to an individual notification obligation [34] only if, in the light of the large amount of the aid, it is considered that notification remains necessary to check whether the positive effects of the aid indeed outweigh the negative impact on competition.

With a view to simplification, only one reference figure applies, in general, for each category of aid: pre-existing BERs often contained several cumulative notification criteria, taking account of a number of factors, such as the amount of eligible costs and or the possible application of bonuses [35]. In the GBER, and with the exception of regional investment aid and R&D project aid, the notification ceilings are all based purely on a single aid amount. The ceilings have also been substantially raised as compared to the existing ones, meaning that larger amounts of individual aid may be provided without advance notification to the Commission.

Individual aid cases exceeding these ceilings should as a matter of principle lead, upon notification, to a detailed economic analysis [36] of the positive and negative effects of the aid measure in question by the Commission. Such detailed economic analysis will however be undertaken by the Commission under a 'rule of reason'.

It is finally to be noted that, where Article 6 does not lay down any notification ceiling with respect

(25) Article 7(g) of Regulation 1628/2006.
(26) Article 1(h) of Regulation 1998/2006.
(27) See SAAP, points 53 et seq. See also the Notice from the Commission 'Towards an effective implementation of Commission decisions ordering Member States to recover unlawful and incompatible state aid', OJ C 272, 15.11.2007, p. 4.
(28) Article 1(6)(c) GBER.
(29) Communication from the Commission — Community guidelines on state aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p. 2, as referred to in recital 15 GBER.
(30) See A. Garcia Bermudez and C. Galand, 'Recent training cases in the car industry', CPN, No 1, Spring 2007, p. 104.
(31) Article 5 GBER.
(32) See recital 21 GBER.
(33) See, inter alia, IP/06/1765.
(34) Article 6 GBER.
(35) See, for instance, the notification ceiling of SME BER 70/2001, as amended by BER 364/2004.
(36) See, as regards the distinction between 'standard economic assessment' and 'detailed economic assessment', section 5 of the risk capital guidelines, section 7 of the R&D&I framework and section 5 of the environmental guidelines.

to a given category of aid — e.g. as regards aid in the form of environmental tax reductions [37] or aid for the loan of highly qualified personnel [38] — any amount of individual aid can be granted under the GBER.

The 'incentive effect' condition

Most pre-existing BERs stipulated, as a minimum requirement, that a beneficiary of aid granted under those instruments had to apply to the granting authority before initiating the subsidised project/activity concerned. The GBER [39] essentially maintains this condition as regards all aid granted to SMEs [40].

The GBER however imposes a new 'positive' requirement to demonstrate the incentive effect for all types of aid granted to large enterprises. Demonstration of an 'incentive effect' is one of the cornerstones of the refined economic analysis [41]. The key to analysing the economic impact of a particular problem will often lie in understanding the motivations of the stakeholders concerned. More precisely, if a grant of aid does not change the behaviour of the recipient, then that aid cannot help to reduce the market failure which it is supposed to address. This means that if the aid does not change the behaviour of the aided companies, then the aid cannot contribute to the furthering of Community objectives, as set out in Article 87(3) of the Treaty. In such a case, the aid should be considered incompatible with the common market [42].

The incentive effect principle is expressed as follows in the recitals of the GBER [43]: 'In order to ensure that the aid is necessary and acts as an incentive to develop further activities or projects, this Regulation should not apply to aid for activities in which the beneficiary would already engage under market conditions alone'. As regards aid to large enterprises, this condition is deemed to be fulfilled if business documentation prepared by the beneficiary and verified by the Member States establishes at least one of four things: a material increase in the size/scope/total amount spent/speed of the project or activity due to the aid.

([37]) Article 25 GBER.
([38]) Article 37 GBER.
([39]) Article 8(2) GBER.
([40]) This includes all types of aid, e.g. training aid (Article 39 GBER), which can also be granted to large enterprises, as long as they are granted to SMEs.
([41]) See points 20 to 25 of the State Aid Action Plan.
([42]) See, in this connection, L. Evans and H. Nyssens, 'Economics in state aid: soon as routine as dentistry?', available at http://ec.europa.eu/comm/competition/state_aid/reform/reform.html.
([43]) Recital 28 GBER.

Under Article 8(3) of the GBER, large enterprises will typically have to produce a business plan indicating how they fulfil one of the four criteria mentioned above. This type of document should, in practice, not involve any substantial increase in workload for the large undertakings concerned, as they can be presumed to carry out this type of analysis anyhow for their own financial purposes. It is important for beneficiaries and Member States to maintain records of the presence of an incentive effect, especially in cases involving large enterprises [44].

The GBER finally makes a number of simplifications of the incentive effect criterion as regards tax aid in general, as well as regarding aid in favour of disabled workers, aid in favour of disadvantaged workers, aid in the form of risk capital and environmental aid in the form of tax reductions.

Transparency and monitoring provisions

Articles 9 to 11 of the GBER consolidate and update the transparency and monitoring provisions already contained in the pre-existing BERs. It is worth noting that these BERs generally included in a single provision the rules relating to transparency to be observed by aid granting authorities vis-à-vis the Commission and the outside world, the rules relating to the Commission's monitoring obligations, and the rules relating to the annual reports compiled each year by Member States. For reasons of clarity, these three categories of rules have now been subdivided into three different articles.

The most substantial change relates to the fact that all aid measures implemented under the GBER should contain an explicit reference to the relevant provision in Chapter II [45]. This means that an aid measure that does not contain an explicit reference to the applicable provision in Chapter II of the GBER (for instance to Article 29 GBER for aid in the form of risk capital) would *ipso facto* be unlawful. An unspecific, general referral to the GBER in its entirety would not be sufficient. This condition is intended to make both Member States and beneficiaries aware of the particular substantive conditions applying to the aid being granted and increase transparency for other stakeholders, including national courts that might be faced with litigation concerning these aid measures.

([44]) Article 10(2) GBER provides that 'Member States shall maintain detailed records regarding any individual aid or aid scheme exempted under this Regulation. Such records shall contain all information necessary to establish that the conditions laid down in this Regulation are fulfilled, including ... information on the incentive effect of the aid ...'.
([45]) See Articles 9(3) and 3 GBER.

Transparency will also be increased through publication of the measures on the internet ([46]). The publication of national (state aid) legislation on the internet is, in practice, already well established for aid schemes introduced by larger national or regional authorities. The transparency conditions of the GBER apply also to other types of authorities including, for instance, municipalities. Member States may decide to delete any confidential business information — except for the name of the beneficiary and the amount of the aid — before publishing ad hoc decisions on the internet ([47]).

A second important change is contained in Article 10 GBER. This provision concerns the procedural consequences of refusal, by a Member State, to provide information to the Commission on an aid measure implemented under the GBER. In such a case, the Commission has the discretion to withdraw the benefit of the GBER for the Member State concerned *for the future*. This means that future measures ([48]) envisaged by the Member State after the adoption of the withdrawal decision would need to be notified to the Commission for approval before implementation.

4. Main features of the substantive rules (Chapter II) ([49])

- Aid to small and medium-sized enterprises (SMEs). Small and medium-sized businesses are one of the main driving forces in the economy, but they often face specific difficulties, such as problems of access to finance. The GBER therefore allows, in addition to the categories of aid available for all enterprises, different types of aid to SMEs to help them overcome 'market failures' ([50]): aid for setting up new companies, aid for investments in machines or for hiring additional workers, aid in the form of risk capital, innovation aid, aid contributing to intellectual property rights costs, aid for adapting to new environmental Community standards or aid for environmental studies.

  This should allow Member States to assist SMEs in the different stages of their development. Furthermore, all of the 26 categories of aid referred to in the Regulation can be provided to SMEs. To the extent such categories are also available to large companies, SMEs will benefit from a special top-up (10% for medium-sized companies and 20% for small companies).

  In this area, the major change as compared to the pre-existing SME BER No 70/2001 lies in the increase in the applicable basic aid intensity from up to 15% for small and 7.5% for medium-sized enterprises to 20% for small and 10% for medium-sized enterprises. The notification ceiling has also been substantially raised, now allowing Member States to grant aid up to €7.5 million. The Regulation also contains a large number of simplifications for SMEs regarding, for instance, the incentive effect condition and the definition of 'undertakings in difficulty', which are in line with the 'Think Small First Principle' promoted by the Small Business Act.

- Social aid. In addition to aid to subsidise employees working on new investments in SMEs (see point above), the GBER covers aid that encourages companies to hire disabled or otherwise disadvantaged workers ([51]). It also allows payments — to the extent they constitute state aid — to compensate for additional costs (special facilities for employees with wheelchairs, or information technology for visually impaired workers) incurred by companies when hiring disabled workers ([52]). The Regulation also favours aid for training workers. Last but not least, in order to ensure a better work life/family life balance, the GBER now covers the possibility to subsidise employers, more specifically as regards child care and parent care costs incurred by their employees ([53]).

  The GBER provisions relating to training aid largely build on the provisions of the pre-existing training aid BER ([54]). However, the new text allows a higher basic aid intensity to be provided in favour of general training for employees (increase from 50% to 60%). The applicable notification threshold has also been doubled to €2 million, allowing higher aid amounts to be granted.

  The existing rules concerning employment aid, previously contained in the so-called employment BER ([55]), have been clarified and simplified in the GBER. The Regulation includes substantially increased aid possibilities in favour

([46]) Article 9(2) GBER.
([47]) Recital 33 GBER.
([48]) Recital 6 GBER clarifies that the Commission does not necessarily need to withdraw the benefit of the entire GBER in case of a failure to provide information.
([49]) See in this respect MEMO/08/482, 7.7.2008, available at http://europa.eu/rapid/.
([50]) As regards this concept, see in particular the Community framework for state aid for research and development and innovation, points 1.3.2 and 7.3.1.
([51]) See Articles 40 and 41 GBER.
([52]) Article 42 GBER.
([53]) See Article 2(15) GBER.
([54]) Commission Regulation No 68/2001.
([55]) Commission Regulation No 2204/2002.

of disabled workers, with higher aid intensities (increase from 60% to 75%) and a notification ceiling which has doubled (from €5 million/year to €10 million/year). The GBER also allows the salary of 'severely' disadvantaged workers ([56]) to be subsidised for a longer period (two years). Overlaps between employment aid and other types of aid, mainly regional aid and SME investment aid, have been removed ([57]).

- Regional aid. The GBER also makes an important contribution to the Community's cohesion objective. The GBER incorporates the pre-existing regional BER 1628/2006 ([58]). This means that it allows amounts up to approximately €37 million of regional investment aid to be granted. Such aid should encourage the creation of large-scale new industrial establishments in the most disadvantaged regions. In assisted regions, aid for newly created small-scale start-ups is also allowed in order to stimulate local entrepreneurial initiatives. Previously, such aid needed to be notified.

  There are only a limited number of minor changes as compared to the pre-existing regional BER. These changes relate essentially to the incentive effect condition and the inclusion of child care and parent care costs in the eligible costs basis. Schemes put into place by Member States before the entry into force of the GBER, in line with BER 1628/2006, will be allowed to be implemented unaffected until 2013 ([59]).

- Environmental aid. No environmental aid was previously included in any BER. The GBER therefore constitutes a first in that it allows Member States to provide environmental aid — including certain environmental tax reductions — without the obligation of prior notification to the Commission. The GBER thus makes it easier for authorities to grant a large number of aid measures favouring environmental protection or tackling climate change, in line with the Commission's Climate Action Plan adopted in January 2008.

  Such measures include investments in energy savings, investments in renewable energy sources and aid in the form of environmental tax reductions. The measures being promoted remain subject to a series of conditions in order to guarantee their positive environmental effect. These conditions are largely inspired by the guidelines on state aid for environmental protection ([60]).

  A notable difference between the guidelines and the GBER is however that the GBER generally provides for a simplified cost calculation methodology: it essentially allows operating benefits to be disregarded when providing environmental investment aid ([61]). This should help Member States to tackle environmental challenges, including the challenges of climate change.

- Aid for research & development & innovation (R&D&I). The GBER includes authorisations for a range of measures including, most prominently, aid for R&D projects and aid for conducting technical feasibility studies, also in favour of large companies. Specific measures allowing SMEs' costs for industrial property rights (patents) to be reduced have also been included, in line with the R&D&I framework. These initiatives contribute to the Community's objective of becoming a more knowledge-based economy. Beyond the more traditional categories of R&D aid, the GBER also includes, for the first time, a series of innovation measures whose conditions were considered sufficiently straightforward to be included in a regulation with direct effect: aid for young innovative enterprises, aid for innovation advisory services and for innovation support services, as well as aid for hiring highly qualified personnel. Such aid should allow SMEs to become more competitive in a climate of heightened international competition.

- Aid in the form of risk capital. The GBER also includes, for the first time, certain aid in the form of risk capital ([62]). The conditions for this type of aid are inspired by the risk capital guidelines adopted by the Commission in 2006 ([63]). This extension is intended to encourage Member States to use aid in the form of risk capital more intensively.

([56]) See definition in Article 2(19) GBER.

([57]) For a detailed explanation of this aspect, see the Commission departments' explanatory memorandum, available at http://ec.europa.eu/comm/competition/state_aid/reform/revised_final_memorandum_gber.pdf.

([58]) See Articles 13 and 14 GBER.

([59]) See recital 66 GBER.

([60]) Community guidelines on state aid for environmental protection, OJ C 82, 1.4.2008, p. 1.

([61]) See Article 18(5), read in the light of recitals 49 et seq. See also 'Helping to combat climate change: new State aid guidelines for environmental protection' by A. Winterstein and B. Tranholm Schwarz, CPN, 2008, No 2, p. 12.

([62]) Article 29 GBER.

([63]) Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises, OJ C 194, 18.8.2006, p. 2.

- Aid for promoting women entrepreneurship. The average rates of business start-ups by women are lower than for men ([64]). This is an obstacle to the EU's economic development. The Regulation includes therefore, for the first time, measures in favour of child care and parent care costs. This should contribute to employees and entrepreneurs achieving a better work life/family life balance. The GBER also allows Member States to support, in both assisted and non-assisted regions, the creation of small enterprises owned and run by women ([65]). This will allow women entrepreneurs to overcome specific market failures which they face, especially when setting up a first business, thereby promoting substantive rather than formal equality between men and women in this area ([66]).

5. Transitional provisions

The validity of the majority of the BERs predating the GBER ([67]) was extended by Regulation 1976/2006 ([68]) until 30/6/2008. As from that date, a six-month transition period has started to run, which allows Member States to continue applying existing schemes implemented under those BERs ([69]). This transition period ends on 31/12/2008, as confirmed by Article 44(2) GBER. This means that between 29/8/2008 (date of entry into force of the GBER) and 31/12/2008, Member States have the choice between continuing to apply existing schemes and setting up new schemes under the GBER. As from 1/1/2009, only schemes complying with the GBER may be validly implemented. Such schemes will need to comply with all substantive and procedural conditions of the GBER, including the transparency obligations laid down in Article 9 GBER. Member States will thus have to provide the Commission with summary information sheets for all measures falling under the GBER, using the IT application established by the Commission (the 'SANI' system).

An exception has however been made for regional aid schemes implemented under regional BER 1628/2006: *existing* schemes may continue to be validly implemented until the end of the so-called structural funds programming period, i.e. until 2013. Any *new* regional scheme adopted after August 2008 would however need to comply with the provisions of the GBER.

The above-mentioned clarifications all concern scenarios whereby aid measures directly fall under a BER. A different scenario arises however where the Commission has, upon notification, approved an aid scheme, using one of the pre-existing BERs as a benchmark for compatibility. The validity of such individually approved schemes whose validity was linked to the validity of the BERs has been extended, by Commission decision, until 30/9/2008 ([70]). This means that if Member States want to continue — after 30/9/2008 — fulfilling the objectives pursued by these old schemes, they need to either adapt the schemes in order to make them fulfil the conditions of the GBER (see above), or notify them to the Commission for approval.

([64]) See 'The entrepreneurial gap between men and women', Statistics in Focus, 30/2007, available at http://epp.eurostat.ec.europa.eu/. See also, inter alia, the studies carried out by the BERR in the UK: http://www.berr.gov.uk/bbf/enterprise-smes/building-enterprise/enterprising-people/Women's%20Enterprise/page38525.html, as well as studies conducted for DG ENTR: http://ec.europa.eu/enterprise/entrepreneurship/craft/craft-studies/documents/womenentrepreneurs.pdf.

([65]) See Article 16 GBER.

([66]) See, inter alia, the study 'Beyond formal equality. Positive action under Directives 200/43/EC and 200/78/EC', available at http://ec.europa.eu/employment_social/fundamental_rights/pdf/legnet/bfe07_en.pdf.

([67]) SME BER 70/2001, Training BER 68/2001 and employment BER 2204/2002.

([68]) Commission Regulation EC No 1976/2006 of 20 December 2006 amending Regulations (EC) No 2204/2002, (EC) No 70/2001 and (EC) No 68/2001 as regards the extension of the periods of application, OJ L 368, 23.12.2006, p. 85.

([69]) See, for instance, Article 11(3) of the employment BER (2204/2002).

([70]) Commission Decision of 20 June 2008 on the prolongation of certain state aid decisions, OJ L 164, 25.6.2008, p. 43.

Rolling back regulation in the telecoms sector: a practical example

Ágnes SZARKA ([1])

1. Introduction

The Regulatory Framework for Telecommunications ([2]), in force since 2003, introduced a new regulatory approach, basing the sector-specific *ex ante* regulation on the principles of competition law. It requires the national regulatory authorities ('NRAs') to define and analyse telecoms markets in accordance with competition law principles. In determining whether an undertaking has significant market power in a specific market, NRAs have to use the concepts and principles of competition law. The concept of significant market power ('SMP') is equivalent to the concept of dominance, as defined in the case law of the Court of Justice and Court of First Instance of the European Communities.

One of the Regulatory Framework's main objectives is to gradually phase out sector-specific regulation and leave an increasing part of the industry to be governed by competition law only. The Regulatory Framework is currently under review ([3]), the Commission having adopted the legislative proposal for the reform in November 2007. The proposals are a big step towards further deregulation and will help to ensure the transition of the telecoms sector to the state of effective competition.

The Regulatory Framework requires NRAs to notify the Commission of the results of their market analyses and the regulatory measures they intend to impose on operators with significant market power. In the context of the electronic communications consultation mechanism (also known as 'Article 7 procedure') ([4]), the Commission checks the draft measure's compatibility with Community law and its contribution to the single market. The Commission has one month to make comments on the notified draft measure (or not). If the Commission has serious doubts about the draft measure's compatibility with Community law or if the draft measure would create a barrier to the single market (due to the market definition or the SMP assessment applied by the NRA), the Commission could require a national regulator not to adopt a notified regulatory measure. In this case the Commission can open a second phase investigation, which would last two months. At the end of the second phase investigation, the Commission may adopt a decision requiring the NRA to withdraw the draft measure (the so-called veto decision) ([5]).

2. The revised Recommendation on relevant markets

The purpose of the Recommendation on relevant product and service markets is to identify, in accordance with the principles of competition law, product and service markets within the electronic communications sector that justify the imposition of *ex ante* regulatory obligations. The Commission adopted the initial version of the Recommendation on relevant markets in February 2003 ([6]). The first Recommendation identified 18 markets (7 retail markets and 11 wholesale markets) where *ex ante* regulation may be warranted. These markets were potential candidates for regulation, although ultimately regulation depends on whether NRAs find one or more operators with SMP in a particular market.

(1) Directorate-General for Competition, unit C-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) The Regulatory Framework consists 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 (the 'Framework Directive' — OJ L 108, 24.4.2002) and four specific directives: the Authorisation Directive (2002/20/EC), the Access Directive (2002/19/EC), the Universal Service Directive (2002/22/EC) and the Data Protection Directive (2002/58/EC).

(3) The Commission adopted three legislative proposals on 13 November 2007 to amend the current Regulatory Framework. [See COM(2007)0697-0699.] The text of the proposal is available at http://ec.europa.eu/information_society/policy/ecomm/tomorrow/index_en.htm

(4) This procedure is set out in Article 7 of the Framework Directive

(5) For an overview of the market review and Article 7 consultation mechanism, see KRUEGER and DI MAURO, 'The Article 7 consultation mechanism: managing the consolidation of the internal market for electronic communications», Competition Policy Newsletter, 2003 — number 3, p.33-36.

(6) Commission Recommendation 2003/311/EC of 11 February 2003 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 communication networks and services, OJ L 114, 8.5.2003, p. 45

Article 15(1) of the Framework Directive requires the Commission to undertake a regular review of the Recommendation on relevant markets, to ensure that the regulation keeps up with the changing market conditions. In December 2007, the Commission thus adopted a revised version of the Recommendation on relevant markets ('the Recommendation') (7). The Recommendation significantly reduced the number of relevant markets considered to be candidates for regulation: there are now 7 markets (1 retail market and 6 wholesale markets) identified as markets susceptible to *ex ante* regulation. The Recommendation opens the door to deregulating most retail markets, following the general principle that retail regulation should only be imposed where wholesale regulation would fail to ensure effective competition.

The Recommendation also removed regulation from certain wholesale markets, the market for trunk segments of leased lines and the transit market being two examples. The main reason behind this was the fact that parallel infrastructure is being built in all Member States at the core level of the network (between major cities). The presence of alternative infrastructure may constrain the incumbent's behaviour when providing trunk segments and transit services. However, it must be noted that in some Member States alternative infrastructure may be less developed in less busy (thin) routes. If the number of these thin routes remains high in a Member State, the NRA might be in a position to demonstrate that *ex ante* regulation is still needed in these markets.

3. The three-criteria test

The Framework Directive states that there is a need for *ex ante* regulation in certain circumstances in order to ensure the development of a competitive market (8). However, at the same time it is important to ensure that *ex ante* regulation should only take place in markets where there is no effective competition, i.e. in markets where there is one or more undertakings with SMP, and where national and Community competition law remedies are not sufficient to address the problem (9).

The test to determine whether *ex ante* regulation is warranted in a market is explained in the Recommendation. The Recommendation states that the following criteria should be applied to identify markets that are susceptible to *ex ante* regulation: (1) there are high and non-transitory barriers to entry; (2) the market structure does not tend towards effective competition within a relevant time horizon; and (3) the application of competition law alone would not adequately address the market failure concerned. These criteria should be applied cumulatively, to the effect that failure to meet one of them should mean that regulation is not warranted. The Commission applied these three criteria when it identified the markets listed in the Annex to the Recommendation. The Recommendation also states that, when identifying markets other than those set out in the Annex to the Recommendation, NRAs should ensure that the three criteria are all met. In other words, NRAs can identify markets which are not on the list of relevant markets (e.g. markets which were removed from the list of relevant markets) provided that they can demonstrate that each of the three criteria are met (10). Meeting the three-criteria test does not automatically mean that regulation is warranted. Regulation is only warranted if, in a market that meets the three-criteria test, one or more operators are found to have significant market power.

In practice, NRAs have to take a two-step approach when defining and analysing markets which differ from those identified in the Recommendation. In the *first step* the NRA has to identify specific aspects of market failure in telecoms markets (Article 15 of the Framework Directive) by means of the three-criteria test. If the three-criteria test shows that regulatory intervention might be warranted in principle, the NRA analyses in a *second step* whether one or more operators in fact have SMP on the respective market. If this analysis establishes that one or more operators have SMP, regulatory obligations have to be imposed on the SMP operator(s).

(7) 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 communication networks and services, OJ L 344, 28.12.2007, p. 65

(8) Recital 25 of the Framework Directive

(9) Recital 27 of the Framework Directive

(10) Although the details of the three criteria are set out in the Recommendation, the need to carry out the three-criteria test stems from the Framework Directive itself and it forms part of the market analysis. Article 16(4) of the Framework Directive provides that a pre-condition for any intervention is that the relevant market is not effectively competitive. Article 16(4) is further explained in recital 27 of the Framework Directive, which stipulates that *ex ante* regulation should only take place in markets where there is no effective competition, i.e. in markets where there is only one or more undertakings with SMP, and where national and Community competition law remedies are not sufficient to address the problem.

4. The transit market and the wholesale market for trunk segments of leased lines in Poland

Two recent cases notified by the Polish NRA under the Article 7 procedure ([11]) illustrate the importance of the three-criteria test. In both cases the Commission had serious doubts as to whether the markets defined by the NRA meet the three-criteria test and whether there was SMP in the given markets. These cases were the first two cases where the NRA wanted to regulate an 'old' market (i.e. a market which is no longer included in the Recommendation) and the Commission did not agree with the NRA's conclusions that the markets passed the three-criteria test. The Commission expressed its view that imposing or maintaining regulation in a market which is not susceptible to *ex ante* regulation would affect trade between Member States and would raise concerns about the measure's compatibility with Community law. Following the Commission's serious doubts, the NRA has withdrawn both notifications.

4.1. The market for transit services in the fixed public telephone network in Poland

In April 2008, the Polish Communications Regulatory Authority ('UKE') notified a draft measure to the Commission concerning the Polish market for transit services in the fixed network. Transit services refer to the conveyance of switched calls between transit switches. Transit services comprise conveyance both between switches on a given network and between switches on different networks, including pure conveyance across a third network.

In the notification UKE concluded that Telekomunikacja Polska S.A. ('TP'), the incumbent operator, should be designated as an operator with SMP in the market.

4.1.1. Failure to establish that the market is susceptible to ex ante regulation

The market for transit services had been removed from the Recommendation and thus is no longer identified as a market susceptible to *ex ante* regulation. Therefore, if the NRA wants to impose regulation, it first has to establish that the market fulfils the three-criteria test (i.e. there are high and non-transitory entry barriers; the structure of the market does not tend towards effective competition; and competition law is not sufficient to address the market failures).

As regards the **first criterion** (high and non-transitory entry barriers), UKE concluded that there were high entry barriers in the transit market due to significant sunk costs related to the creation of the necessary infrastructure (especially if the new entrant wanted to build an infrastructure similar in size to the incumbent's network). UKE stressed that none of the alternative operators has a network which is comparable in size to TP's network. Moreover, TP has points of interconnection with almost all operators and uses its own infrastructure while other operators also use leased infrastructure (sometimes they lease infrastructure from TP). UKE also claimed that the new entrants are active only in certain selected areas of Poland and their activities are small-scale.

The Commission took the view that, when assessing the first criterion, UKE had to examine whether the market has experienced entry and whether entry has been or is likely to be sufficiently immediate and persistent to limit market power. The Commission noted that there are several operators providing transit services in Poland. Even if a number of these operators are active only in certain selected areas of Poland, new entry has taken place in this market and some of the new entrants have managed to achieve a substantial market share. For example, one of the alternative operators, EXATEL S.A., secured a substantial market share (approx. 12% when including on-net transit in the market definition and approx. 18% when looking at the merchant market), while TP's market shares have decreased significantly.

Although UKE stated that alternative operators have rolled out their own infrastructure only on a small scale, the Commission noted that parallel infrastructure has been built in Poland. There seems to have been extensive network roll-out by some of the alternative operators, such as EXATEL S.A, Netia and GTS Energis. Even taking only these three alternative operators into account shows the possibility of achieving the requisite scale and that any barriers to entry are surmountable.

With regard to the **second criterion,** UKE concluded that the structure of the market does not tend towards effective competition. However, the Commission noted that the incumbent's market share has decreased in this market and alternative operators have gained a substantial market

([11]) The two cases were registered under PL/2008/0766 and PL/2008/0772, available at http://ec.europa.eu/information_society/policy/ecomm/implementation_enforcement/article_7/index_en.htm share. When looking at market shares in the merchant market, TP was the third biggest operator in 2007, with a market share of slightly more than 10%. Even when including self-supply in the market definition, TP's decreasing market shares are below 40%. Based on these developments, UKE's conclusion that the market would not tend towards effective competition lacks justification.

On the basis of the evidence provided by UKE, the Commission believed that the market for transit services in the fixed telephone network in Poland did not fulfil the three-criteria test and therefore is not susceptible to *ex ante* regulation.

4.1.2 The SMP finding

According to the Framework Directive and to the Guidelines on market analysis ([12]), markets must be defined and SMP must be assessed using the same methodologies and principles as under competition law. In the Commission's experience, single dominance concerns normally arise in the case of undertakings with market shares of over 40%, although the Commission may in some cases have concerns about dominance even with lower market shares, as dominance may occur without the existence of a large market share.

UKE explained that TP's market share is close to 40%, indicating SMP in the relevant market. UKE stated that TP is the largest telecommunications operator in Poland; it has the most developed network and the biggest subscriber basis. Moreover, TP is active on all telecommunications markets. UKE maintained that the transit market is characterised by low countervailing buyer power and high entry barriers.

The Commission pointed out, however, that the low and decreasing market shares of TP do not create any presumption of dominance. In the merchant market TP's market share is around 10%. Even if captive sales are included, TP's market share is below 40%. With regard to the **inclusion of captive sales** in the market definition, the Commission noted that UKE did not provide sufficient justification for the inclusion of these sales in the market. According to Commission practice ([13]) and the case law of the Court of First Instance ([14]), the inclusion of captive sales in the relevant market may depend on whether internal traffic would be made available in the merchant market in the event of an increase or decrease in market prices (i.e. whether the captive sales would be sufficiently quickly switched to the merchant market in response to a change in the competitive conditions). Mere hypothetical supply-side substitution, however, is not sufficient for the purposes of market definition.

The Commission was of the opinion that there was no justification for the inclusion of captive sales in the market. In particular, there was no evidence that TP, in the event of a significant price change on the market, would stop supplying its subsidiary, PTK Centertel (which is 100% owned by TP), or that PTK Centertel, in such a case, would purchase the services from other operators. On the contrary, UKE itself admitted that the above scenario is only a theoretical possibility.

In the light of the above, the Commission found insufficient evidence to support the conclusion that TP had significant market power in the relevant market.

4.2 The wholesale market for trunk segments of leased lines in Poland

In April 2008, UKE notified a draft measure concerning the wholesale market for trunk segments of leased lines in Poland. Leased lines secure a dedicated connection and capacity between two locations. Typically, leased lines are used by businesses to connect geographically distant offices. At wholesale level, it is possible to distinguish separate markets between trunk segments and terminating segments of leased lines. While terminating segments involve a connection to end-users, trunk services refer to supplying high capacity connection for aggregated traffic. The differentiation between the terminating and trunk segments depends on the network topology specific to particular Member States.

4.2.1 Failure to establish that the market is susceptible to ex ante regulation

The market for trunk segments of leased lines had also been removed from the Recommendation, and thus, if UKE wanted to impose regulation, it first had to establish that the market fulfils the three-criteria test.

([12]) Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165, 11.07.2002, p. 6.
([13]) Case No COMP/M.2314 — *BASF/Eurodiol/Pantochim.*
([14]) Case T-310/01 *Schneider Electric v Commission* [2002] ECR II-4071; Case T-221/95 *Endemol v Commission* [1999] ECR II-1299.

With regard to the **first criterion** (high and non-transitory entry barriers), UKE pointed out that the infrastructure used to provide leased lines services is difficult to duplicate since there are significant sunk costs. Although in the market for trunk segments of leased lines there are 30 operators, only TP has a nationwide network and points of interconnection with almost all operators. Moreover, TP is the only operator to use only its own network to provide trunk segments of leased lines whereas other market players partly lease lines from other operators (including from TP) in order to provide trunk segments to third parties.

As regards the **second criterion** (structure of the market does not tend towards effective competition), UKE emphasised that TP's market share grew between 2005 and 2006 and reached a level of around 40% in terms of lines. UKE also stated that, although the market is constantly developing, investments are costly and time-consuming and therefore UKE does not expect any new entrants in the next two years who could be real competitors for TP. UKE noted that TP's prices are decreasing, although this trend is a consequence of regulatory intervention. UKE estimated that TP would raise its prices if the regulatory obligations were removed.

The Commission took the view that, when assessing the first criterion, UKE had to examine whether the industry has experienced entry and whether entry has been or is likely to be sufficiently immediate and persistent to limit market power. The Commission noted that there are several operators providing trunk services in Poland. While it is true that most of the alternative operators offer their services on a small scale, it has to be noted that two of them (i.e. Exatel SA and Telekomunikacja Kolejowa Sp. z o.o.) have gained substantial market shares.

The Commission noted that TP's network has already been to some extent duplicated by alternative infrastructure (for example, alternative operators are active in 12 transit areas, in 49 large cities which are former capitals of administrative regions, and in a certain number of TP's local switches). Moreover, schemes of backbone networks of alternative operators show that their network is developed on several major routes. Therefore, UKE's assessment that barriers to entry and lack of duplicability of TP's network would point to the existence of high and non-transitory entry barriers does not appear to be justified.

With regard to the second criterion, it has to be stressed that alternative operators have been able to gain substantial market shares and have therefore brought dynamic to the market. The mere fact that TP's market share in terms of lines increased from 2005 to 2006 does not indicate per se that the dynamics of the market have changed.

The Commission took note of the fact that alternative operators are not in a position to provide their services using only their own networks, although UKE failed to examine in its analysis to what extent alternative operators have to rely on TP's infrastructure. UKE also failed to examine the impact of any hypothetical refusal by TP to provide these particular lines (or the impact of a price increase) on the alternative operators affected.

On the basis of the evidence provided by UKE, the Commission believed that the market for trunk segments of leased lines in Poland did not fulfil the three-criteria test and therefore is not susceptible to *ex ante* regulation.

4.2.2 The SMP finding

UKE maintained that TP's market share, which was around 40% in 2006 (in terms of volume, including self-supply), and the trend of market shares (TP's market share has increased in terms of volume) indicate that TP has SMP in the respective market. However, the Commission noted that, in parallel, the main alternative operators' market shares are also slowly going up. Looking at market shares in terms of value, a somewhat different picture emerges: TP seems to have lost market shares due to regulatory price intervention whereas the market shares of Exatel and Telekomunikacja Kolejowa have gone up. The trend as regards TP's market shares is therefore unclear and further analysis would be required to draw conclusions.

It is important to mention that the market share information provided by UKE included self-supply. In this respect, the Commission noted that only about 40% of TP's overall services in the relevant market are provided to third parties as the greater part of the dedicated capacity is used by TP's subsidiaries. The Commission noted that there was not sufficient justification for the inclusion of these sales in the market (for more about captive sales, see section 4.2.1 above). UKE itself admitted that it is unlikely that TP, in the event of a price change on the market, would stop supplying its subsidiaries or that, in such a case, its subsidiaries would purchase the services from other operators. If these captive sales were removed from the market, TP's market share would be even lower than indicated in the notification.

Moreover, there was no information about the development of trunk segments in total or about the existence or non-existence of migration from competitors to TP or *vice versa*. It should also be underlined that a substantial part of the market for trunk segments of leased lines consists of end-to-end leased lines ([15]), which, for the terminating part, are regulated in the market for terminating segments of leased lines. This type of leased line seems to be gaining more influence in Poland but there was no clear evidence about the effect these lines have on other types of leased lines. Nor was it established to what extent the market shares of alternative operators are dependent on the reliance of regulated infrastructure provided by TP.

In the light of the above, the Commission found insufficient evidence to support the conclusion that TP had significant market power in the relevant market.

4.3 Withdrawal of notifications

During the second phase of the consultation procedure the Commission held meetings with UKE to discuss its concerns about the findings of the two notifications. The European Regulators Group ('ERG') set up expert groups to examine the notifications and to deliver an opinion. The ERG opinion supported the Commission's position, agreeing with the Commission in both cases that insufficient data had been provided to support the findings regarding the three-criteria test and TP's designation as an operator with SMP ([16]). Following these discussions, UKE decided to withdraw the notifications ([17]). An NRA has the possibility through the consultation mechanism to withdraw a notification at any time. Such withdrawal ends the procedure and the Commission does not adopt a decision in such cases.

5. Conclusion

When defining relevant markets which are different from those listed in the Recommendation, NRAs have to apply the three-criteria test. NRAs may impose regulation only in markets which meet the three criteria (i.e. markets where there are high and non-transitory entry barriers; the structure of the market does not tend towards effective competition; and competition law is not sufficient to address the market failures). The above cases illustrate the importance of the three-criteria test ([18]). Imposing or maintaining regulation in a market which is not susceptible to *ex ante* regulation would affect trade between Member States and would raise concerns about the measure's compatibility with Community law. The cases indicate that, if the Commission cannot agree with the findings of the three-criteria test, it will probably issue a serious doubts letter and the case will go into the second phase of the consultation procedure. The cases also demonstrate the importance of the revised Recommendation, which fosters further deregulation in telecoms markets where justified.

([15]) End-to-end lines are leased lines between two points which are not network nodes. These lines consist of both terminating and trunk segments. From the service provider perspective, these lines are one product (service) ensuring transmission of signals between two specified locations. In order to allocate that particular service to leased lines markets, UKE proposed to split these lines between terminating and trunk segments in a ratio of 2:1 (i.e. two pieces of an end-to-end line belong to the terminating segments and one piece is treated as a trunk segment).

([16]) The executive summary of the ERG opinion regarding the two cases is available at http://www.erg.eu.int/whatsnew/index_en.htm

([17]) In July 2008, UKE re-notified the draft measure concerning the market for transit services in the fixed public telephone network in Poland (see case under PL/2008/0788). In this new notification UKE came to the conclusion that the transit services market is competitive and proposed to withdraw regulation from this market.

([18]) Although at the same time the SMP assessment in the cases was also the basis for the Commission's serious doubts.

The new Guidelines on the application of Article 81 of the EC Treaty to the maritime sector

Carsten BERMIG and Cyril RITTER (1)

On 1 July 2008, the European Commission adopted guidelines on the application of Article 81 of the EC Treaty to maritime transport services ('the Guidelines'). This followed a public consultation in 2007.

In 2006, the Council adopted Regulation 1419/2006 (2), which repealed the liner conference block exemption contained in Regulation 4056/86 (3) with effect from 18 October 2008. Since 18 October 2008, liner companies have to assess whether all their business practices comply with Article 81. The Guidelines will help liner operators understand the implications of this change, and will provide details in particular on exchanges of information between carriers.

Regulation 1419/2006 also extended the procedural competition rules in Council Regulation 1/2003 (4) to tramp shipping services (unscheduled maritime transport of non-containerised bulk cargo). In this connection, the Guidelines provide details on the legal assessment of operational cooperation agreements between tramp operators (so-called 'pool agreements').

Background

The maritime transport sector essentially comprises two types of transport: liner shipping and tramp shipping. Liner shipping refers to the scheduled transport of containerised cargo. Tramp shipping (also called bulk shipping) refers to the unscheduled transport of bulk cargo (for example grain, iron ore, etc). Tramp shipping is usually unscheduled because the demand is more seasonal, irregular and geographically imbalanced than for liner services.

Since the 1870s, the liner sector has been organised in so-called 'conferences'. Conferences are groups of shipping companies that collude on a particular 'trade' (i.e. a route) by fixing prices and capacity. In 1986, the Council adopted Regulation 4056/86, which block-exempted liner conferences on the assumption that they 'have a stabilising effect, assuring shippers of reliable services', and that 'they contribute generally to providing adequate efficient scheduled maritime transport services' (5).

In September 2006, following a four-year consultation process on the continued soundness of the liner conference block exemption, the Council unanimously adopted Regulation 1419/2006 repealing the block exemption with effect from 18 October 2008, on the grounds that the four conditions in Article 81(3) were no longer fulfilled.

During the consultation process, the liner industry made it clear that following the abolition of conferences it would put in place an information exchange scheme in order to have more visibility on prices and capacity. The Guidelines provide a framework for the legal assessment of this project.

The tramp sector differs from the liner sector in that (a) it is more fragmented and (b) the main cooperation mechanism between tramp shipowners is the so-called 'pool' agreement. Moreover, for many years, the tramp sector was not subject to the Commission's normal investigation and enforcement powers (as set out in Regulation 17 (6) and then in Regulation 1/2003). Instead, the tramp sector was subject to the procedural rules in Article 85 of the EC Treaty (7). In 2006, Regulation

(1) Directorate-General for Enterprise and Industry, Unit B-3, and Directorate-General for Competition, unit F-1, respectively. 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) Council Regulation (EC) No 1419/2006 of 25 September 2006 (OJ L 269, 28.9.2006, p. 1).

(3) Council Regulation (EEC) No 4056/86 of 22 December 1986 (OJ L 378, 31.12.1986, p. 4).

(4) Council Regulation (EC) No 1/2003 of 16 December 2002 (OJ L 1, 4.1.2003, p. 1).

(5) Recital 8 of Regulation 4056/86.

(6) EEC Council Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty (OJ 13, 21.2.1962, p. 204).

(7) 'Without prejudice to Article 84, the Commission shall ensure the application of the principles laid down in Articles 81 and 82. On application by a Member State or on its own initiative, and in cooperation with the competent authorities in the Member States, which shall give it their assistance, the Commission shall investigate cases of suspected infringement of these principles. If it finds that there has been an infringement, it shall propose appropriate measures to bring it to an end. If the infringement is not brought to an end, the Commission shall record such infringement of the principles in a reasoned decision. The Commission may publish its decision and authorise Member States to take the measures, the conditions and details of which it shall determine, needed to remedy the situation.'

1419/2006 — the same Regulation that repealed the liner conference block exemption — also brought tramp shipping within the scope of the Commission's full investigation and enforcement powers under Regulation 1/2003.

As the liner and tramp sectors are now subject in full to Article 81 and Regulation 1/2003, the Commission undertook to issue guidelines on the maritime sector. A draft version of the Guidelines was published for an eight-week consultation in September 2007. The final version was adopted on 1 July 2008 and takes account of comments made by shipowners, shippers, Member States and other stakeholders ([8]).

This calls for two further comments. First, sector-specific guidelines are very rare. In recent years, guidelines have rather been of a general nature, dealing with substance (vertical agreements, horizontal mergers, fines) or with procedure (such as the notice on complaints). Guidelines have also been adopted for specific types of agreements (for example technology transfer agreements). The present Maritime Guidelines are therefore the only sector-specific guidelines adopted since the modernisation of EU competition law in 2004.

Second, the role of guidelines is to provide clarity and predictability to stakeholders as to how the Commission will apply the competition rules in practice. However, Commission Guidelines cannot in any way lead to endorsement of any hypothetical conduct that a firm might like to adopt on the market. Guidelines are not supposed to constitute a Commission decision on a particular case.

Guidelines are also normally based on accumulated experience in the relevant field. Here, the Commission agreed to issue Guidelines in two areas that it has never dealt with before (information exchange in the liner sector and tramp pools). Therefore, it is understandable that there should be some degree of generality, at least at this stage. The guidelines simply aim to provide a general analytical framework, which should be adapted to the particular circumstances in a given case. They are meant to provide indications regarding the reasoning and relevant factors. In the area of competition law, the legal assessment always depends on the particular circumstances of the case in question. So, by nature, guidelines will always contain a number of qualifiers and open-ended statements.

Scope of the Guidelines

As regards the temporal scope, the Commission decided to limit the validity of the Guidelines to a period of five years. The five-year period runs from 18 October 2008, which marks the abolition of liner conferences in the EU, to 17 October 2013.

Tramp pools have of course been fully subject to the full force of Article 81 since 18 October 2006, so the analysis of pools in the Guidelines also applies to potential pool cases in the period between 18 October 2006 and 18 October 2008.

The reason for the five-year limitation is that (a) the aim of the Guidelines is merely to facilitate the transition, and (b) this will allow the Commission to review them in 2013 in view of future market developments and in order to reflect its growing experience of the sector. The Commission may also decide to let the Guidelines lapse.

In terms of substantive scope, the Guidelines cover the liner sector and the tramp sector. In the past, some Commission decisions have identified a third category known as specialised services (e.g. car carriers), which did not come within the scope of liner or tramp services ([9]). This categorisation is now devoid of purpose, as all three categories are subject to Article 81 and Regulation 1/2003. In any event, the Guidelines are relevant to 'specialised' services insofar as the issues discussed in the Guidelines apply to such services (information exchange and pool agreements).

Although the Guidelines do not specifically address cabotage services (maritime transport services within the same Member State), they nevertheless apply to these services insofar as they are provided either as liner or tramp shipping services.

The Guidelines do not apply to the transport of passengers or to any other economic sector.

Structure and contents of the Guidelines

The Guidelines first make a number of general points in relation to the end of the liner conference block exemption and about the interaction with other Commission Guidelines. The Guidelines then address the notion of effect on trade between Member States, market definition, information exchanges in the liner sector, and pool agreements in the tramp sector. We address each point in turn below.

([8]) All the comments received are published on the website of the Competition DG. See also press release No IP/08/1063 and the frequently asked questions in MEMO/08/460.

([9]) Case IV/34.446 Trans Atlantic Agreement ('TAA') (OJ L 376, 31.12.1994, p. 1), paragraphs 47-49.

General points

The Guidelines first address general points in connection with the abolition of the liner conference block exemption. The Guidelines recall that all liner conference activity must cease in relation to services to or from one or more EU ports (or non-EU ports serving the same catchment area as an EU port, including via trans-shipment; see paragraph 20 of the Guidelines) ([10]). The carriers are also reminded that their behaviour must be in compliance with Article 81 from day one of the new regime, i.e. 18 October 2008.

This is regardless of whether other jurisdictions allow, explicitly or tacitly, price-fixing by liner conferences or discussion agreements. The Commission's view is that the abolition of the liner conference block exemption on EU trades would only create an incompatibility with the laws of another jurisdiction if that jurisdiction actually required the formation of price-fixing conferences on EU trades. Although some jurisdictions still allow conferences, the Commission is not aware of any jurisdiction that currently *requires* the formation of conferences.

The Guidelines also recall that they do not affect the consortia block exemption ([11]). Finally, the Guidelines do not affect, do not replace and do not deviate from other existing Commission guidelines ([12]).

Effect on trade between Member States

The Guidelines recall that transport services are often international in nature, and that therefore in most cases there is likely to be an effect on trade between Member States, for example on account of the impact on the markets for the provision of transport and intermediary services. By contrast, cabotage cases may be less straightforward. In any event, in both types of cases, it is necessary to refer to the Commission's Guidelines on the 'effect on trade' concept in Articles 81 and 82 of the Treaty ([13]).

Market definition

In the liner sector, the Guidelines reflect past Commission decisions and court judgments defining markets on deep-sea trades. The relevant market includes container transport services between a range of substitutable ports at one end of the service and another range of ports at the other end. For short-sea trades, however, the Guidelines note that intermodal competition may be an additional consideration.

In the tramp sector, the Commission followed the principles expressed in the 1997 Notice on the definition of the relevant market ([14]) (i.e. mainly demand-side and supply-side substitutability). In the area of tramp shipping, demand-side substitutability is to be assessed among other things on the basis of vessel types, vessel sizes and contract types. Supply-side substitutability is to be assessed on the basis of e.g. vessel types and vessel sizes, although terminal and draught restrictions and environmental standards may exclude certain vessels from the relevant market. The geographic market is to be assessed on a case-by-case basis (i.e. port-to-port routes, regional market or global market, as the case may be).

Information exchanges in the liner sector

In general, the Guidelines acknowledge that exchanges of information lead to greater market transparency and may contribute to improving the way liner services are provided, in the interest of carriers and transport users (in particular where the information is shared with customers). However, under certain circumstances, information exchanges may also have the effect of reducing or removing uncertainty as to the future behaviour of the market players, with the result that competition between undertakings is restricted. This approach reflects the case-law of the Community courts.

A restriction of competition may occur if certain circumstances are present, namely a concentrated market structure and exchanges of commercially sensitive information.

- The market structure is to be assessed in view of the level of concentration and the structure of supply and demand, notably the number of competitors, the symmetry and stability of their market shares and the existence of structural links between them.
- Whether information is sensitive depends on (a) its age and the period to which it relates, (b) its aggregated or individualised nature and (c)

([10]) This means that liner conference activities, such as price-fixing or fixing capacity, on a route from e.g. the Far East to Morocco or to Turkey, with the aim of ultimately trans-shipping containers to the EU, falls foul of Article 81 provided all other conditions in Article 81 are met.

([11]) Commission Regulation (EC) No 611/2005 of 20 April 2005 (OJ L 101, 20.4.2005, p. 10).

([12]) For example, the Guidelines on the applicability of Article 81 of the Treaty to horizontal cooperation agreements (OJ C 3, 6.1.2001, p. 2) and the Guidelines on the application of Article 81(3) of the Treaty (OJ C 101, 27.4.2004, p. 97).

([13]) OJ C 101, 27.4.2004, p. 81.

([14]) OJ C 372, 9.12.1997, p. 5.

the frequency of the exchange. It also depends on whether the information is public or not, although in some cases public information may be enhanced or combined or made more accessible in a way that makes it sensitive.

The Guidelines note that in the past the Commission considered information more than one year old as historical whereas information that was less than one year old was viewed as recent. However, this does not constitute an absolute rule. Accordingly, the historical or recent nature of the information will be assessed on a case-by-case basis with regard to all other factors in the relevant market.

It should also be noted that the three key factors (age, level of aggregation and frequency) will be assessed by the Commission as a whole rather than separately, because some factors may have an impact on others. For example, the moment when the information becomes historical is likely to be sooner if it is aggregated rather than individual.

Pool agreements in the tramp sector

A shipping pool brings together a number of similar vessels under different ownership in order to place these vessels under a single commercial management. A common feature of pools is joint selling, although they also contain elements of joint production. This section is based on the Commission's market investigation. The various pool agreements that the Commission has seen in the course of its market investigation reveal a typical profile, which is referred to as the 'standard' shipping pool in the Guidelines.

The characterisation and analysis of the 'standard' shipping pool set out in the Guidelines may not extend to all pools. By necessity, there is a certain amount of generalisation in the text, although in practice the Commission will examine each case on its own merits, as is the rule in EC competition law.

Indeed, paragraph 12 of the Commission's Guidelines on Horizontal Agreements states that 'the centre of gravity of [an agreement] determines' its categorisation as a joint selling agreement or a joint production agreement or one of the other types of agreement. This 'centre of gravity' test applies to tramp pools as well: if, on the basis of the centre of gravity test, a particular pool between competitors is found to be closer to joint selling than to joint production, it will be analysed as such.

Paragraphs 60 to 63 of the Guidelines contain a definition of the standard pool and provide some legal background. The rest of the section follows the familiar structure of the Guidelines on Horizontal Agreements and the Guidelines on Vertical Restraints: there are 'pools that do not fall under Article 81(1)', 'pools that generally fall under Article 81(1)', and 'pools that may fall under Article 81(1)'.

- Pools between non-competitors and pools that benefit from the *De Minimis* Notice ([15]) do not fall under Article 81(1).
- The sub-section on pools 'that generally fall under Article 81(1)' refers to section 5 of the Guidelines on Horizontal Agreements.
- Pools 'that may fall under Article 81(1)' include pools that do not involve joint selling but nevertheless entail some degree of coordination on the parameters of competition (e.g. joint scheduling or joint purchasing).

Finally, the Guidelines make it clear that if the parties are indeed competitors and the agreement does fall under Article 81(1), there remains the possibility to apply the exemption in Article 81(3). The final version of the Guidelines contains a significantly expanded section on Article 81(3) compared to the draft version published in September 2007.

Generally, it should be kept in mind that other Commission guidelines are relevant and may provide additional guidance for the assessment of pools, with regard to both Article 81(1) and Article 81(3).

Conclusion

In a spirit of cooperation with the maritime sector, the Commission issued these Maritime Guidelines in order to help operators transition to a new era of competition and self-assessment. It was clear from the consultation process that there was some tension between the views of the industry and the views of the customers. This was especially so in the liner sector, where the carriers and shippers expressed conflicting views. We believe that the Guidelines arbitrate between these competing claims in a way that reflects the correct application of Article 81. As regards the level of detail in the Guidelines, we believe that the Guidelines strike the right balance between the necessary level of generality and the need to provide guidance to the industry on what would constitute a breach of Article 81.

The reform of competition rules applying to maritime transport services will be completed in the coming months by a public consultation on a

([15]) Commission notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty (OJ C 368, 22.12.2001, p. 13).

preliminary draft regulation on the renewal of the Block Exemption Regulation for liner shipping consortia (Commission Regulation (EC) No 823/2000 of 19 April 2000, as amended). That regulation allows shipping lines to enter into extensive cooperation for the purpose of providing a joint service (so-called 'consortia'). The Maritime Guidelines are an integral part of the Commission's Action Plan to implement the Integrated Maritime Policy ([16]).

([16]) See http://ec.europa.eu/maritimeaffairs/dev_imp_en.html.

The new settlement procedure in selected cartel cases

María Luisa TIERNO CENTELLA [1]

The Commission has introduced the option of settling cartel cases where the Commission and the parties reach the same conclusions on the scope of the respective parties' liability and the facts of the infringement on the basis of the evidence in the Commission file. To this end, the Commission has amended Regulation (EC) No 773/2004 and adopted a Commission Notice on the subject (together referred to as the 'Settlements Package'). EU settlements are not an informal tool for closing infringement procedures, but regular, simplified procedures leading to the adoption of a Decision establishing an infringement and imposing a fine, and they are subject to judicial review. Fines imposed at the end of settlement procedures will be 10% lower than the fines that would have been imposed otherwise. From the point of view of the general interest, settlements are appropriate where procedural savings can be obtained and resources can be redeployed on other cases. The settlement procedure only applies to cartels, as an alternative to the ordinary antitrust procedure, and it does not interfere with the application or the level of reward provided for in the Leniency Notice.

Introduction

Settlements are an option for companies which, in full knowledge of the strength of the Commission case in a cartel investigation, prefer to admit liability, bring an end to the procedure and obtain a reduction of the fine, rather than explore every procedural option available. Companies are free to stick to the ordinary antitrust procedure instead, if they intend to contest the Commission's findings and challenge its interpretation of evidence by all means and exhaust all time-limits up until the final decision and beyond. So settlements are an alternative to the ordinary antitrust procedure, which continues to apply to cartel cases by default and as a fall-back procedure, i.e. whenever a settlement is not reached either because it was never explored in a given case or because such efforts failed.

EU settlements are not informal ways of closing an investigation, quite the contrary. A 'settlement' is a formal infringement Decision reflecting the findings of the investigation and imposing a fine (reduced by 10%), adopted under Articles 7 and 23 of Regulation (EC) No 1/2003 at the end of a regular, streamlined procedure in which the addressees have expressly accepted liability for an infringement of Article 81 EC.

The settlements package is designed to extract procedural efficiencies from some of the ways in which companies may choose to exercise their subjective rights. Even under the ordinary procedure, the right of access to the file and the right to participate in an oral hearing are exercised only if the parties so request, and any company may decide to contribute to the Commission's investigation or acknowledge its findings, for example. Provided that those choices are not imposed on the company, they are unimpeachable and they have no bearing on the legality of the Decision adopted at the end of the procedure. Some choices may be more helpful than others in speeding up the adoption of a decision. However, one-off decisions by individual companies do not simplify proceedings significantly in multilateral cases, such as those of cartels: for example, substantive replies to the statement of objections made by others will need to be processed, an oral hearing might still be held and full access has to be prepared for other parties anyway.

The settlement package introduces specific incentives and safeguards to encourage options that can lead to a streamlined procedure if chosen by all or most of the parties under investigation. It also introduces procedural variations to allow for the possibility to speed up proceedings ahead of the formal statement of objections, and it provides guidance for companies willing to explore that course of action. The settlements package also ensures that parties make an informed choice in the light of the evidence in the Commission's file and in full awareness of the charges and consequences they face.

The settlement procedure applies only to cartel cases. Since cartels are deliberate, flagrant infringements, in such cases the debate between the suspect companies and the Commission focuses on the scope and accuracy of the facts and on the value and extent of evidence in the

(1) Directorate-General for Competition, Directorate G (Cartels). 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.

file. In contrast to other antitrust cases, there is no discussion of intent, market definition or how anti-competitive and pro-competitive effects should be balanced. Convergent views are likely to be reached relatively quickly in cartel cases, which are often driven by compelling evidence and/or insiders' statements, compared with other antitrust cases. On the other hand, the Commission has no obligation to settle a case and may make its own judgment about whether the features of the case or the overall progress made is likely to result in procedural efficiencies justifying the reduction in the fine.

Simplifying cartel procedures may be worth a reward for cooperation and a dedicated legal instrument because cartel investigations are comparatively frequent and procedural costs may be high because of the multiplicity of parties and languages involved and the fact that the average cartel file numbers tens of thousands of pages, all of which have to be screened for confidentiality issues, while only a few hundred of those pages, on average, are actually used in evidence.

The Commission conducts thorough investigations in all cartel cases. By the time settlement discussions start, it is ready to issue a fully fledged statement of objections drafted to stand up in court, failing a settlement. So settlement discussions are not meant to extract more evidence but to debate the preliminary findings and the evidence already gathered by the Commission. Under the settlement procedure, the Commission effectively hears the parties and gives them the opportunity to argue their case convincingly, but there is no negotiation or bargaining on the scope of the objections envisaged, the use of evidence or the appropriate sanction in exchange for parties' cooperation in reducing the cost of the case. If the parties and the Commission cannot convince each other of their case, they will argue it again through the ordinary procedure.

The 'Settlements Package' in the legal and institutional framework

While, as we have seen, parties can choose whether or not to exercise certain rights, there is no scope for adjusting or compromising on a number of other rights and duties:

— Any commitment not to appeal against a Commission decision would be unenforceable and void.

— The College of Commissioners must remain free to decide and must still consult the Advisory Committee. Therefore, a settlement is only reached when the Commission set out its final position in the Decision, after consulting the Advisory Committee.

— Any infringement Decision would be null and void if the Commission: (a) had not previously initiated proceedings or (b) had not issued a statement of objections against the companies including all the objections in the Decision (2) or (c) had not given them the opportunity to argue their case, or (d) had refused access to the evidence used to support objections against the parties concerned. By contrast, if no access is granted to other documents in the file requested by a party, the decision will only be void if the party concerned can show that the Decision would have been different if it had obtained access.

The Settlements Package has been conceived to create flexibility within the existing limits imposed by the Treaty, Regulation 1/2003 and consolidated case law. It consists of:

— *Commission Regulation (EC) No 622/2008 of 30 June 2008 amending Regulation (EC) No 773/2004, as regards the conduct of settlement procedures in cartel cases* (3), which introduces the option of applying alternative rules and timing for the initiation of proceedings, the role of complainants, access to the file and oral hearings, within the limits laid down by Council Regulation (EC) No 1/2003.

— *Commission Notice on the conduct of settlement procedures in view of the adoption of Decisions pursuant to Article 7 and Article 23 of Council Regulation (EC) No 1/2003 in cartel cases* (4) (the Settlements Notice), which provides guidance on the interpretation of the new provisions of Regulation No 773 and on the particulars of the new procedure. Companies can rely on this basic framework to understand the stakes and guarantees available, to anticipate and evaluate the cooperation expected from them and to assess whether or not it is worth settling.

(2) 'The rights of the defence are infringed as a result of a discrepancy between the statement of objections and the final decision only where an objection stated in the decision was not set out in the statement of objections in a manner sufficient to enable the addressees to defend their interests' (Case T-44/00 Mannesmannröhren-Werke v Commission [2004], paragraphs 98 to 100; Case T-15/02 BASF AG v Commission, paragraph 95).

(3) OJ L171, 01.07.2008, pp. 3-6.

(4) OJ C167, 02.07.2008, pp. 1-6.

Procedure leading to settlement decisions in cartel cases

No settlement without a prior, ordinary investigation

The usual investigative measures and means, such as inspections, leniency applications and information requests will be used. At that stage there are no means to assess whether settling might be an option. The Commission will investigate and provisionally verify the facts internally before it explores the option of a settlement with the parties.

Exploring the parties' interest in settling

In deciding whether it is worth exploring a settlement in a given case, the Commission will assess the prospects of reaching a settlement with all companies concerned and hence handling the case more efficiently than by following the ordinary procedure. It may be possible to exclude settlements from the outset if one can reasonably foresee that some company is unlikely to settle or that several companies concerned are not likely to settle on the same (or compatible) terms. The factors set out in point 5 of the Settlements Notice give an idea of the considerations that might be relevant, such as the number of parties concerned, the number of parties which have not applied for a leniency reward or will not obtain one, the number of parties that have spontaneously opted to engage in settlement discussions, foreseeable divergences in their relative positions and conflicts over the attribution of liability, and the likely extent to which the facts will be contested.

If the Commission considers that it is worth exploring settlements, it will notify the relevant companies of the decision to initiate proceedings and set a time-limit within which each of them can declare in writing its interest in participating in bilateral settlement discussions with the Commission (participating in them does not imply any admission of illegal conduct or duty to settle for the parties concerned). If the Commission has initiated proceedings against several legal entities which it identifies within the same group of undertakings, it will also indicate that to the legal entities concerned, which should then appoint a single representative to participate in settlement discussions. This does not imply parental liability, but facilitates the conduct of bilateral discussions and allows parties with identical or similar interests to be equally and simultaneously aware of the content and conclusions of the meetings. Parties will be reminded that the time-limit set to declare their interest in participating in settlement discussions is also the time-limit within which they can still submit any leniency application under preparation. Beyond that time-limit, leniency applications are not forbidden, but they may (and normally will) be rejected on the grounds that the time-limit has expired ([5]).

Bilateral settlement discussions with the parties to the proceedings

Bilateral settlement discussions with the parties take place between the initiation of proceedings and the issuing of a formal statement of objections (SO), with the investigated companies that have become 'parties to the proceedings' by then. Such is the effect of a decision initiating proceedings for its addressee. Moreover, the companies in question can be sure from the moment that proceedings are initiated that only the Commission is competent to apply Article 81 EC to the case (the initiation of proceedings by the Commission relieves national competition authorities of that duty).

Settlement discussions are bilateral in order to focus efficiently on the concerns of the relevant undertaking (several parties may correspond to a single undertaking) in a relatively short sequence of meetings, without having to get into comparative exercises.

Settlement discussions allow both the parties and the Commission to evaluate the benefits of settling from their respective viewpoints and make an informed choice between the settlement procedure and the ordinary procedure. They take place on the basis of a template of settlement submission.

The Commission is not obliged to pursue settlement discussions if the parties' positions and arguments lead to the conclusion that a settlement is unlikely or that it would not serve the public interest because the efficiencies sought with a settlement procedure are not likely to be achieved overall. In such a scenario, the Commission may put an end to settlement discussions and, consequently to any further disclosure of evidence or information and revert to the ordinary procedure.

As discussions progress, the Commission informs the parties of the objections envisaged against them, discloses the evidence supporting those objections and, ultimately, discloses the fine range calculated according to the Guidelines on fines.

([5]) Point 13 of the Settlements Notice reads: 'The Commission may disregard any application for immunity from fines or reduction of fines on the ground that it has been submitted after the expiry of the time-limit referred to in point 11'.

Parties have every opportunity to express their views on the objections and the evidence and to argue their position. Their arguments will be considered and they may convince the Commission to amend or drop some original objections, with an effect on the range of potential fines. In this way, parties are able to effectively exercise their rights to be heard on the objections envisaged (see point 24 of the Settlements Notice ([6])). Additionally, parties will have been informed of the range of likely fines that they may face (which does not happen in the ordinary procedure).

Further to the evidence supporting the objections envisaged, a company genuinely lacking information about its own past behaviour or the circumstances surrounding a certain period or aspect of the cartel (e.g. if former employees or other individuals who represented the company or its predecessor are no longer available), may lodge a reasoned request justifying this and specifying other (non-confidential versions of) accessible documents or document categories that it would like to consult to make an informed choice. For this purpose, the parties consult the case-file list as it stands at that point in time. The Commission grants this sort of request if it is justified, unless the access requested would jeopardise the procedural economies intended under the settlement procedure. The Commission does not refuse to grant access to the documents or full access to the file altogether, but it may refuse to grant it before issuing the SO and do it following the ordinary procedure. The parties may always call upon the Hearing Officer for any issue concerning access to the file and due process.

On the other hand, parties are warned that coordination to distort the facts, or to distort the evidential value of documents in the file to find common ground suiting all parties, may lead the Commission to end settlement discussions, to cite this as an aggravating circumstance and to withdraw leniency (see point 5 of the Settlements Notice ([7])). In the same way that the Commission does not bargain with companies, but merely relies on the compelling nature of the evidence gathered and the 10% incentive in order to get companies to settle, it does not depend on undertakings negotiating joint settlement terms amongst themselves. There are no formal records of settlement discussions other than the parties' settlement submissions, if that stage is reached. That allows the parties to have frank exchanges and helps protect the confidentiality of settlement discussions, as does the ban on parties disclosing the contents of the talks to other companies or authorities in any jurisdiction without the Commission's permission (see point 7 of the Settlements Notice ([8]) and the new Article 10a(2) of Regulation 773/2004 ([9])).

Parties' Settlement Submissions

Once an understanding has been reached on the terms of the settlement submission and similar progress has been made with all parties concerned in the settlement discussions, the Commission may set a time-limit within which the undertakings may lodge their respective settlement submissions.

([6]) '(...) for the parties' rights of defence to be exercised effectively, the Commission should hear their views on the objections against them and supporting evidence before adopting a final decision and take them into account by amending its preliminary analysis, where appropriate. The Commission must be able not only to accept or reject the parties' relevant arguments expressed during the administrative procedure, but also to make its own analysis of the matters put forward by them in order to either abandon such objections because they have been shown to be unfounded or to supplement and reassess its arguments both in fact and in law, in support of the objections which it maintains'. These principles are based on the case law of the European Court of Justice in Case 41/69 *ACF Chemiefarma v Commission* [1970] ECR 661, at paras 47, 91 and 92; Joined Cases 40/73 to 48/73, 50/73, 54/73 to 56/73, 111/73, 113/73 and 114/73 *Suiker Unie and Others v Commission* [1975] ECR 1663, at paras 80, 437 and 438; and Joined Cases 209/78 to 215/78 and 218/78 *Van Landewyck and Others v Commission* [1980] ECR 3125, para. 68; and of the Court of First Instance in: Case T-44/00 *Mannesmannröhren-Werke v Commission* [2004] ECR II-0000, paras 98 to 100; and in Case T-15/02, BASF *AG v Commission,* of 15 March 2006, at paras 93 and 95.

([7]) '(…) The Commission may also decide to discontinue settlement discussions if the parties to the proceedings coordinate to distort or destroy any evidence relevant to the establishment of the infringement or any part thereof or to the calculation of the applicable fine. Distortion or destruction of evidence relevant to the establishment of the infringement or any part thereof may also constitute an aggravating circumstance within the meaning of point 28 of the Commission Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation (EC) No 1/2003 (the Guidelines on fines), and may be regarded as lack of cooperation within the meaning of points (12) and (27) of the Leniency Notice (…)'.

([8]) 'The parties to the proceedings may not disclose to any third party in any jurisdiction the contents of the discussions or of the documents which they have had access to in view of settlement, unless they have a prior explicit authorisation by the Commission. Any breach in this regard may lead the Commission to disregard the undertaking's request to follow the settlement procedure. Such disclosure may also constitute an aggravating circumstance, within the meaning of point 28 of the Guidelines on fines and may be regarded as lack of cooperation within the meaning of points (12) and (27) of the Leniency Notice'.

([9]) '(…) This information shall be confidential vis-à-vis third parties, save where the Commission has given a prior explicit authorisation for disclosure (…)'.

A party lodging a settlement submission formally commits to the settlement procedure and to settling, provided that the Commission follows up. Should the SO raise objections other than those acknowledged by a party or if the Commission intends to impose a fine exceeding the maximum amount submitted, the party concerned is no longer bound by its submission, and the acknowledgements provided cannot be used in evidence against any of the parties to the proceedings (see points 21 ([10]) and 22 ([11]) of the Settlements Notice).

Parties' settlements submissions must include the following (see the new Article 10a(2) of Regulation (EC) No 773/2004 and point 20 of the Settlements Notice):

1. An acknowledgement of the parties' liability for the infringement and of their involvement in it, as described (object, duration, main facts, legal assessment, etc.).
2. An indication of the maximum amount of the fines the parties would expect to be imposed.
3. The parties' request to:
   a) apply the settlement procedure to the case,
   b) receive the SO and the final decision in one of the official EU languages.
4. The parties' confirmation that they:
   a) Have kept the contents of settlements discussions confidential;
   b) Have been informed of the Commission's objections in a satisfactory manner;
   c) Have been given the opportunity to be heard, so that they will request neither further access to the file nor an oral hearing.

Settlement submissions receive the same protection from discovery as corporate statements to qualify for leniency under points 35 to 39 of the Settlements Notice.

([10]) 'The acknowledgments and confirmations provided by the parties in view of settlement constitute the expression of their commitment to cooperate in the expeditious handling of the case following the settlement procedure. However, those acknowledgments and confirmations are conditional upon the Commission meeting their settlement request, including the anticipated maximum amount of the fine'.

([11]) 'Settlement requests cannot be revoked unilaterally by the parties which have provided them unless the Commission does not meet the settlement requests by reflecting the settlement submissions first in a statement of objections and ultimately, in a final decision (…)'.

Simplified procedure until the final Decision

Pursuant to Article 10(1) of Regulation 773/2004, issuing a statement of objections is a mandatory step prior to the adoption of a final Decision in any EU antitrust procedure. In settlement procedures, if the parties' settlement submissions correspond to the understanding reached during the settlement discussions, the Commission, in turn, normally adopts a streamlined SO reflecting their content (see point 22 of the Settlements Notice). Consequently, parties committed to settling are expected to reply to the SO by confirming that the SO reflects their submission (see point 26 of the Settlements Notice ([12])). Following this confirmation, further access to the file or an oral hearing is superfluous (see new Articles 12(2) ([13]) and 15(1a) ([14]) of Regulation 773/2004). It must be noted that parties who choose to settle have already had access to the necessary parts of the file to their satisfaction, and that they have been heard orally during bilateral discussions in advance of their voluntary submission and of the formal notification of objections. Also, a settlement is reached only if the final Decision reflects the parties' submissions.

Consequently, the streamlined SO can be turned into a decision with minimal changes and additions. In particular, the final settlement decision imposes a fine including the 10% settlement

([12]) 'Should the statement of objections reflect the parties' settlement submissions, the parties concerned should within a time-limit of at least two weeks set by the Commission in accordance with Articles 10a(3) and 17(3) of Regulation (EC) No 773/2004, reply to it by simply confirming (in unequivocal terms) that the statement of objections corresponds to the contents of their settlement submissions and that they therefore remain committed to follow the settlement procedure. In the absence of such a reply, the Commission will take note of the party's breach of its commitment and may also disregard the party's request to follow the settlement procedure'.

([13]) 'However, when introducing their settlement submissions the parties shall confirm to the Commission that they would only require having the opportunity to develop their arguments at an oral hearing, if the statement of objections does not reflect the contents of their settlement submissions'.

([14]) 'After the initiation of proceedings pursuant to Article 11(6) of Regulation (EC) No 1/2003 and in order to enable the parties willing to introduce settlement submissions to do so, the Commission shall disclose to them the evidence and documents described in Article 10a(2) upon request and subject to the conditions established in the relevant subparagraphs. In view thereof, when introducing their settlement submissions, the parties shall confirm to the Commission that they will only require access to the file after the receipt of the statement of objections, if the statement of objections does not reflect the contents of their settlement submissions'.

reduction and not exceeding the maximum level of the fine as accepted by the party in its submission. The 10% reduction applies to the final calculation of the fine, after any leniency reward has been granted. This ensures that any company settling gets the same level of settlement reduction, even if it reaches the ceiling for financial liability laid down in Article 23(4) of Regulation (EC) No 1/2003 ([15]).

Before adoption, the draft decision is submitted to the Advisory Committee of representatives of the Member States, for their opinion (see new Article 10a (3) of Regulation 773/2004 ([16])) and the Hearing Officer drafts a report, as in any other antitrust procedure.

Under point 29 of the Settlement Notice ([17]), in the hypothetical (and truly exceptional) case that the Commission intends not to settle in the end, it cannot adopt a decision without issuing a new statement of objections and allowing a new defence following the ordinary procedure.

Final remarks

Practice will bring proficiency, in this field as in any other. Once experience is gained in dealing with settlements, procedural economies should be made in the length of the administrative procedure and in the resources necessary to deal with individual cases both at the administrative stage and in litigation.

In the field of cartels, the Settlements Package, like the revision of the Leniency Notice, shows that the Commission does not rest on its laurels, but actively searches for ways to maintain and improve its performance and record against a moving target, so that its enforcement efforts increase deterrence against cartel behaviour.

([15]) 'The financial liability of each undertaking in respect of the payment of the fine shall not exceed 10% of its total turnover in the preceding business year'.

([16]) 'When the statement of objections notified to the parties reflects the contents of their settlement submissions, the written reply to the statement of objections by the parties concerned shall, within a time-limit set by the Commission, confirm that the statement of objections addressed to them reflects the contents of their settlement submissions. The Commission may then proceed to the adoption of a decision pursuant to Article 7 and Article 23 of Regulation (EC) No 1/2003 after consultation of the Advisory Committee on Restrictive Practices and Dominant Positions pursuant to Article 14 of Regulation (EC) No 1/2003'.

([17]) 'The Commission retains the right to adopt a final position which departs from its preliminary position expressed in a statement of objections endorsing the parties' settlement submissions, either in view of the opinion provided by the Advisory Committee or for other appropriate considerations in view of the ultimate decisional autonomy of the Commission to this effect. However, should the Commission opt to follow that course, it will inform the parties and notify to them a new statement of objections in order to allow for the exercise of their rights of defence in accordance with the applicable general rules of procedure. It follows that the parties would then be entitled to have access to the file, to request an oral hearing and to reply to the statement of objections. The acknowledgments provided by the parties in the settlement submissions would be deemed to have been withdrawn and could not be used in evidence against any of the parties to the proceedings'.

The importance of access to fuels for competition in the electricity sector: the case of lignite in Greece

Philippe CHAUVE and Polyvios PANAYIDES (1)

On 5 March 2008 the Commission adopted a Decision finding that the Hellenic Republic had infringed Article 86(1) in conjunction with Article 82 of the EC Treaty by maintaining the preferential access to lignite in favour of the incumbent Greek electricity provider, Public Power Corporation (PPC). The Hellenic Republic had thereby conferred a competitive advantage on PPC in the wholesale electricity market, because lignite is the most competitive source of electricity generation in the Greek market. This action maintained and strengthened the dominant position of PPC in that market and created inequality of opportunity between economic operators. The abovementioned Decision calls on the Hellenic Republic to grant fairer access to lignite, and is an important step in the Commission's efforts to introduce more competition into energy markets: it underlines the need to ensure fair access to the cheapest sources of generation in order to ensure effective competition.

1. The Greek electricity market

In terms of the process of liberalisation of energy markets that has taken place in the European Union, the liberalisation of the Greek electricity market began in 2001. The earliest steps of this process included the introduction of freedom to generate electricity and to supply electricity to large consumers. Subsequently, retail supply was further liberalised so as to include other categories of consumers. Moreover, a mandatory day-ahead market (pool) was created in 2005 for the sale of all locally generated and imported electricity.

At the beginning of the liberalisation process, the incumbent undertaking (PPC) was producing almost all of the electricity generated in Greece and supplying virtually all consumers: the only exceptions were a few industrial companies which had previously obtained authorisation to operate their own generation plants, usually Combined Heat-And-Power (CHP) plants, to meet their manufacturing needs. The aim of the liberalisation process was to bring new generators into the market.

However, entries by newcomers were only very limited: the new power plants built between 2001 and 2006 were 1) plants using Renewable Energy Sources (RES, such as wind power) under an attractive guaranteed tariff regime, 2) plants built by PPC itself and 3) two gas-fired plants only which were built by competitors. For all practical purposes in 2006 PPC still owned 90% of the installed capacity (which was about 12 300MW), RES plants represented 4.1%, industrial CHP plants amounted to about 1.5% and the two new generators active on the market (Hellenic Petroleum and GEK) together amounted to 5.7% (2).

This lack of investment was not due to lack of demand, since consumption grew by about 15% in the relevant period. In fact, because supply was not keeping pace with the growth in consumption, there was a serious risk of black-outs, and the Regulator had to subsidise the building of one of the two new gas-fired plants mentioned above (on the basis of tender procedures) to ensure that the necessary supply would be available in 2004. The Regulator had to organise further tenders in 2006 in order to subsidise the building of more plants and to ensure that 900MW of additional capacity was put in place. This situation was not caused by the licensing process either: between 2001 and 2006, 21 licences for a total capacity equal to half of the existing installed capacity were granted to potential competitors of PPC and many of these licences were obtained as soon as 2001. The real issue was that competitors were not building new power plants.

2. The specific role of lignite in Greece

As explained in previous articles of this Newsletter (3), the electricity sector has particular characteristics: the product cannot be stored, flexibility of demand is very limited, and the level of demand varies significantly within a day or a week and on a seasonal basis. This leads to a system where demand must be continuously matched by supply (in practice on an hourly basis). In addition, the production costs of different sources of generation

(1) Directorate-General for Competition, units B-1 and B-3. 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.

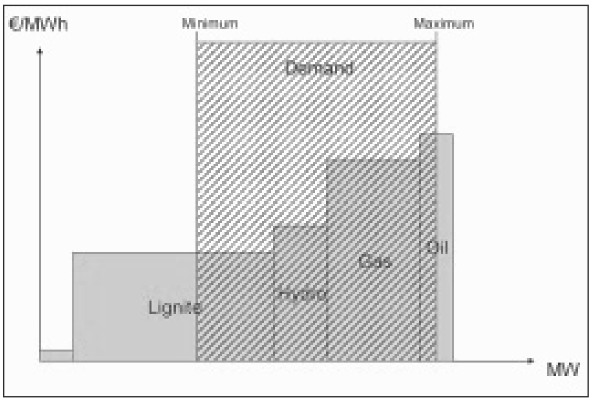
(2) This percentage includes CHP plants owns by these two operators and which date back to pre-liberalisation times

(3) See Competition Policy Newsletter 2/2007, 'Modelling competitive electricity markets, are consumers paying for a lack of competition?', page 18.

(based on various fuels or on hydropower) vary very considerably, thereby creating a steep merit curve; moreover, the price is set every hour, by the last plant in the merit order that is called upon to meet the demand.

The merit order of plants in Greece (shown in the graph below) is simpler than on other markets, given that at present there are no nuclear or coal-fired power plants in the Greek market. The cheaper plants are lignite-fired plants. In recent years, the shares of electricity production for each of the different sources of generation were around 60% for lignite-fired plants, 6-12% (depending on the year) for hydro-power plants and about 30% for gas and oil-fired plants.

Figure 1: the Greek merit curve



This is a schematic representation of the supply curve on the Greek wholesale electricity market based on data collected in the investigation. The box on the left in which the price is virtually zero corresponds to electricity which benefits from priority dispatch in the pool (imports and RES).

As demand varies between peak and off-peak, the cheaper plants (so-called 'baseload plants') are operating continuously to meet demand and the more expensive plants are called upon to produce only during certain hours. In order to compete in the market, it is thus important to have plants along the merit curve so as not to rely only on peak plants with a sporadic output. Furthermore, the cheaper plants generate far more profits than other plants as they enjoy inframarginal rent during peak hours. It is thus of key importance for an electricity undertaking to have cheap baseload plants, which in the case of Greece means lignite-fired plants. Indeed, the OECD had already reported in 2001 and in 2006 (4) on the advantages of lignite-fired plants in Greece, and this was admitted publicly by PPC itself (5). The advantage of lignite-fired generation is not only the fact that it is the cheapest source of generation (6), but also that it is a very stable source. Lignite is very expensive to transport and is thus hardly traded: lignite extracted from a deposit is thus systematically burnt in nearby power plants which are designed specifically to fire the lignite of that deposit. This is the practice throughout Europe.

The problem is that, to date, only PPC can build lignite-fired plants in Greece since it has been given a virtual monopoly access to the Greek lignite reserves.

3. The State measures giving control of lignite to PPC

Lignite is an abundant resource in Greece and is essentially used for electricity generation. Greece is the second largest lignite producer in Europe and fifth in the world. Virtually all (98%) of lignite reserves are owned by the State. The State therefore controls access to lignite in Greece.

The State does not exploit lignite directly: it grants lignite exploration and exploitation rights to companies by individual decisions. Initially this was done without a specific legal framework. Then, in 1973, Greece adopted a mining code applying to all companies and, in 1975, a specific law creating a separate procedure for granting rights to PPC. The code was used only for the allocation of rights on very small deposits, whereas PPC was granted rights on all large deposits. The result of the decisions taken by Greece is that, by the time the electricity sector was liberalised, 91% of the reserves granted for exploitation had been granted to PPC and only 9% to other undertakings. Seven years later, in 2008, the situation had not changed.

It therefore comes as no surprise that competitors of PPC cannot in practice build new lignite-fired plants. In fact, undertakings applied for licences to build new lignite-fired plants in Greece as early as 2001, but these applications were all rejected, *inter alia* on the grounds that there were not sufficient quantities of lignite to fuel such plants.

(4) OECD report on Greece (OECD, 2006) and OECD report 'Regulatory Reform — Greece' (OECD 2001)

(5) PPC recognised that lignite is a strategic fuel for instance in presentations to sector experts and in its annual reports. Statements gradually disappeared from the annual reports as the procedure of the Commission went forward.

(6) This is confirmed by PPC internal data and by the price of electricity offered by PPC in the day-ahead market.

4. The infringement

Article 86 (1) of the EC Treaty states that 'in the case of **public undertakings** and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor **maintain** in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.' PPC is a public undertaking because it is 51% owned and controlled by the Hellenic Republic.

According to the case law of the Court of Justice, if a State measure results in an inequality of opportunity between economic operators, and therefore a distortion of competition, such a measure constitutes an infringement of Article 86(1) in conjunction with Article 82 ([7]).

By granting and maintaining in force quasi-monopolistic rights giving PPC privileged access to lignite exploitation, and thus to lignite-based electricity, the Hellenic Republic ensured that PPC had privileged access to the cheapest available fuel for electricity production. This created an inequality of opportunity between PPC and competitors on the wholesale electricity market. The Hellenic Republic thus enabled PPC to protect its quasi-monopolistic market position despite the liberalisation of the wholesale electricity market, thereby maintaining and reinforcing the PPC's dominant position in that market

5. The case made by the State

During the administrative procedure, the Greek State argued that the measures had essentially been adopted before the liberalisation of the electricity sector. In the Commission's view, however, the problem was related to the fact that the Hellenic Republic had maintained those measures after liberalisation. No new deposits were granted to competitors, the legislation for the granting of rights to PPC is still in force and PPC remained free to obtain rights on more lignite deposits ([8]).

The Greek State also argued that lignite was not conferring an advantage on PPC given that it was proving increasingly expensive to mine owing to environmental concerns and that there were many alternatives available (e.g. for instance it was argued that a large number of projects are in the pipeline for new gas-fired and even coal-fired plants and that this showed that these were suitable alternatives to lignite-fired plants). Increasing costs have not affected the competitive advantages of lignite: this is demonstrated *inter alia* by the plans announced by PPC itself to build new lignite-fired plants and to develop new deposits. Although other projects do exist, the analysis by the Commission ([9]) demonstrated that alternatives are still clearly more expensive than lignite. In fact, several of the projects announced by competitors continue to be delayed because these operators cannot compete effectively if they do not have lignite-fired power plants. This is the very reason why the State was obliged to subsidise new plants to ensure security of supply. The Greek State further argued that imports were placing a constraint on competition: however, that constraint remains very limited, as imported capacity accounts for only around 10% of peak electricity demand.

The Greek State also argued that the real issue for (the reduced) market entry was the existence of regulated tariffs in the downstream retail supply to consumers. While these tariffs may have compounded the effect of the State measures on lignite, these tariffs could not be the only reason for the low level of entry in the market by competitors. Furthermore, after the mandatory day-ahead wholesale market was created, this issue was no longer relevant. As admitted by the Greek State and PPC themselves, competitors need lignite-fired generation as part of their portfolio.

6. Remedies

The Commission Decision of 5 March 2008 (which found that there had been a violation of Article 86(1) in conjunction with Article 82 of the EC Treaty) called on the Hellenic Republic to adopt remedies in order to correct the anti-competitive effects of the State measures in question. Specifically, the Decision provided that the Hellenic Republic, within the framework of its overall policy regarding lignite-fired generation in Greece, should adopt specific measures to ensure that competitors of PPC have access to sufficient amounts of lignite and to generation of electricity on the basis of lignite to allow them to compete with PPC in the electricity wholesale market.

([7]) C-462/99 Connect Austria [2003] ECR I-5197, paragraph 84.

([8]) In particular PPC can apply for the exploitation of the only two remaining significant deposits which are immediately exploitable, based on the provisions of its licence for exploration of those deposits. PPC was also allowed to participate in the reallocation process of one of the few deposits which had not been granted to it.

([9]) The analysis used inter alia. the 2005 report of IEA and NEA on 'Projected costs of generating electricity' which is available at http://www.iea.org/textbase/nppdf/free/2005/ElecCost.pdf and the trend in fuel prices since then (in particular the surge in gas and coal prices), which underlines the advantage of the stable cost of lignite.

Under the terms of the Decision, as an indicative objective, 40% of total exploitable lignite reserves in Greece must be made available to PPC's competitors in the electricity market. The type of measures that the Hellenic Republic could adopt cumulatively or individually may include the allocation of new deposits to competitors, the reallocation of previous deposits and possibly connected power plants, and the imposition of a cap which would be binding on all market participants, including PPC.

7. Conclusion

This case underlines the important role of access to fuels in ensuring competition in electricity markets and the specific role of certain fuels in that respect. This case also demonstrates how State measures could hamper the development of competition in the energy sector. However, the Commission is determined to address such distortions through **structural measures** wherever necessary, in order to ensure that there is enough investment and better supply for the benefit of consumers.

Approved guarantee methods for regional aid or de-minimis aid — the German and the Hungarian example

Rolf TUCHHARDT, András TARI and Christophe GALAND (1)

Introduction

Member States often use public guarantees as a tool to support enterprises and to provide incentives to invest, for example, in certain regions. Member States gain an advantage from the reduced budgetary impact of such guarantees compared to direct grants. However, in the context of State aid control, guarantee schemes are rather complex. The aid element of a public guarantee depends on the risk borne by the State and detailed analysis is needed in order to estimate that risk and quantify the aid.

In view of the complexity of estimating the risk borne by the public guarantor, the adoption of the Block Exemption Regulation for regional aid (RAG-BER) (2) in 2006 resulted in guarantee schemes being classified as intransparent forms of aid. An aid scheme is only considered to be transparent if it is possible to calculate precisely the gross grant equivalent as a percentage of eligible expenditure ex ante without having to undertake a risk assessment. Only transparent aid schemes can be block-exempted.

On 29 August 2008, the new general block exemption Regulation (GBER) (3) came into force replacing the RAG-BER. While the GBER introduced more flexibility for SME guarantee schemes, the general approach of identifying transparent and intransparent forms of aid is maintained.

Guarantee schemes are by definition not transparent, as the aid element can only be established after a risk assessment of the underlying transaction. However, in order to enable Member States to use the block-exemption Regulation also for guarantee schemes, in a similar way to the RAG-BER, the GBER allows Member States to notify a method to establish the aid element of guarantees. Once the method is approved, guarantee schemes which use the approved method can be considered as transparent, and be block-exempted.

Similarly, the new de-minimis Regulation (4), which came into force in December 2006, allows Member States to apply a methodology to ascertain whether a guarantee is within the de-minimis ceiling if this methodology has been accepted by the Commission following notification on the basis of another block-exemption Regulation, such as the GBER, and if the approved methodology explicitly addresses the type of guarantees and the type of underlying transactions at stake in the context of the application of the de-minimis Regulation.

In order to assess a notified guarantee method, the Commission follows a guarantee notice. For both the German and the Hungarian methodologies, which are presented in more detail below, the assessment was based on the Commission Notice of 2000 on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (5), since the Commission approved these methods before the new guarantee Notice entered into force (6).

However, as the main principles of the old guarantee Notice are retained in the new guarantee Notice, the decisions taken under the old Notice are still relevant. In any event, Member States can still use the methodologies approved under the old guarantee Notice until 1 January 2010. Only then is an adaptation to the new guarantee Notice required. This adaptation means that administrative and capital costs have to be included, as these are also required under the new guarantee Notice when calculating the aid element of a guarantee.

The economic rationale

In economic terms, a guarantee is a risk management tool which, in its most common form, is associated with a loan or other financial obligation to be contracted by a borrower with a lender.

(1) Directorate General for Competition, units H-1 and E-3. 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 Regulation (EC) No 1628/2006 of 24 October 2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid, OJ L 302, 1.11.2006, p. 29.

(3) 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), OJ L 214, 9.8.2008, p. 3.

(4) Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid, OJ L 379, 28.12.2006, p. 5.

(5) OJ C 71, 11.3.2000, p.14.

(6) OJ C 155, 20.6.2008, p. 10, the new guarantee Notice was published on 20 June 2008.

The guarantee reduces the risk borne by the lender, as the guarantor undertakes vis-à-vis the lender to transfer to him the guaranteed amount in the event of the borrower defaulting on its payment obligations. In this way, a guarantee can help overcome the reluctance of a risk-alert lender to provide the necessary funding to the borrower.

A public guarantee can be a useful economic policy instrument to leverage funds for certain activities or categories of enterprises that are seen as too risky by financial institutions.

Under normal market conditions, the guarantor has to be remunerated for taking on part of the risk through a premium which is ultimately borne by the borrower. The premium is proportional to the risk of loss faced by the guarantor, which in turn depends on the probability of default of the borrower and the chances of recovery of part of the guarantee payments from the security provided as collateral or through legal proceedings.

If the guarantee is provided by the State, which does not act as a market investor (e.g. by charging a premium which is lower than the market premium), it may involve a State aid element which usually benefits the borrower.

In order to establish the State aid element, subsection 3.2 of the 2000 guarantee Notice outlines how the aid element is to be calculated in the case of guarantee schemes. The cash grant equivalent of a loan guarantee in a given year should be considered as '[…] the difference between (a) the outstanding sum guaranteed, multiplied by the risk factor (the probability of default) and (b) any premium paid, i.e. (guaranteed sum x risk)-premium.' ([7])

The German guarantee methodology

The German guarantee methodology for investment loans (case N 197/2007)

Germany was the first Member State that made use of the new approach introduced by the RAG-BER and, in April 2007, following an intensive pre-notification phase, notified a methodology to establish the aid element of guarantees. This notification covered public guarantees for loans given by banks to finance investment expenses. Germany indicated at the same time that it also wished to use this methodology for guarantees on investment loans provided under the de-minimis Regulation.

The Commission approved this methodology on 25 September 2007. The main characteristics of the methodology are described below.

Main characteristics of the methodology

The German methodology is based on a risk differentiation approach, which is the standard approach foreseen for guarantee schemes in the guarantee Notice. The method uses probabilities of default to establish the aid element of a guarantee. In broad terms, the aid element of a guarantee is equal to the sum of the present values of the indemnification payments expected to be made by the guarantor to the lender, less the sum of the present value of the guarantee fees expected to be received over the entire duration of the guarantee.

In general, prior to the granting of a loan (with or without public guarantees), banks assign ratings to potential borrowers on the basis of a detailed analysis, taking into account both 'hard' financial data as well as 'soft' factors, such as management quality. The ratings are then used in deciding whether or not to issue the loan. As a rule, banks classify borrowers under their own rating systems.

However, since the rating grid of each bank is different, a mechanism was developed that enables the bank-specific rating to be converted into the rating grid of the German methodology. For the purposes of this conversion, the bank estimates the one-year probability of default by the borrower. The borrower will then be classified in the methodology rating category which has the corresponding one year probability of default.

Since the annual probability of default varies greatly over the duration of a loan, multi-year default probabilities are used, as they provide greater information value than multiplying the 1-year default probabilities by the duration of the loan.

On the basis of historic default rates from Creditreform Rating AG ([8]), Germany has established cumulative multi-annual probabilities of default for each rating category. Creditreform has the world's largest database on German companies, containing information on a total of 3.6 million companies. The database reflects the structure of commercial borrowers in Germany.

([7]) The new guarantee Notice requires under point 4.4. that, for each risk class, the calculation of the aid element is established 'as the difference between (a) the outstanding sum guaranteed, multiplied by the risk factor of the risk class ('risk' being the probability of default after inclusion of administrative and capital costs), which represents the market premium, and (b) any premium paid, i.e. (guaranteed sum × risk) — premium paid.'

([8]) The Creditreform association (Verband der Vereine Creditreform e.V.) has a decentralised structure and comprises 130 independent companies.

Ratingkategorie Bürgerschaften/ Credit Rating Guarantees	1-Jahres PD	Bonitäts-index	2-Jahres PD	3-Jahres PD	4-Jahres PD	5-Jahres PD	6-Jahres PD	7-Jahres PD	8-Jahres PD
1	2,00	100-262	2,2525	3,8087	5,4379	6,6248	7,6130	8,3178	8,8846
2	3,00	263-278	3,4375	5,4387	7,3122	8,8945	10,0594	10,8462	11,4634
3	4,50	279-309	4,9115	7,6106	9,9516	11,8842	13,2666	14,2402	15,0678
4	7,00	310-339	10,4740	15,0189	18,7805	20,6897	22,5151	23,1208	23,7212
5	10,00	340-382	18,0532	24,5023	28,2599	31,4100	33,3173	34,7203	35,3552

Figure 1: Creditreform multi-year cumulative default probabilities in %

As can be seen from figure 1 above, the probability of default increases the longer the duration of the underlying loan and the lower the creditworthiness of the borrower.

In order to establish the aid element of a guarantee, the method takes account of the fact that when a firm defaults the full amount of the guarantee is not lost, because some money may be recovered by the sale of the assets of the firm. Based on historical data, Germany calculated a recovery rate of between 12.5% and 20%. In addition, the reimbursement profile of the loan has an influence on the aid element of a guarantee. Indeed, a guarantee on a 10-year loan with reimbursement of the capital in 10 annual and identical instalments is significantly less risky than the same loan with reimbursement of the entire capital at the end of the 10-year period. The method also takes into consideration the fact that the State will not have to indemnify the lending bank until some years after the grant of the guarantee, which means that the current value of these future payments is less than their nominal value. Lastly, the method calculates the guarantee premium that the guarantor will receive and which reduces the aid element.

The German guarantee methodology for working capital loans — an amendment to the general method (case N 541/2007)

In addition to guarantees for investment loans, Germany also provides guarantees for working capital loans, i.e. loans financing current assets (inventories, work in progress, receivables, etc.), either as de-minimis aid or under the recently approved guarantee schemes for working capital loans in the new Länder ([9]). In practice, guarantees for investment loans are often provided in combination with guarantees for working capital loans.

In September 2007, Germany notified an amendment to the approved guarantee method for investment loans. This amended method was approved by the Commission on 28 November 2007.

Main characteristics of the amended methodology

Following a detailed analysis, the Commission concluded that only the parameter 'recovery rate' would need to be adapted in the approved methodology for guarantees for investment loans in order to explicitly address guarantees for working capital loans.

As indicated above, the recovery rate reflects the fact that, in the case of default by a borrower, the payment by the guarantor to the lender is usually less than the full amount of the guarantee. Before the payment occurs, the creditor has to recover money by selling the securities which were given as collateral for the loan. Additional amounts might be recovered through the selling of other assets of the defaulted firm, or through guarantees given by the owners. The basic assumption is that guarantees for working capital loans lead to higher payments in the event of default because fewer (or no) securities are available compared to investment loans.

As regards guarantees for investment loans, Germany calculated a recovery rate of 12.5% for net programmes and 20% for gross programmes. Net-programmes are constructed in such a way that the public guarantee only covers that part of a loan which is not secured by collateral. For gross programmes, the collateral covers both — i.e. the part of a loan which is covered by the public guarantee and the part of the loan that forms part of the commercial risk of the bank. Therefore, the recovery rate is higher for gross programmes than for net programmes.

Although Germany has advanced some arguments as to why, in theory, the recovery rate for guarantees for investment loans and guarantees

([9]) Cases N 430/07, N 431/07, N 432/07, N 433/07, N 439/07 and N 311/08. For details see http://ec.europa.eu/comm/competition/state_aid/register/.

for working capital loans could be equal ([10]), in the absence of any empirical data on the recovery rates of guarantees for working capital loans ([11]), Germany has suggested using a recovery rate of 12.5% for these types of loans, which corresponds to the recovery rate for net programmes for investment loans in respect of which no collateral is provided to the public guarantor ([12]).

Germany's guarantee methodology for loans to special purpose vehicles and newly created firms (Case N 762/2007)

Both the guarantee method for investment loans and the amended method to include guarantees for working capital loans require the beneficiary to have a standard bank rating. The two approved methods exclude firms that do not have a rating. Therefore, in December 2007, Germany notified a further amendment to the guarantee methods to include guarantees to firms without a rating, such as guarantees for special purpose vehicles (so-called 'Projektgesellschaften') and newly created firms.

The Commission approved this extension of the German guarantee method on 17 June 2008.

Main characteristics of the methodology

In order to include special purpose vehicles and newly created firms in the guarantee method, a transfer methodology was developed with the aim of using the existing database for historical default rates and applying the data to those beneficiaries for which no standard rating is available.

In this context, the German authorities suggested applying the definitions of Directive 2006/48 ([13]) *'relating to the taking up and pursuit of the business of credit institutions'*, which was transposed into German law through the so-called 'Solvabilitätsverordnung' ([14]), and the requirements of Basel II ([15]).

Directive 2006/48 defines 'specialised lending exposures' ([16]) (which would include loans to special purpose vehicles and newly created firms) and, together with the Basel II agreement, a framework is provided with which banks have to evaluate risks for those exposures. In Germany, in line with Directive 2006/48, the financial markets supervisory authority (BAFIN) allowed the use of internal bank ratings to define the equity needs under Basel II for specialised lending exposures. Subject to certain minimum conditions and disclosure requirements, banks that have received supervisory approval may rely on their own internal estimates of risk components when determining the capital requirement for a given exposure. This so-called Internal Ratings Based Approach *(or: 'IRBA')* is subdivided into the foundation (or 'simple') IRBA and the advanced IRBA.

While under the advanced IRBA detailed risk calculations are carried out by the lending bank, for the application of the simple IRBA banks use so-called 'slotting' criteria, which are pre-defined under Basel II ([17]).

Under both the simple and the advanced IRBA, banks are establishing ratings for their special lending exposures. Furthermore, on the basis of

([10]) Germany explained that investment loans and working capital loans are always cross-secured, which means that an investment loan is secured in the first place by the investment good (assets) and in the second place by working capital — and a working capital loan is secured in the first place by working capital and in the second place by investment goods (assets). On this basis, recovery rates could be identical.

([11]) Germany was unable to provide empirical data on recovery rates for guarantees for working capital loans, and confirmed that no empirical data are available, mainly due to the fact that, in the relatively limited number of cases where guarantees for working capital loans had been granted, they had always been granted in combination with guarantees for investment loans.

([12]) As an example, under the approved German method to establish the aid element in guarantees (State aid N 197/2007), assuming a company with a credit rating of B1 requesting a loan with a repayment of the capital in 10 annual instalments and an annual guarantee premium of 1%, the *de minimis* threshold for a guarantee applicable in the case of a working capital loan will be € 4.75 million (recovery rate of 12.5%), while for an investment loan with the same characteristics the threshold will be € 5.78 million (recovery rate of 20%).

([13]) OJ L 177 of 30 June 2006, p.1.

([14]) Verordnung über die angemessene Eigenmittelausstattung von Instituten, Institutsgruppen und Finanzholding-Gruppen (SolvV), http://www.bundesbank.de/download/bankenaufsicht/pdf/solvv_070119.pdf

([15]) http://www.bis.org/publ/bcbs107.pdf

([16]) According to Directive 2006/48/EC — specialised lending exposures are exposures which possess the following characteristics: (a) the exposure is to an entity which was created specifically to finance and/or operate physical assets; (b) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and (c) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

([17]) Although the advanced IRBA is more exact, for the purpose of a wide application of the guarantee method it would have been not feasible to limit the method to the advanced IRBA since a high number of German banks use the simple IRBA.

this rating it is possible to link the results to the approved guarantee method and to transfer the rating into the method. This is done by means of an estimated one-year probability of default (for the advanced IRBA) or corresponding external ratings from international rating agencies (for the simple IRBA). The existing data on probabilities of default from the approved German guarantee method could then be used for the final calculation and the establishment of the aid element of a guarantee for a special lending exposure.

For young, innovative firms, special provisions have been introduced because, under the simple IRBA, these firms are classified under the slotting criteria in the so-called 'weak' category, which comprises the rating categories 4, 5 and 6 of the guarantee method. Since rating category 6 is excluded from the application of the guarantee method [18] and in order to avoid difficulties in the provision of guarantees to these firms, a selection mechanism is established which goes beyond the simple IRBA and is designed to allow some firms to be selected and to classify these selected firms into a better risk class, which is included in the method.

The Hungarian guarantee method (case N 201/b/2007)

The Hungarian authorities notified a methodology to be applied within the context of both the RAG-BER and the de minimis Regulation for guarantees to SMEs up to a guaranteed amount of EUR 1.5 million. The methodology is to be applied by the Rural Credit Guarantee Foundation (Agrár-Vállalkozási Hitelgarancia Alapítvány — 'AVHGA')

Main characteristics of the methodology

The method relies on establishing a hypothetical market premium that a private investor would charge. The aid element is the aggregated amount of the yearly differences between this market premium and the premium actually paid that are discounted to the date of granting of the guarantee. The methodology calculates the hypothetical market premium individually for each segment identified.

The core of the calculation consists in establishing, based on own historical data of the institution, what the **average annual revenue from guarantee premiums** would have had to be over the last 10 years in order for this revenue to ensure a profit after tax on the institution's equity that is proportionate to the relative size of the segment, taking also into account

— the 10-year average annual amount of the mobilised guarantees in the given segment;

— the 10-year average annual recovery in the given segment;

— the part of the 10-year average annual operating expenses of the guarantee institution that is proportionate to the size of the segment; and

— the part of the 10-year average annual revenue earned from the investment of the capital of the guarantee institution that is proportionate to the size of the segment.

The revenues from the hypothetical market premium (M) and revenues earned from the investment of the capital (I) constitute the income of ongoing operation. This income must exceed the net losses (L) (i.e. guarantees mobilised minus recovery) arising from guarantee commitments and the operating expenses (E) by a margin equal to the profit benchmark [19] (P). Thus, the revenue from the hypothetical market premium of the segment is calculated as follows:

$M = P + L + E — I$

(which ensures that $M + I = P + L + E$)

The variables M (revenue from premiums of the segment) and L (net losses of the segment) are segment-specific data, while the other variables reflect proportional values according to the size of the segments. The calculated average annual revenue from the premium (M) is divided by the average size of the segment [20] to obtain **the market premium** in percentage terms applicable for the segment [21].

Segmentation

There are seven segments in total. The segmentation of AVHGA is based on two criteria only, namely the amount of the guaranteed loan/leasing and the maturity of the guarantee.

(18) Rating category 6 was excluded from the application of the guarantee method since this category might have included firms in difficulty.

(19) The expected profit (P) after tax should reflect a return equivalent to the central bank base rate. According to Hungary, taking the central bank base rate as the profit benchmark is transparent and it is a good proxy for yield expectations over the long term.

(20) The size of the segment is the average end-of-the year amount of outstanding guarantees in the given segment. Averaging takes place over a 10-year period, or at least 3 years if even the oldest individual transaction included in the segment took place less than 10 years ago.

(21) The market premiums are recalculated on 1 July every year taking into account the latest historic data.

	Maturity		
Guaranteed loan/leasing amount (HUF)	**Up to 1 year**	**From 1 to 7 years**	**Over 7 years**
1-1.000.000 *[up to EUR 4000]*	Segment 1		
1.000.001-100.000.000 *[EUR 4000 — EUR 400 000]*	Segment 2	Segment 3	Segment 4
100.000.001- *[above EUR 400 000]*	Segment 5	Segment 6	Segment 7

Figure 2: Segments of AVHGA

De minimis application

The Hungarian authorities wish to apply the methodology also for calculating the gross grant equivalent of support granted under the de minimis Regulation. Guarantee support covering working capital loans is also eligible under that Regulation, although this is not the case for RAG-BER.

However, as explained above, guarantees that are not related to initial investments may have different characteristics from investment loan or leasing guarantees, e.g. in terms of a lower recovery rate due to a more likely lack of collateral.

Therefore, the Hungarian authorities distinguish between historical data on defaults (i.e. mobilised guarantees) and recoveries in the segments concerned ([22]) (segments 1, 3 and 6) according to the type of guarantee (investment loan/leasing or working capital loan). This allows the market premium to be calculated separately for guarantees covering investment loan/leasing and guarantees covering working capital loans.

As the Commission has concluded, the method ensures that, if the calculated market premiums had been charged, the whole scheme (as well as each individual segment) would be self-financing and would even make a profit. It should be noted that it is only the new guarantee Notice (which entered into force after the decision was taken on this case) that goes as far as requiring administrative and capital costs to be considered. The method is transparent and easily verifiable, relies on easily accessible external data as well as on the institution's own historical data, and is based on data covering a relatively long (10-year) period.

On the other hand, taking the averages of the portfolio over the last 10 years means lumping together amounts of guarantees granted/mobilised guarantees/recoveries for projects at different stages of their lifecycle. In this regard this method is much less sophisticated than the German method, where data on the marginal probability of default allow us to see exactly the probability of default of a 10-year guarantee in its fifth year in a given risk category, for instance. With the Hungarian method this is not possible: there is only one average annual default and recovery rate (i.e. default or recovery per guaranteed amount) per segment, which is taken into account when calculating the market premium.

It should also be noted that the measure does not have a risk-based segmentation, which means that, even though the calculation method is robust and on average the market premium for a given segment is correct, it may conceal important differences for the individual guarantees by underestimating the market premium for the riskiest enterprises and overestimating it for the less risky enterprises in the segment. However, carrying out an individual risk assessment of each borrower in cases where a scheme covers a large number of small loans is a costly exercise. Given that guarantees are likely to cause less distortion of competition for SMEs, point 4.5 of the new guarantee notice of 2008 would also allow a valuation of the aid intensity of the scheme as such, without the need to carry out a valuation for each risk class within a scheme, in the case of schemes where the guaranteed amount remains below a threshold of EUR 2.5 million. Since the approved methodology would only apply to guarantees up to EUR 1.5 million, the lack of clearly risk-based segments was acceptable. The Commission approved the method in its decision of 2 April 2008.

Conclusion

The German guarantee methods and the Hungarian guarantee method were the first to be adopted by the Commission under the new approach to guarantees related to transparency requirements, which was introduced in 2006 in the RAG-BER. Several other Member States have also notified guarantee methods. While the development of a guarantee method is rather complex, the application of the method should always be simple so as to avoid incorrect applications by granting authorities or banks. In this respect, Germany

([22]) There was no need to split data in segments 2, 4, 5 and 7. Segments 2 and 5 (with a maturity of less than one year) include overwhelmingly (for more than 90 %) guarantees for working capital loans. Similarly, in segments 4 and 7 (with a maturity of over seven years) guarantees for investment loan/leasing make up more than 90%.

has developed an internet-based calculation tool that allows the simple application of the approved method.

With the adoption of the GBER, the Commission confirmed the approach introduced by the RAG-BER regarding the treatment of guarantees. Guarantee schemes can only be considered as transparent when the Commission has approved beforehand a guarantee method that makes it possible to estimate the risk borne by the State (the public guarantor) and ultimately to establish the aid element of a guarantee.

Experience has shown that the new approach leads to considerably improved results ([23]) that are in line with the new economic approach in State aid control. The economic foundation of the approved methods leads to an estimation of the State aid component of a guarantee that genuinely reflects the actual risk borne by the State.

As explained above, the GBER has introduced more flexibility as regards guarantees to SMEs. Guarantee schemes where the beneficiaries are solely SMEs are considered to be transparent if the aid element has been calculated on the basis of the safe-harbour premiums laid down in the new guarantee Notice. For all other cases, Member States need to continue to notify guarantee methods to the Commission. This includes guarantees to SMEs up to a guaranteed amount of EUR 2.5 million, where Member States want to make use of the possibility of a single premium introduced by the new guarantee Notice.

([23]) For example, in Germany, until the end of 2006 in line with past practice (i.e. 0.5 % aid element in all guarantees granted to healthy firms), guarantees up to EUR 20 million under the old de minimis rules did not constitute State aid.

Economic analysis in vertical mergers

Raphaël DE CONINCK (1)

Economic analysis played a central role in the Commission's recent assessment of several purely vertical mergers, such as TomTom/TeleAtlas, Nokia/Navteq and Itema/BarcoVision. This paper describes the economic and econometric analysis that the Commission carried out in these cases, focusing in particular on input foreclosure, and explains why this analysis ultimately led, in each of these cases, to a clearance decision without remedies.

1. Introduction

Vertical integration has been the subject of considerable economic research since Coase's seminal contribution on the nature of the firm (2). While the efficiency enhancing effect of vertical mergers has long been recognised (3), the last two decades have seen the development of game-theoretic models showing that, under certain conditions, vertical mergers could have anticompetitive effects (4). From an empirical point of view, however, efficiencies associated with vertical integration are found to outweigh possible anticompetitive effects in most contexts (5).

Drawing on the economic literature on vertical integration, the Commission adopted its Non-Horizontal Merger Guidelines in November 2007 (hereinafter the 'Guidelines'). The Guidelines stress that vertical and conglomerate mergers between firms operating in closely related but different markets should be treated differently than horizontal mergers between rivals. While non-horizontal mergers do not remove direct competition between rivals, in certain circumstances, they may lead to anticompetitive effects, e.g. through input foreclosure. The Guidelines also emphasise that non-horizontal mergers offer substantial scope for efficiencies through the elimination of double margins and other productive efficiencies (6).

In the few months that followed the adoption of the Guidelines, the Commission assessed three purely vertical mergers, *TomTom/TeleAtlas, Nokia/Navteq* and *Itema/BarcoVision,* which were each cleared without conditions after an in-depth investigation. This paper describes the economic analysis that was carried out in light of the recently adopted Guidelines, with a particular focus on input foreclosure (7). This paper also touches upon a number of important issues raised in these cases, such as confidentiality concerns, coordination, commitment problems, non-linear prices, efficiencies and merger specificity.

This paper is structured as follows: Section 2 describes the main theory of harm considered in the above-mentioned decisions; Section 3 reviews the empirical analysis that was carried out by the Commission; and Section 4 concludes.

2. Main theory of harm considered

On the day that the Guidelines were adopted, the Commission started an in-depth investigation into the acquisition of digital map supplier TeleAtlas by TomTom, a manufacturer of Portable Navigation Devices (PNDs). Shortly after, the Commission reviewed a similar merger: the acquisition of TeleAtlas' competitor, Navteq, by mobile handset manufacturer Nokia. Both mergers were examples of backward integration, where a downstream producer acquires one of the two suppliers of navigable digital maps, which constitute an input for its downstream product (8). *Itema/BarcoVision* is another purely vertical merger which, although in a totally different industry (equipment for the textile industry), shares a number of structural characteristics with *TomTom/TeleAtlas* and *Nokia/*

(1) Directorate-General for Competition, Chief Economist's Team. 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) Coase (1937).

(3) For example, vertical mergers solve issues arising from contract incompleteness (e.g. Grossman and Hart (1986)) and allow the elimination of double margins (see, for example, Tirole (1988)).

(4) E.g. Hart and Tirole (1990), Choi/Yi (2000), Chen (2001), Nocke and White (2007) and Hombert et al. (2007).

(5) See, for example, Syverson and Hortacsu (2007) for a recent empirical study on this question. Lafontaine and Slade (2007) provide a detailed survey of the empirical literature.

(6) Guidelines, § 11-15.

(7) Economic analysis also played an important role in shaping the theory of harm in *Google/DoubleClick,* another recent case in which both conglomerate effects and input foreclosure were considered (De Coninck and Papandropoulos (2008)). *Thomson/Reuters* was another high-profile merger with vertical aspects, adopted shortly after the non-horizontal merger guidelines came into force. However, any potential vertical effects were resolved in this case through divestitures addressing the horizontal overlaps.

(8) Both *TomTom/TeleAtlas* and *Nokia/Navteq* are described in more detail in Esteva Mosso et al. (2008).

Navteq: in all three mergers, the upstream market is a duopoly, and the acquiring party has an important position in the downstream market (9).

The main theory of harm that was considered in these three cases was input foreclosure, whereby the merged entity would potentially restrict access to an essential input to its downstream competitors (10), thereby raising its downstream rivals' costs and increasing the price charged to consumers (11). In particular, it was considered whether the integrated company would stop supplying its downstream competitors (total foreclosure), who would be faced with only one other input supplier and the possibility of increased prices. Alternatively, it was considered whether the integrated company would increase prices or degrade the quality of the input supplied to its downstream competitors in a way that may harm end users (partial foreclosure).

Input foreclosure can only be a concern if the anticompetitive effects of the transaction are more important than the efficiencies brought by the vertical integration. In this regard, the three decisions recognise that the transaction would create efficiencies through the elimination of double margins, which is a direct result of profit maximisation (12). In addition, in *TomTom/TeleAtlas,* the decision recognises that other efficiencies would materialise, as the transaction will allow the development of better maps and faster updates by integrating end-user data gathered by TomTom into TeleAtlas' mapmaking process (13).

Finally, it is interesting to note that, in view of the market characteristics, vertical integration was considered unlikely to lead to coordinated effects in all three mergers. Of course, every case is different, and coordination may play a more central role in future cases (14).

3. Empirical assessment of the incentive to foreclose

This section first describes the main motivation for relying on empirical analysis to assess non-horizontal mergers. It then describes the econometric analysis and competitive assessment that were carried out in the above-mentioned merger investigations.

3.1. Motivation

Although the three mergers share a relatively similar structure, the competitive analysis needs to go beyond that observation and take into account the specificities of each case. As detailed in the Guidelines, the profitability of an input foreclosure strategy consists of a trade-off between profits lost upstream and profits gained on the downstream market. In particular, the Guidelines (15) indicate that whether an input foreclosure strategy is profitable depends on how much sales the merged entity would capture in the downstream market, which is best addressed with a detailed empirical

(9) See also Neven and Albaek (2008) for a discussion of these three mergers.

(10) In *TomTom/TeleAtlas* and *Nokia/Navteq,* the input was the navigable digital map. In *Itema/BarcoVision,* the input product supplied by BarcoVision was electronic sensors. These sensors are used in the winding machines ('winders') manufactured by Itema and its competitors (winders transform yarn from spinning bobbins into larger packages). The downstream products were portable navigation devices in *TomTom/TeleAtlas,* mobile handsets in *Nokia/Navteq* and winders in *Itema/BarcoVision*. In these three cases, the input made up 10% or less of the price of the downstream product.

(11) See paragraph 38 of Guidelines: 'When competition in the input market is oligopolistic, a decision of the merged entity to restrict access to its inputs reduces the competitive pressure exercised on remaining input suppliers, which may allow them to raise the input price they charge to non-integrated downstream competitors. In essence, input foreclosure by the merged entity may expose its downstream rivals to non-vertically integrated suppliers with increased market power. […]'

(12) It should be noted that the elimination of double margins would not be considered merger-specific if it were just as likely to be eliminated in the absence of the merger through non-linear pricing. On the other hand, the use of non-linear pricing by the upstream competitors may limit the impact on the downstream market of an increase in the input price.

(13) The Commission assessed whether these efficiencies were likely to materialise in the absence of the merger in order to determine whether they should be considered merger-specific. Although part of this information could possibly be exchanged between the parties through contractual means, the Commission concluded that, given the required investment specificity and contract incompleteness in a rapidly evolving and uncertain environment, the parties would be unlikely to improve the map production process with the use of TomTom's data to the same extent in the absence of the merger as with the merger. In other words, the decision considered that the merger would reduce transaction costs and allow a more efficient production process for digital maps.

(14) Recent economic theory suggests that vertical integration may increase the scope for coordination, in particular by limiting the non-integrated company's incentive to deviate from a collusive agreement (Nocke and White 2007).

(15) Guidelines, § 42.

analysis [16]. The remainder of this section will describe the empirical analysis carried out by the Commission regarding the incentive to foreclose.

While some of the elements described in the Guidelines, taken in isolation, may give the impression that foreclosure would result from these mergers, other elements invariably point in the other direction. For example, gross margins are much higher in absolute value downstream than upstream, but this is because the input accounts for a small portion of the downstream product price, which would tend to limit the risk of foreclosure. The main advantage in conducting an economic analysis of the incentive to foreclose is that, contrary to a checklist approach, it allows an assessment of the likely effect of the transaction without having to arbitrarily give weight to opposing criteria.

3.2. Econometric analysis

In *TomTom/TeleAtlas* and *Nokia/Navteq,* the Commission estimated downstream elasticities to calculate how much sales the merged entity would be able to capture downstream if it were to carry out an input foreclosure strategy [17].

The Commission estimated a discrete choice demand system (nested logit). Specifically, the utility u of consumer i for good j belonging to group (or nest) g is given by:

$u_{ij} = \delta_j + \zeta_{ig} + (1\text{-}\sigma)\varepsilon_{ij}$ where $\delta_j = x_j\beta - \alpha p_j + \xi_j$

where δ_j is the mean utility for product j, which depends on the product characteristics x_j (observed) and ξj (unobserved by the econometrician) and is negatively related to the price of good *j*; ε_{ij} is an i.i.d. extreme value random variable specific to product *j* for individual *i*, while ζ_{ig} is a shock common to group *g* for individual *i*. Sigma is a parameter between zero and within one, which captures the within-nest correlation of utility levels. With the inclusion of nests, the independence of irrelevant alternatives assumption, whereby consumers switch to each good in proportion to market shares, is only imposed within each nest.

The model was estimated with retail data covering monthly sales and volumes of PNDs (in the case of *TomTom/TeleAtlas*), and of mobile handsets (in *Nokia/Navteq*). The data were used at the stock-keeping unit level and covered a period of three years. The datasets also contain a detailed description of each device's characteristics, such as the presence of an MP3 player, the presence of Bluetooth, and the size and format of the screen. The nest structure of the base specification was defined on the basis of a premium and non-premium segmentation in *TomTom/TeleAtlas* and on whether the mobile handset was GPS-enabled or not in *Nokia/Navteq*.

The parameters of the nested logit model described above were obtained by estimating the linear statistical expression derived by Berry (1994):

$\ln (s_j) - \ln (s_0) = xj\beta - \alpha p_j + \sigma \ln (s_{j/g}) + \xi_j$

where s_j stands for the share of good *j*, s_0 is the share of the outside good and $s_{j/g}$ is the share of good *j* in nest *g*. In addition, year and manufacturer fixed effects were included in the base regression, as was a fixed effect for each month in the product's life cycle. Instrumental variables were used to account for the possible endogeneity of the coefficients alpha and sigma. For example, the share of other products with a media player and the share of other products with Bluetooth were used as instruments in the base specification in *TomTom/TeleAtlas*. Additional instruments, such as the size and the format of the screen, were also used, which led to similar results.

Using these estimated coefficients for alpha and sigma, own-price elasticities and inter- and intranest elasticities were calculated for each product, as detailed in Verboven (1996). These elasticities for each product were then used to measure the impact on the merged entity's downstream sales of a percentage price increase of all other products (except for downstream competitors protected by a long-term contract). In *TomTom/TeleAtlas,* for example, the results indicate that, if all other PNDs except Garmin [18] increase their prices by 10%, TomTom's sales would increase in the range of 3-5%. Numerous robustness tests were carried out, in particular with respect to the definition of nests, the choice of instruments and the total market size.

(16) A related issue raised during these three investigations concerned the potential access by the integrated companies to confidential information from its downstream competitors. In all three cases, however, it was considered that the integrated company would have a strong incentive to solve these confidentiality concerns and/or decrease prices to keep supplying the input. Indeed, confidentiality concerns are a form of product degradation, and a similar upstream/downstream profit trade-off applies (see footnote 20 for a discussion of product degradation).

(17) In *Itema/BarcoVision,* robust and precise elasticity estimates could not be calculated econometrically due to the lack of appropriate instruments and the data frequency. In order to approximate the volume of sales that the merged entity could capture by raising its rivals' costs, own-price elasticities were calibrated using the Lerner index (see, for example, Werden 1998), and a wide range of diversion ratios were considered for cross-price elasticities starting from the calibrated own-price elasticities.

(18) Garmin is TomTom's main competitor; Garmin is protected from foreclosure by a long-term contract with Navteq.

3.3 *Profit trade-off and competitive assessment*

Using these econometric estimates and industry data on prices, margins and sales, the Commission calculated whether the sales that the merged entity could capture downstream by raising its rivals' costs would be sufficient to compensate for the lost sales upstream if it engaged in input foreclosure. In particular, the Commission calculated the critical price increase by the remaining upstream supplier that would make a foreclosure strategy profitable for the merged entity. In both *TomTom/TeleAtlas* and *Nokia/Navteq,* given in particular the small share of the map cost in the PND price and the relatively limited cross-price elasticities downstream, the critical price increase was superior to 200%. Such a price increase by the integrated company's upstream competitor appears unrealistic and might trigger entry.19 The Commission also calculated that the integrated company would not raise map prices to its downstream competitors in a way that would have a significant effect downstream (partial foreclosure) ([20]), even if the remaining upstream supplier is assumed to match any price increase by the merged entity ([21]).

In *Itema/BarcoVision,* although robust and reliable econometric estimates of elasticities could not be obtained, the available evidence suggested that the critical price increase would also be very high ([22]). Such a price increase appeared unlikely given the threat of vertical integration by customers. If Uster (BarcoVision's competitor on the upstream market) increased prices as a result of an input foreclosure strategy by the merged entity, Itema's competitors on the downstream market (Schlafhorst and Murata) would have a strong incentive to develop their own sensors for winders in-house, which would lead to significant revenue losses for Uster and the merged entity. Remarkably, even though this may take several years to materialise, the threat was considered credible, particularly in light of the vertical integration of Schlafhorst in spinning ([23]).

The decisions therefore highlight the importance of qualitative arguments to be used in conjunction with the empirical exercise, as any model will only reflect part of the market reality. In these cases, the likelihood that the upstream competitor would increase the price by more than the critical price increase has to be measured against market characteristics, such as the reaction of potential entrants. Taken in a vacuum, i.e. without reference to the specifics of the market, the critical price increase would not be informative.

Finally, it is important to stress that the likelihood of an input foreclosure will also depend on the merged entity's ability to commit to stop competing on the upstream market. Indeed, the integrated company may be tempted to re-enter the upstream market by slightly undercutting its rival, as this would allow it to gain upstream sales with only a marginal effect on the downstream market ([24]). However, since the three mergers were cleared, the question as to whether the merged entity could commit to stop competing upstream (e.g. through technical means) could be left open.

([19]) A new entrant could recoup its investment by capturing a relatively limited market share. Indeed, it was calculated that, as the market for digital maps is growing, the minimum viable scale for a new entrant is relatively limited, even at current prices.

([20]) Similarly, the Commission considered that the merged entity would have no incentive to degrade the quality of the input supplied to its downstream competitors. Indeed, downstream companies can always turn to the integrated company's upstream competitor for a quality input. Degrading quality would therefore only be profitable for the merged entity if, as a result of a price increase by its upstream competitor, it is able to capture sufficient sales downstream to compensate for the losses upstream. As detailed above, this was considered unlikely in these three cases.

([21]) In order to estimate the overall impact of the proposed transaction, the Commission also simulated pre- and post-merger equilibrium prices with a simple model of Bertrand competition with differentiated products facing a linear demand. The model indicated that the vertical integration would lead to a small decrease in the average price of the downstream product as a result of the elimination of double marginalisation. Indeed, the vertical integration allows the merged entity to internalise the double mark-ups resulting from both parties setting their prices independently pre-merger, thereby allowing the merged entity to profitably expand output on the downstream market.

([22]) The critical price increase by Uster (BarcoVision's competitor on the upstream market) that would make a foreclosure strategy profitable for the merged entity was calculated using a simple model of Betrand competition with differentiated products and linear demand, in which elasticities were calibrated as detailed in footnote 17.

([23]) In addition, Premier, which is a committed entrant on the market of sensors for winders, may exert additional competitive pressure on Uster.

([24]) This refers to the commitment assumption in Ordover et al. (1990). It is different from the Hart and Tirole (1990) commitment problem, whereby a monopolist could not exert market power if it is not able to commit to its customers that it will not sell at lower prices to their rivals (as further explained in footnote 40 of the NHM guidelines). This second commitment problem is also discussed in *TomTom/TeleAtlas*.

4. Conclusion

Economic analysis played a central role in assessing the likely effect of *TomTom/TeleAtlas, Nokia/Navteq* and *Itema/BarcoVision*. In particular, it is clear from these three decisions that carrying out a detailed economic analysis is an essential tool in assessing whether an integrated company would have the incentive to engage in input foreclosure to the detriment of end-users.

All three cases reviewed in this paper were subject to an in-depth investigation, but were ultimately cleared without remedies by the Commission. This in no way suggests that vertical mergers should be subject to an in-depth investigation as a matter of course. However, experience has shown that complaints are often expressed during the initial market investigation in vertical cases, and it may be difficult at first sight to distinguish between the valid concern of a company that has reason to believe that it will be foreclosed (possibly harming customers) and the opportunistic concern of a company which is afraid of facing a fiercer competitor thanks to the efficiencies resulting from the vertical integration. This does stress the need for the parties and complainants to be forthcoming and provide substantial economic data and analysis early in the merger review process, ideally during the pre-notification stage, to allow the Commission to make an informed decision at the end of phase I and, if appropriate, avoid the cost of opening a phase II investigation without running the risk of clearing an anticompetitive transaction.

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The CISAC decision — creating competition between collecting societies for music rights

Alain ANDRIES and Bruno JULIEN-MALVY (1)

1. Introduction

On 16 July 2008 the European Commission adopted a decision prohibiting 24 European collecting societies from restricting competition as regards the conditions for the management and licensing of authors' public performance rights for musical works (2). The collecting societies were found to have restricted the services they offer to authors and commercial users outside their domestic territory.

The Commission took the view that a series of measures, including membership and territorial restrictions incorporated in the reciprocal representation agreements concluded between the collecting societies constituted infringements of Article 81 of the EC Treaty and Article 53 of the EEA Agreement.

The case was initiated following complaints lodged by the broadcasting group RTL and the UK online music provider Music Choice Europe, which both sought to obtain multi-territorial licences for public performance rights for musical works but were denied such a possibility by the collecting societies.

2. Reciprocal representation agreements signed by collecting societies

Music authors (lyricists and composers) hold the copyright, including public performance rights (3), on the works they have created. They usually sign over to collecting societies the rights to manage on their behalf, worldwide, the copyright on their musical works. This portfolio of rights constitutes the repertoire of the collecting society.

All the European collecting societies are members of the Confederation of Societies of Authors and Composers ('CISAC'). One of the major objectives of CISAC is to promote reciprocal representation agreements among collecting societies by means of model contracts. Based on the CISAC model contract, collecting societies have concluded reciprocal representation agreements for the collective management of the public performance rights of their musical works of their right holders enabling each collecting society to offer on its domestic territory the repertoire of all the artists represented by the other collecting societies participating in the representation agreements. Under this system, each collecting society collects royalties due as a result of exploitation of the rights in its own country, not only for its own members, but also for the authors and publishers abroad who are members of other collecting societies with which it has concluded bilateral representation agreements.

3. The relevant markets

The Commission took the view that as regards the management of public performance rights for musical works three different markets were affected by the reciprocal representation agreements: (a) the market for the provision of copyright administration services to authors, (b) the market for the provision of copyright administration services to other collecting societies and (c) the market for the licensing of public performance rights for satellite, cable and internet transmissions to commercial users.

4. The restrictive clauses contained in the reciprocal agreements

The decision does not challenge the existence of the reciprocal agreements as such, but certain of their clauses and a concerted practice among collecting societies.

4.1. The membership clause

A number of bilateral agreements concluded among collecting societies contain a membership clause under which the contracting collecting societies may not, without the consent of the other, accept as member an author who is either already a member of another collecting society or a national of the territory where the other collecting society operates (4). The membership clause

(1) Directorate-General for Competition, unit C-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.

(2) Case COMP/C2/38.698 — CISAC.

(3) Public performance rights enable authors of musical works to authorise or prohibit the exploitation of their works by commercial users such as TV channels and radio stations, and to receive royalties every time their music is played.

(4) The CISAC model contract also incorporated a mem-

was found to restrict the ability of an author to become a member of the collecting society of their choice or to be simultaneously a member of different EEA collecting societies for the management of his or her rights in different EEA territories. The membership clause has the object and effect of restricting competition between collecting societies on the market for the provision of copyright administration services to authors.

4.2. The exclusivity clause

Under the exclusivity clause, a collecting society authorises another collecting society to licence and administer its repertoire on the territory of the latter on an exclusive basis ([5]). This clause, still present in a substantial number of reciprocal agreements, prevents a collecting society from licensing its own repertoire in other territories (direct licensing) or allowing an additional collecting society to represent its repertoire in the territory of the domestic collecting society ([6]). As a consequence, collecting societies are reciprocally guaranteed a monopoly in their domestic markets to give licences to commercial users (broadcasters and online content providers). The exclusivity clause therefore restricts competition between collecting societies on the market for licensing public performance rights to commercial users.

The infringements relating to the membership and exclusivity clauses concern all forms of public performance rights, including live (discos, bars, concerts), online (internet), satellite, cable and broadcasting.

5. The concerted practice of restricting mandates to domestic territory

The decision also challenges the concerted practice among the 24 collecting societies whereby the collecting societies limit their mandates to the domestic territory of the other collecting societies for internet, satellite and cable exploitation of musical works. All the reciprocal representation agreements contain a clause on the territorial scope of the licence, under which a collecting society located in country A may authorise a collecting society located in country B to licence its portfolio solely within the territory of country B.

The Commission found that the systematic restriction to domestic territory for these three modes of exploitation amounts to a concerted practice because it is not the result of normal competitive conditions. The issue of the territorial restriction of mandates, in particular for new forms of exploitation, has been the subject of multilateral discussions among collecting societies within CISAC. For instance, when the issue of internet use arose, the European members of CISAC coordinated their positions and agreed on the so-called Santiago Agreement ([7]), which was jointly notified for a possible exemption under Article 81(3) of the Treaty. The fact that it was decided not to renew the Santiago Agreement, which resulted in a strict restriction to domestic territories, was an indication that the collecting societies coordinated their behaviour as regards the scope of licences for internet use.

Further, the systematic restriction cannot be explained by individual market behaviour or an alleged need for geographic proximity between licensor and commercial user. Parallel behaviour is strong evidence for a concerted practice, unless there are reasons indicating that market segmentation results from autonomous behaviour ([8]). The decision highlights that local presence is not required to monitor the use of licences for internet, satellite and cable and that collecting societies have the technical capacity to issue multi-territorial licences.

Because of the uniform territorial restriction, each collecting society's authority to licence is limited in that it can only grant access to its portfolio of works for exploitation in its 'domestic' territory (regardless of where the user is located). By including this territorial restriction in all such agreements, the end result is that only one collecting society per country is able to grant multi-repertoire licences for use of the music concerned in that country. This effectively leads to national monopolies for the multi-repertoire licensing of public performance rights and has the effect of segmenting the EEA into national markets. Competition is restricted on two levels: (i) on the market for copyright administration services

bership clause until 2004.

([5]) For example, the application of the exclusivity clause implies that under a reciprocal representation agreement concluded between two collecting societies Y and Z located in two different countries, Z will be the only collecting society authorised in its territory to licence the portfolio of public performance rights owned by Y.

([6]) The CISAC model contract also incorporated an exclusivity clause until 1996.

([7]) The Agreement concerned internet licensing and provided for collecting societies to issue multi-territorial licences. The Commission issued a Statement of Objections in 2004 taking issue with the customer allocation clause, under which collecting societies undertook to issue worldwide licences only to users located in their domestic (i.e. national) territory. The Santiago Agreement expired at the end of 2004 and the parties did not renew it (See Commission press release IP/04/586 of 3 May 2004).

([8]) See on this issue the ECJ court rulings of 1989 in Lucazeau and Tournier (cases 395/87 and joined cases 110/88, 2241/88 and 242/88).

which collecting societies provide to each other; and (ii) on the market for licensing public performance rights for internet, satellite and cable retransmission to commercial users.

6. No exemption under Article 81(3) of the Treaty

The collecting societies did not put forward arguments specifically addressing the application of Article 81(3) of the Treaty to the membership and exclusivity clauses. The decision therefore only assessed how Article 81(3) of the Treaty applied to the concerted practice, which amounts to a systematic territorial restriction to domestic territory.

Under the first condition of Article 81(3) of the Treaty and Article 53(3) of the EEA Agreement, the decision, agreement or practice in question must contribute to improving the production or distribution of products or to promoting technical or economic progress. None of the parties raised the argument that a concerted practice imposing a uniform national territorial restriction on CISAC members contributes to these potential benefits.

Furthermore, the prohibition of a concerted territorial restriction does not call into question the system of reciprocal representation agreements. Even without the restriction, the alleged benefits, in particular national one-stop shops and proper monitoring and reporting, can still be provided. The restriction is consequently not indispensable. In addition, it eliminates competition on the markets for administration of the repertoires of other EEA CISAC members and for the licensing of rights.

7. Failure of a commitment procedure under Article 9

Upon proposals submitted by the parties in March 2007, the Commission considered a commitment procedure under Article 9 of Regulation 1/2003. 18 collecting societies offered to remove the membership and exclusivity clauses from the reciprocal representation agreements concluded with each other. With regard to the territorial restriction, they undertook to grant multi-repertoire, multi-territorial performing right licences for internet services, satellite services and cable retransmission services to each signatory society that fulfilled certain qualitative criteria.

The commitments were market-tested on the basis of the publication of a Notice on 9 June 2007 ([9]). More than 80 observations were submitted. However, market players generally considered that the commitments would not be effective. Given the exceptions and conditions listed in the proposed commitments, nearly no commercial users would have been eligible to obtain a multi-territorial and multi-repertoire licence. Further, some collecting societies who had offered the proposed commitments took the opportunity of the market test to criticise them. It was therefore concluded that the package of commitments was not sufficient to introduce effective competition on the market.

8. Impact of the decision

8.1 More competition to the benefit of authors, collecting societies and commercial users

The implementation of the decision will have a positive impact on the market in several respects. First, the decision will make it easier for authors to select which collecting society(ies) will manage their public performance rights. For instance, a Belgian author will be able to license his or her rights to any collecting society, including SACEM of France or BUMA in the Netherlands, and may decide not to license to the Belgian collecting society (SABAM). This is of interest for authors (irrespective of whether they are local composers or artists with an international audience), because efficiency, quality of services and conditions of membership differ appreciably between collecting societies.

The decision also allows collecting societies to licence their repertoire to more than one other collecting society per territory. For internet, satellite and cable exploitation, the decision improves the chances of commercial users (broadcasters and content providers) being able to obtain a licence covering more than one territory. By opening up the market to more competition between collecting societies, the decision will provide incentives to collecting societies to improve their efficiency and the quality of their services to the benefit of authors and commercial users.

8.2. The decision addresses cultural diversity issues

In line with Article 151(4) of the EC Treaty and the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions, the decision assesses its potential impact on cultural diversity. Cultural diversity in the music sector is not called into question by the decision, both in terms of authors' revenues and the impact on local repertoires, in particular in small countries.

([9]) See press release IP/07/829.

Collecting societies can maintain or introduce models to protect the author's royalties as such and only allow competition in the level of administration fees ([10]). The decision does not affect collecting societies' rights to decide how they distribute royalties between their members and to maintain a system of cross-subsidisation among members — including the offering of social or cultural services — or their right to distribute royalties only on the basis of the actual use of musical works. However, the decision will encourage competition in the level of administration fees charged by collecting societies to authors. It is likely to have a positive impact on authors' income, because it will encourage collecting societies to be more efficient in their management of authors' rights. The more efficient collecting societies are, in terms of maximising the collection of royalties due to authors and composers and minimising the costs of managing these rights (administrative fees), the more revenue will be paid out to authors.

8.3. The decision and the 2005 Recommendation concerning online licensing

The decision is in line with the Commission's practice and policy concerning online licensing and in particular with the 2005 Commission Recommendation on rights management in the online environment ([11]), which advocates that right-holders should be free to choose their rights managers and to choose the scope of the rights managed, irrespective of the residence or nationality of the right-holder. The Recommendation also clearly states that collective rights managers should grant licences to commercial users on the basis of objective criteria and '*without any discrimination among users*', and advocates the introduction of multi-territorial licences. The Recommendation and the present decision are therefore consistent in that they both encourage the removal of anti-competitive barriers impeding right-holders from freely choosing their collecting societies and rights managers from delivering multi-territorial licences.

9. Conclusion

The decision calls upon collecting societies to bring immediately to an end the infringements concerning the membership and exclusivity clauses contained in the representation agreements and to cease the concerted practice within 120 days.

By removing restrictions in the system of bilateral representation agreements between collecting societies, the decision encourages collecting societies to bring their business practices up to speed with the borderless nature of satellite, cable and internet exploitation. It will also provide the necessary guidance to collecting societies by creating the framework for a more competitive market which should benefit authors, collecting societies and commercial users. The Commission will ensure a full and effective implementation of the decision.

([10]) For example, the current country of destination principle as accepted in the Simulcasting Decision of 2002 (Decision 38/014 of 30.04.2003) or agreement on a uniform royalty rate as accepted in the Cannes extension agreement decision of 2006 (Decision 38/681 of 15.11.2007).

([11]) See press release IP/05/1261.

Recent cartel cases — Sodium Chlorate and Aluminium Fluoride

Anna TISSOT-FAVRE, Andrej KRÁLIK, Tiina PITKÄNEN and Petr ŠOCHMAN (1)

In June 2008, the Commission adopted two prohibition decisions against infringements of Article 81 of the EC Treaty and Article 53 of the EEA Agreement and imposed fines totalling some €84 million. In both cases, the product concerned was a specific chemical compound used as a processing agent for the production of further commodities, such as paper pulp (the *Sodium Chlorate* case) and aluminium (the *Aluminium Fluoride* case).

The fines were set in accordance with the Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation (EC) No 1/2003 (2) **('Guidelines on fines').** In setting the amount of the fines, the Commission took account of all the circumstances and in particular the gravity and duration of the respective infringements.

The Sodium Chlorate case

On 11 June 2008, the Commission adopted a prohibition decision and imposed fines totalling €79 million on the Akzo Nobel, Finnish Chemicals, Elf Aquitaine and Uralita groups for operating a cartel in the Sodium Chlorate **('SC')** sector (3). The addressees of the decision participated in a single and continuous infringement of Article 81 of the EC Treaty from September 1994 to February 2000.

The product

SC (chemical formula represented by $NaClO_3$) is a strong oxidising agent manufactured by the electrolysis of a sodium chloride water solution in a diaphragm-less cell. Hydrogen gas is the only by-product. The main raw materials are sodium chloride and water. The largest application (90%) of SC is for the manufacturing of chlorine dioxide, which is used in the pulp and paper industry for the bleaching of chemical pulp. Other applications include drinking water purification, textile bleaching, herbicides and uranium refining. The estimated EEA market value for SC in 1999 was over €200 million. At that time, the four undertakings involved in the infringement had an estimated market share of about 93%, i.e. between €185 and 195 million.

The cartel

The addressees of the decision pursued a strategy of stabilising the SC market with the ultimate aim of dividing SC sales volumes between themselves, coordinating pricing policy towards their customers and thereby maximising their margins. They further attempted to implement the illicit arrangements on the market by means of renegotiating SC prices with their respective customers. Compliance was monitored mostly in bilateral meetings and telephone conversations during which the parties exchanged commercially sensitive information on negotiations with customers, including contracted sales volumes and prices. The cartel covered a significant part of the EEA territory.

The participants usually discussed the total demand for SC in the EEA and made forecasts per country for the upcoming year. The parties tried to assess developments in the market in order to ensure the necessary stability for their planned price increases. Contacts among competitors usually intensified towards the end of each calendar year to reflect the annual negotiations of contracts between SC manufacturers and their customers. Negotiations with customers were often continued at the beginning of the following year.

Fines

In determining the fine, in accordance with Point 28 of the Guidelines on fines, the Commission also took account of the fact that, at the time of the infringement, Arkema France SA **('Arkema'),** a subsidiary of Elf Aquitaine, had already been the addressee of three previous Commission decisions concerning cartel activities. The Commission concluded that this justified an increase of 90% in the basic amount imposed on Arkema for repeated infringement.

The Commission further considered the need to ensure that fines have a sufficiently deterrent effect. In view of the size of Elf Aquitaine's turnover beyond the sales of goods or services to which the infringement relates, the decision increased the fine to be imposed on this undertaking by 70%.

(1) Directorate-General for Competition, Cartels Directorate. 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 210, 1.9.2006, p.2.
(3) Case 38.695

In its decision, the Commission granted full immunity to Akzo Nobel and its subsidiary EKA Chemicals AB under the 2002 Notice on the non-imposition or reduction of fines in cartel cases ([4]) **('the 2002 Leniency Notice').** Finnish Chemicals was granted a 50% reduction of the fines that would have been otherwise imposed for its cooperation with the Commission under the 2002 Leniency Notice. This reduction took account of the added value provided by the evidence submitted by Finnish Chemicals, and of the time at which this evidence was submitted.

The Aluminium Fluoride Case

Another prohibition decision was adopted by the Commission on 25 June 2008. A number of aluminium fluoride producers, namely Boliden Odda S/A (Norway), Fluorsid S.p.A. (Italy), Minmet Financing Company S.A. (Switzerland), Société des Industries Chimiques du Fluor (Tunisia), Industrial Quimica de Mexico S.A. de C.V. and Q.B. Industrias S.A.B. de C.V. (both Mexico), were held liable for infringements of Article 81 of the EC Treaty and Article 53 of the EEA Agreement. During the second half of 2000, the addressees of the decision agreed worldwide target prices and market division. The Commission imposed fines of €4 970 000 ([5]).

The product

Aluminium fluoride **('AlF')** is a chemical compound with the formula AlF_3. Adding AlF to the production process of aluminium lowers the consumption of electricity required in the smelting process and thereby considerably helps to reduce the production costs of aluminium. Energy is a major cost factor in aluminium production. AlF is not substitutable by other products in this respect. Aluminium producers (smelters) are the main users of AlF. The estimated total value of AlF sold on the open market in the EEA for 2000 was approximately €71 600 000.

The infringement

The Commission's decision established that the cartel members organised a meeting in Milan in July 2000 where they agreed on a worldwide target price increase. They looked at various parts of the world, including Europe, to establish a general price level and, in some cases, a market division. The parties agreed that the overall aim was to obtain a higher price level and that they should discourage deep price discounting. They also exchanged commercially sensitive information. In the second half of 2000, the cartel members followed up with bilateral contacts with a view to monitor the implementation of the cartel arrangements agreed in Milan. In doing so, the parties adhered to a common plan, which limited or was likely to limit their individual commercial conduct by determining the lines of their mutual action on the market. They expressed their joint intention and reached a common understanding to operate on the market in a specific way, with the common objective of restricting competition. The agreement reached at the meeting in Milan and the follow-up contacts in the second part of 2000 enabled the cartel members to predict with at least a reasonable degree of certainty what the pricing policy pursued by their competitors would be. Such agreement was capable of distorting the normal formation of prices on the aluminium fluoride market. The infringement lasted from 12 July 2000 to 31 December 2000.

Fines

In setting the fines in accordance with the Guidelines on fines, the Commission also took account of the short duration of the infringement, and of the level of turnover in the aluminium fluoride market that was affected by the cartel.

In the Aluminium Fluoride case, the Commission applied Point 18 of the Guidelines on fines, providing a calculation method for cartels that are geographically wider than the EEA. This method has been applied by the Commission in its Decisions (and confirmed by the European Courts), but it was laid down for the first time in the Guidelines on fines in 2006. Point 18 provides for the relative shares of the cartel members' sales in the geographic area covered by the cartel to be used as a basis to calculate the value of sales in the EEA for each cartel member. The purpose of this is to reflect the weight of each member in the cartel, which would not be taken sufficiently into account were the Commission to base itself only on the EEA turnover of the participants, since the geographic scope of the cartel was wider than the EEA.

Application of the 2002 Leniency Notice

The Commission's investigation was triggered by an application for immunity lodged by Boliden Odda in March 2005. Boliden Odda was the first to inform the Commission of the existence of a cartel. The undertaking also applied to other competition authorities worldwide. In contrast to these other authorities, the Commission was able to uncover contemporaneous evidence in the EEA through its unannounced inspections. Boliden Odda continued to cooperate fully with the Commission throughout the administrative procedure, in accordance with Point 11 of the 2002 Leniency

([4]) OJ C 45, 19.2.2002, p. 3.
([5]) Case 39.180

Notice, and was eventually granted immunity from any fines that would otherwise have been imposed.

Fluorsid was the second undertaking to approach the Commission under the Leniency Notice. Its leniency application was submitted nearly two years after the beginning of the Commission's investigation. The Commission found that the information and evidence provided by Fluorsid did not constitute significant added value within the meaning of Points 21 and 22 of the 2002 Leniency Notice. Accordingly, Fluorsid was not granted any reduction of fines under the Leniency Notice.

Conclusion

The Sodium Chlorate and the Aluminium Fluoride cases illustrate a number of key aspects of the new methodology of calculating fines under the 2006 Guidelines on fines (as opposed to the 1998 Guidelines ([6])). In particular, it is worth noting that by increasing the fine substantially on grounds of repeated infringement in the case of Arkema, the Commission demonstrated its determination to pursue and punish repeat offenders. Similarly, the Aluminium Fluoride decision sends a clear signal that cartel members that achieve smaller sales and are involved in a cartel of short duration should not escape the Commission's scrutiny. Commenting on the Aluminium Fluoride case Commissioner Neelie Kroes said: *'This decision shows that the Commission takes all cartels seriously. Whatever the scope of the affected market, the duration of the cartel or the size of the companies involved, there is no safe haven for those who do not play by the rules.'*

([6]) OJ C 9, 14.1.1998, p.3

Mergers: Main developments between 1 May and 31 August 2008

Mary LOUGHRAN and John GATTI (1)

Introduction

The number of notifications received rose again in this four month period reaching a total of 135, considerably higher than the total for the previous four month period of 114. A total of 119 decisions were adopted. Of these 105 were decisions adopted after a first phase investigation and 69 were decisions according to the simplified procedure. The Commission also adopted 9 conditional clearances in phase I (under Article 6(2)). Four cases were cleared unconditionally under Article 8(1) after a Phase II investigation and one other was cleared subject to conditions (Article 8(2)). In a further case the notification was withdrawn in Phase II. The Commission initiated 5 second phase proceedings the period (Article 6(1) (c)). Finally two decisions were adopted referring cases to the appropriate Member States under Article 4 (4) and one referral was made pursuant to Article 9.

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

Vienna Insurance Group/Erste Bank

On 17 June the Commission decided to approve, subject to conditions, the proposed acquisition by Vienna Insurance Group (VIG) of the insurance subsidiaries of Austria's Erste Bank.

Vienna Insurance Group is an international insurance group based in Austria providing both life and non-life insurance in Austria as well as in Central and Eastern Europe. Erste Bank is Austria's second largest bank. It provides insurance through its subsidiaries s-Versicherung (Austria), BCR Life and BCR Non-Life (Romania), and others in the Czech Republic, Slovakia and Hungary.

Following consultation of a wide range of customers, intermediaries and competitors in all the affected markets, the Commission identified serious competition concerns in relation to life insurance products for pension and investment purposes in Austria, and non life insurance, particularly car insurance, in Romania.

In Austria, the proposed transaction would have given VIG around 40% market share, almost double the size of its nearest competitor, Uniqa. The Commission was particularly concerned by its post-merger strength in the key banking distribution channel, where two out of the three big Austrian retail banks would have distributed VIG's life insurance products almost exclusively. In order to address these concerns VIG undertook to divest Bank Austria Creditanstalt Versicherung AG (BACAV) in Austria and Unita in Romania. The sale of BACAV to competitor Ergo, which until then had only a limited presence on the market, also included the continued distribution relationship to Bank Austria, thereby ensuring that a competitive force would remain on the market.

In Romania, the post-merger position of VIG would have been even more significant, reaching market shares of over 50% for motor liability insurance, over four times that of its nearest competitor. The Commission concluded that its strength across all distribution channels — in-house, agent, broker and bank — would have raised formidable obstacles to competitors. However the divestiture of Unita would fully eliminate the overlap in all the key segments of non-life insurance and would ensure that the rapidly growing Romanian market would continue to benefit from competition, service quality and innovation.

The Commission also looked carefully into the Romanian markets for credit and warranty insurances, but came to the conclusion that the parties would not have any particular market strength after the merger. Aside from the commitments in relation to pharmaceutical product liability insurance received during the examination in 2006 of the acquisition by Talanx of Gerling Versicherungsgruppe, this was the first general insurance case under the EU Merger Regulation to be the subject of remedies.

Rewe Group/ADEG

In June the Commission approved the proposed takeover of ADEG of Austria by the German REWE Group, subject to conditions. Both parties were active on the Austrian retail and wholesale markets for everyday consumer goods. The Commission was concerned that the strength of the combined company in certain Austrian regions could lead to higher prices for everyday consumer

(1) Directorate-General for Competition, units F-4 and B-3. 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.

goods in Austria. During the Commission's preliminary investigation REWE proposed to divest outlets in the relevant regions.

ADEG was jointly owned by ADEG independent merchants' organisation AÖGen, Edeka Chiemgau and by REWE which has a minority shareholding of 24.9%. REWE is active on the Austrian retail market for everyday consumer goods through the retail chains Billa, Penny and Merkur. REWE is the market leader, closely followed by its competitor SPAR Austria. ADEG is a relatively small competitor.

In April 2008, REWE notified its intention to acquire control over ADEG to the Commission. Following the transaction, REWE would own 75% of ADEG, giving it sole control, while AÖGen would retain a minority interest of 25%.

The Commission's initial investigation found that the market shares in Austria would remain moderate following the transaction and that ADEG was not a strong competitive force on the Austrian market. However, during its preliminary investigation, the Commission was not able to exclude serious doubts that the combined strength of REWE and ADEG at the level of several Austrian districts would not result in increased price levels on the national retail market.

In response to the Commission's preliminary findings, REWE offered to sell all ADEG-owned shops in the relevant districts and to encourage ADEG merchants to leave the ADEG network. In the event that too few merchants left the ADEG network, REWE made a commitment to sell certain REWE outlets. This would reduce the presence of the combined entity in the affected regions and therefore remove the Commission's competition concerns.

For a more extensive treatment of this case see the article on page 75 of this Newsletter.

News Corp/Premiere

In June a conditional approval was granted to the proposed acquisition of Germany's pay-TV operator Premiere AG by News Corporation (News Corp) of the US. The approval was granted subject to commitments which would ensure third party access to Premiere's satellite platform.

News Corp is a media company primarily active in the production and distribution of TV programming, TV satellite and cable broadcasting, the development of digital broadcasting, the development of conditional access and subscriber management systems and the creation and distribution of on-line programming worldwide. Premiere operates pay-TV channels to viewers in Germany and Austria. Premiere offers its channels to final customers via its satellite platform and via cable and IP-TV. To encrypt its programmes, Premiere had announced that it would exchange its current conditional access (CA) technology for that of News Corp's subsidiary NDS.

Under current contractual arrangements between Premiere and its third party technical service provider, other pay-TV operators in Germany have access to Premiere's satellite set-top boxes so that consumers owning such set-top boxes can receive not only Premiere's programmes, but also those of Premiere's competitors. In allowing third-party access, the technical service provider is performing a neutral role between Premiere and its pay-TV competitors. The relevant contractual arrangements include, in particular, a sub-licence granted by Premiere to its technical services provider for the encryption of third-party pay-TV operators' programmes with its current CA technology.

Following consultation of a wide range of market players in Germany and Austria, the Commission found that Premiere's switch to the NDS CA system would most likely impede third-party access to Premiere's satellite platform via its technical services provider, thereby strengthening Premiere's dominant position in the German pay-TV market. The Commission's investigation also revealed that the management of the smartcards gives the provider of CA technology the possibility of impeding access by other pay-TV operators.

To address these competition concerns News Corp submitted commitments confirming that the technical services provider would continue to be in a position to grant third party access to Premiere's satellite platform in the same way as before the merger. Specifically, a sublicensing agreement between Premiere and its technical services provider was concluded with regard to NDS' CA technology, and all other rights necessary to give third-party pay-TV operators access to Premiere's satellite platform in Germany would be given to the technical service provider, as well as the necessary hardware to implement the NDS CA system at the head-end of Premiere's satellite platform. In addition the commitments provide for the direct delivery of smartcards by NDS to the technical service provider, sanctioned by appropriate penalties should they fail to comply.

The Commission concluded that the commitments submitted by News Corp were suitable to restore the pre-merger level of third-party access to Premiere's satellite platform and to eliminate the competition concerns identified.

The Commission also carefully looked into possible vertical concerns arising from the combination of News Corp's activities as a provider of audiovisual content and Premiere's activities as an acquirer of such content, but came to the conclusion that the proposed acquisition would be unlikely to deny access to audiovisual content for competitors of the merged entity, mainly because Premiere's competitors would retain several alternative suppliers.

British American Tobacco/Skandinavisk Tobakskompagni

In June conditional approval was given to British American Tobacco's (BAT) proposed acquisition of the cigarette business together with certain roll-your-own tobacco and 'snus' (a type of oral tobacco) interests of the Danish company Skandinavisk Tobakskompagni (STK). The approval was granted subject to the divestment of a number of tobacco brands, primarily in Norway.

BAT manufactures, markets and sells primarily cigarettes and, to a lesser extent, other tobacco products, including cigars, pipe and roll-your-own tobacco throughout the world. The company's range of cigarette brands includes *Dunhill, Lucky Strike, Kent* and *Pall Mall.*

STK is among Denmark's largest international companies. It is the parent company of a number of subsidiaries engaged in the production and sale of tobacco products and pipes and it holds a share in the Tivoli amusement park in Copenhagen. The company's cigarette brands include *Prince, Rockets, Slim Agenda, Camelia, Corner* and *Main.*

BAT proposed to acquire the following STK subsidiaries: House of Prince A/S in Denmark and its subsidiaries in Sweden, Estonia, Latvia, Lithuania, Poland, Czech Republic, Hungary and Greece, J.L. Tiedemanns Tobaksfabrik AS in Norway and Fiedler & Lundgren AB in Sweden.

The target STK would retain activities in roll-your-own tobacco, pipes and pipe tobacco and cigars via a number of other group companies. STK's ownership of the Danish convenience goods company Dagrofa and its shareholding in the Tivoli amusement park were unaffected by the proposed transaction.

The Commission's investigation found competition concerns in the market for cigarettes in Norway, where the merged entity would have a significant market share. The merged entity would also have a dominant position in the relatively large market for roll-your-own tobacco, although the proposed transaction would not lead to any increase in market share given that BAT does not currently sell any tobacco of this type in Norway. The Commission's investigation found that the commercial negotiations for the supply of tobacco in Norway cover all types of tobacco products, such as cigarettes, roll-your-own tobacco and 'snus'. The combination of the merged entity's leading market positions in both cigarettes and roll-your-own tobacco would therefore give it a strong position in sales negotiations with customers.

In order to address the competition concerns identified by the Commission, BAT offered to divest a number of tobacco brands, primarily in Norway. The divestment of these brands, which include Petterøe's and Tiedemanns Rød, would remove the major part of the market share increase that would have resulted from the proposed transaction as initially notified in the market for cigarettes. The divestment of these brands would also reduce the merged entity's share of the roll-your-own tobacco market as some of the brands to be divested are also sold as roll-your–own tobacco products.

The Commission analysed the commitments submitted by BAT and concluded that they would remedy its serious doubts and therefore ensure that effective competition would not be impeded as a result of the proposed transaction.

Hexion/Huntsman

In July the proposed acquisition of Huntsman Corporation by Hexion Specialty Chemicals Inc. was approved subject to conditions.

Both parties to the transaction are US-based chemical manufacturers Hexion, which is owned by the US-based private investment company Apollo Group, produces a range of chemicals and in particular epoxy resins. It manufactures a range of resins that are used primarily in binding, bonding and coating applications, including acrylic, alkyd, amino, epoxy, phenolic and polyester resins.

Huntsman produces a wider range of chemicals, including inter alia epoxy resins. It also produces a diverse range of specialty and intermediate chemicals including polyurethanes, performance products, pigments, epoxy resins and formulated systems, textile dyes and textile chemicals.

The activities of Hexion and Huntsman overlap at all three levels of the epoxy value chain (production of inputs, components and formulated systems) and lead to a number of horizontally and vertically affected markets.

Although the parties would enjoy a high share with respect to the component Bis-F liquid epoxy resins (Bis F-LER), the Commission's market investigation showed that the proposed transaction would not raise horizontal competition concerns. Indeed, the parties would be facing competition from blends containing Bis-F LER and from the substitution of Bis-F LER by other technical alternatives. Furthermore, the market investigation revealed the existence of significant Bis-F LER spare capacity from players already having merchant sales and potential market entry from new players. This is likely to prevent any attempts of the merged entity to increase the price for Bis-F LER. The market investigation concluded for the same reasons that no related concern would arise from the vertical relationships between Bis-F LER and formulated systems for composites used in wind energy applications and electronic applications.

However, the Commission's market investigation showed that the proposed transaction, as initially notified, raised horizontal competition concerns with respect to a number of specialty resins and formulated systems in which the merged entity would hold very high market shares both worldwide and in the EEA.

The Commission also identified vertical concerns for the supply chains (i) from the production of polyetheramines (input) to polyetheramine-based curing agents (component) and further downstream to formulated systems for adhesives and composites used in wind energy applications and composites used in aerospace applications, as well as (ii) for the supply chain from the production of the specialty resins TGMDA and TGPAP to formulated systems used in aerospace applications.

To remove the Commission's concerns, Hexion offered to divest all facilities belonging to its own epoxy resin business at Duisburg (Germany), its facility at Stuttgart (Germany), its facility at Argo (US), its High Performance Resin Unit at Norco (US), as well as R&D assets in Duisburg, Stuttgart and Houston (US), including tangible and intangible assets, such as IPRs, licenses, permits, contracts, brands and personnel. 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.

Lesaffre/GBI UK

In July the Commission gave a conditional go-ahead to the proposed acquisition of GBI UK — GB Ingredients Ltd and BFP Wholesale Ltd engaged in the yeast business and owned by Gilde B.V, by the French yeast manufacturer Compagnie des Levures Lesaffre. The approval was granted subject to the fulfilment of Lesaffre's commitment to divest GBI's yeast production facility in Felixstowe, UK.

Lesaffre is a privately-owned family company, which focuses on three main business areas: yeast, yeast extracts and bakery ingredients. Lesaffre has manufacturing facilities in 26 countries, including France and Belgium.

GBI UK consists of a yeast manufacturing business (GBI) and a wholesale distribution of yeast and bakery ingredients business (BFP) in the UK. Prior to its acquisition by Lesaffre, GBI UK was controlled by GBI Holding International, ultimately controlled by Gilde, a Dutch private equity investor.

The transaction was initially notified to the Office of Fair Trading (OFT), the UK competition authority, as it did not meet the turnover thresholds of the EC Merger Regulation. However, the OFT requested the Commission to examine this concentration pursuant to Article 22 of the Merger Regulation.

The Commission's initial market investigation found that the notified transaction raised competition concerns in the UK market for liquid and compressed yeast. The transaction would have reduced the number of competitors from three down to two in the UK with respect to both liquid and compressed yeast. Lesaffre and ABF would remain the only suppliers of yeast in the UK and it is unlikely that other suppliers would have the ability and incentive to enter the market. To remove the Commission's concerns, Lesaffre offered to divest GBI's yeast production facility in Felixstowe, UK. The Commission concluded that such a divestment was suitable to address the competition concerns initially identified in the market investigation.

Nordic Capital/ConvaTec

In July the Commission cleared the proposed acquisition of ConvaTec of the US by Nordic Capital of Jersey, the Channel Islands. The Commission's decision was conditional upon the commitment by Nordic Capital to divest its entire wound care business as well as its ophthalmic needles business both located at the Redditch site.

Nordic Capital is a private equity company which controls *inter alia* Unomedical, which is active in advanced wound care products, urinary incontinence products and other hospital care products. ConvaTec, a wholly owned business unit of Bristol-Myers Squibb, is a producer of advanced wound care products, ostomy products and products for acute faecal incontinence.

The parties' were both producers of advanced wound care products, in particular for alginates (seaweed-based moisture-absorbing wound care products). The Commission's initial investigation showed that this would raise competition concerns in the United Kingdom, where the proposed transaction would combine the two largest players in the alginates market resulting in very high combined market shares. All other competitors had small or very small market shares.

To remove the Commission's concerns, Nordic Capital offered to divest Unomedical's entire wound care business and also its ophthalmic needles business, both located at the Redditch site. After market testing the proposed remedies the Commission concluded that they would adequately address the competition concerns initially identified in its market investigation.

Pernod Ricard/V&S Vin & Sprit

In July clearance was granted to Pernod Ricard's proposed acquisition of the Swedish state-owned company V&S Vin & Sprit (V&S).

Pernod Ricard is a publicly quoted French company active in the production and distribution of alcoholic beverages on a worldwide basis. Its main brands include *Chivas Regal, Ballantine's* and The *Glenlivet Scotch* whiskies, *Jameson* Irish whiskey, *Beefeater* gin, *Havana Club* rum, *Martell* cognac, *Jacob's Creek* and *Montana* wines and *Mumm* champagne.

Pernod Ricard currently distributes the vodka brands *Stolichnaya and Moskovskaya* which are owned by the SPI Group. Pernod Ricard has announced that its proposed acquisition of V&S would result in the termination of the *Stolichnaya and Moskovskaya* distribution agreements although Pernod Ricard would continue to distribute the brands during a short transitional period until SPI identified a new distributor.

V&S is also active in the production and distribution of alcoholic beverages. Its most famous international brand is *Absolut* vodka but it also distributes a range of other spirits, such as *Aalborg Aquavit* and *Gammel Dansk* bitter, as well as wines primarily in northern Europe.

The Commission's investigation identified competition concerns in a number of national markets where the merged entity would have a strong market position. These concerns related to the market for aniseed flavoured spirits in Finland, vodka in Greece, gin in Poland and Sweden and cognac, port and Canadian whisky also in Sweden.

In order to address the competition concerns identified by the Commission, Pernod Ricard offered to divest its businesses conducted under the following brands: *Dry Anis* in Finland, *Serkova* vodka in Greece, *Lubuski* gin in Poland and *Star Gin, Red Port* and *Grönstedts* cognac in Sweden. In the case of Canadian whisky in Sweden, Pernod Ricard also undertook to discontinue the distribution of a third party's brand, *Royal Canadian*. As a result of these commitments, the proposed transaction would not lead to any increment in the market share of the merged entity in any of the markets concerned.

The Commission analysed the commitments submitted by Pernod Ricard and concluded that they would remedy its serious doubts and therefore ensure that effective competition would not be impeded as a result of the proposed transaction.

The Commission also examined the potential effects on competition arising from the combination of Pernod Ricard and V&S' broad portfolios of alcoholic beverages. The Commission concluded that as there were other companies in the drinks sector, often with one or more strong brands of their own, the merged entity would not be able to restrict its competitors' access to the market or engage in other practices likely to harm consumers.

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

STX/Aker Yards

In May the Commission approved the proposed acquisition of control of the Norwegian shipbuilder Aker Yards by STX of South Korea. After an in-depth investigation, launched in December 2007 the Commission concluded that effective competition on the shipbuilding markets would not be significantly impeded as a result of the proposed transaction.

Aker Yards is active in the construction of cruise ships and ferries, and also builds merchant vessels and offshore vessels. It is one of the three main players on the global market for the construction of cruise ships, together with Fincantieri (Italy) and Meyer Werft (Germany).

STX is a Korean shipbuilder mostly active in building various types of cargo vessels, such as container ships or gas tankers.

On 20 December 2007, the Commission opened an in-depth investigation because of concerns that the proposed merger might, in particular, remove STX as a potential new market entrant into a concentrated cruise ship manufacturing market.

The Commission's in-depth investigation of the proposed transaction has however dispelled the initial doubts. The Commission found that by itself STX was still far from close to becoming an effective competitive constraint on the existing cruise ship construction market. The in-depth investigation also showed that STX was not the only possible market entrant and that post-merger a number of other Far-East shipbuilders would be as equally well placed as STX to enter the market.

The Commission also examined a concern brought forward by a third party related to subsidies, that South Korea might have granted or might grant in the future to the merged entity and that might enable the latter to undercut prices and monopolise the cruise ship market.

The Commission found that, regardless of whether any of the financial instruments granted to STX in the past were subsidies, the current financial position of STX would not give the merged entity a dominant position.

In addition, the Commission found no evidence indicating that STX was likely to receive subsidies in the future which could significantly strengthen its financial position and enable it to impede competition in the markets concerned.

In particular, the Commission found that even if the type of future hypothetical subsidies identified by the third party (subsidised loans and guarantees) were granted, the advantage would not be such as to enable the merged entity to acquire a dominant position on the cruise ship market. This was because:

(i) the current financial position of STX would not give the merged entity a dominant position

(ii) Aker Yards was also not currently dominant, as it competes with the market leader Fincantieri and with Meyer Werft

(iii) there were a number of structural features of the market such as the buyer power of a few large customers, that would make very unlikely any attempt by STX to monopolise the cruise ship construction market based on the alleged subsidised pricing in the current market structure.

The Commission therefore concluded that competition on the market for cruise ships would not be reduced as a result of the transaction. The Commission also analysed the ferries market, where similar concerns were raised, and came to the same conclusion.

The in-depth investigation also confirmed that there were no competition concerns arising from minor overlaps of the merging companies' activities in the area of certain types of cargo ships or from the vertical integration of STX into engine production or shipping services.

TomTom/Tele Atlas

In May the Commission approved the proposed acquisition of Tele Atlas by TomTom, both of the Netherlands. Tele Atlas is a provider of navigable digital maps and TomTom produces portable navigation devices (PNDs — often known as satellite navigation devices or SatNavs).

Tom Tom provides navigation software and PNDs, where it is the market leader in the EEA. Tele Atlas is one of two providers of navigable digital maps offering a complete coverage of Europe and North America. Navigable digital maps are essential inputs for PNDs.

On 2 October 2007, TomTom launched a public bid to purchase all shares in Tele Atlas. The proposed transaction was notified to the Commission on 22 October 2007. On 28 November 2007 the Commission opened an in-depth investigation.

The Commission's in-depth investigation assessed whether the vertical integration of Tele Atlas into TomTom would lead to a significant impediment of competition within the EEA, in particular in the light of the duopoly market for navigable digital maps (Tele Atlas and Navteq) and TomTom's strong position on the market for PNDs.

The Commission conducted its analysis in line with its recently adopted guidelines on the assessment of non-horizontal mergers. It focused on the ability and incentives of the merged company to increase the costs of other PND manufacturers for navigable digital maps or to limit their access to these maps, and on the impact any of these strategies might have on PND consumers.

On the basis of its in-depth investigation, the Commission found that the merged company would be unlikely to pursue these strategies because its ability to restrict access to digital maps for other PND manufacturers would be limited by the presence of an upstream competitor, Navteq. In addition, the merged company would have no incentive to restrict access to digital maps because the sales of digital maps lost by Tele Atlas would not be compensated by additional sales of PNDs. The Commission's analysis also took into account the efficiencies that are likely to be generated by the proposed transaction. As a result, the Commission concluded that the proposed concentration would not raise competition concerns.

For a more extensive treatment of this case and the Nokia/NAVTEQ case see the article on page 70 of this Newsletter.

Nokia/NAVTEQ

In July the Commission approved the proposed acquisition of NAVTEQ of the US by Nokia of Finland. NAVTEQ is a provider of navigable digital map databases and Nokia mainly produces mobile telephones.

Nokia is the largest manufacturer of mobile telephones in the world. NAVTEQ is one of two providers of navigable digital map databases offering a complete coverage of Europe and North America. Navigable digital map databases are essential inputs for navigation applications on mobile telephones.

On 1 October 2007, Nokia announced the acquisition of all shares and outstanding options in NAVTEQ. The proposed transaction was notified to the Commission on 19 February 2008. On 28 March 2008, the Commission opened an in-depth investigation to assess whether the vertical integration of NAVTEQ into Nokia could lead to a significant restriction of competition within the EEA, in particular with regard to the duopoly market for navigable digital map databases (NAVTEQ and Tele Atlas being the only suppliers) and Nokia's strong position on the market for mobile telephones.

The Commission's analysis was in line with its Guidelines on the assessment of non-horizontal mergers and its recent decision concerning the merger between TomTom and Tele Atlas, the other supplier of navigable digital map databases. The Commission focused on the merged firm's ability and incentives to raise competitors' costs by increasing the price of navigable digital map databases. Moreover, the Commission analysed the merged company's incentives to limit competitors' access to such databases. Finally, the possible impact of such a restrictive strategy on competitors and end-consumers was carefully assessed.

On the basis of the in-depth economic analysis carried out during its investigation, the Commission concluded that the merged company would be unlikely to pursue a strategy of closing off competitors. The merged firm's ability to deny competitors access to map databases is limited by the presence of the other competitor, Tele Atlas. In addition, the merged company would lack incentives to close off supplies of digital map databases to its competitors because a loss in sales of maps would not be compensated by increased sales of mobile telephones. Other mobile phone manufacturers could still compete with Nokia by working together with independent developers of navigation applications or by developing other features of their handsets. As a result, the Commission concluded that the proposed concentration would not raise any competition concerns.

For a more extensive treatment of this case and the TomTom/Tele Atlas case see the article on page 70 of this Newsletter.

Itema/BarcoVision

In August the Commission approved the proposed acquisition of BarcoVision of Belgium by the Italian company Itema. Itema produces textile machinery while BarcoVision manufactures sensors and other inputs for the textiles industry.

Itema is active in the production and sale of machinery for textile manufacturing. Itema is one of the three main companies supplying textile mill owners with winders, which are machines used to stock yarn before it is woven or knitted.

BarcoVision focuses on the production and sale of sensors for textile machinery as well as software systems specifically designed for the textile industry. BarcoVision is one of the two main companies currently producing sensors for winders, an essential component of the winder to ensure yarn and textile quality.

On 14 April 2008, the Commission opened an in-depth investigation to assess whether the new entity would be likely to stop supplying competing winder manufacturers with sensors, thereby raising the prices of winders for textile mills.

The Commission's analysis is in line with its Guidelines on the assessment of non-horizontal mergers. It mainly focused on the merged company's incentives to stop selling sensors to competitors — effectively withdrawing from the sensor market in order to raise its competitors' costs. The Commission concluded that such a strategy would not be profitable for the merged company: the additional profits made on the winder market would not compensate the losses incurred on the sensor market by refusing to sell to competitors. The Commission also assessed the incentives of the other main supplier of sensor to increase sensor prices following the merger and concluded that the merged firm's ability to raise competitors' costs will be limited. In addition, competitors on the winder market are able to start in-house production of sensors in the medium term and this would further constrain the sensor suppliers' behaviour. As a result, the Commission concluded that the proposed concentration did not raise any competition concerns.

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

Arjowiggins/M-Real Zanders' Reflex paper mill

In June the Commission approved the proposed takeover of the Reflex paper production mill in Germany that currently belongs to the Finnish paper manufacturer M-Real, by the French paper manufacturer Arjowiggins, subject to conditions. In December 2007 the Commission opened an in-depth investigation into the proposed takeover because of competition concerns, particularly on the market for carbonless paper. In the light of the Commission's concerns, Arjowiggins offered to divest M-Real's carbonless paper business.

Arjowiggins, a subsidiary of Sequana Capital (formerly known as Worms & Cie), is one of the world's largest manufacturers of specialty paper, mainly graphic or creative paper, communication paper, including carbonless copy paper, and security and technology paper (for example, paper used to print banknotes).

Reflex is a paper production mill located in Düren, Germany. It is owned by M-Real Zanders GmbH of Germany, which is controlled by M-Real, a subsidiary of the Finnish forest industry group Metsäliitto. The Reflex paper mill manufactures a range of specialty papers including carbonless (auto copy) paper, digital imaging paper, tracing paper used for industrial and graphic purposes, and premium fine paper.

In October 2007, Arjowiggins notified its intention to acquire the Reflex paper mill to the Commission. During its initial investigation, the Commission identified serious concerns with regard to competition on the market for carbonless paper.

During its in-depth investigation, the Commission received market information from numerous customers and competitors of Arjowiggins and analysed extensive quantitative transaction data. An analysis of this information led the Commission to conclude that there was a serious risk that the proposed transaction, as originally notified, would significantly harm competition in the market for carbonless paper in the EEA. The Commission was concerned that Arjowiggins would have obtained a very high market share in this already concentrated market, which would have enabled it to restrict the quantity of paper available in the market and thereby raise prices.

In response to the Commission's findings, Arjowiggins offered to divest the carbonless paper businesses at the Reflex paper mill, which accounts for the bulk of the plant's production. The assets and trademarks relating to tracing paper and premium fine paper, where the Commission found that competition would not be harmed, are not concerned by the commitment. Arjowiggins may finalise the transaction only after the divestiture commitments have been fulfilled. The Commission found these commitments suitable to remedy its initial concerns.

D — Summaries of decisions taken under Article 9

REWE/Plus Discount

In July, following a request of the Czech Competition Authority under the EC Merger Regulation, the Commission decided to refer the acquisition of Plus Discount (Czech Republic) by REWE (Germany) to the Czech Competition Authority for examination. The Commission decided to refer the case in its entirety as it considered the proposed concentration would affect competition only in the Czech Republic.

REWE is active in food and non-food wholesale and retail, travel and tourism in a number of European countries. In the Czech Republic, REWE operates under the brand names 'Penny' (171 discount shops) and 'Billa' (181 stores in the full-range supermarket segment). Plus Discount is active in the Czech Republic in the retail of daily consumer goods and operates 146 discount shops under the brand name 'Plus'. The main horizontal overlaps between REWE and Plus Discount relate to the retail market for daily consumer goods through modern distribution channels (hypermarkets, supermarkets and discounters) in the Czech Republic.

The Czech Competition Authority requested the Commission both under Article 9(2) (b) and under Article 9(2) (a) of the EC Merger Regulation to refer the notified transaction to it. It considered that the transaction would affect competition in a number of local retail markets within the Czech Republic, which present all the characteristics of distinct markets and which do not constitute substantial parts of the common market (9(2)(b)). In addition, the Czech Competition Authority submitted that the transaction would threaten to significantly affect competition within distinct markets in the Czech Republic (9(2) (a)).

The Commission found that the conditions for referral under Article 9(2) (a) were met and left open whether conditions for referral under Article 9(2) (b) are fulfilled. When the conditions under Article 9(2) (a) are met, according to Article 9(3), the Commission has discretion to refer the part of the case relating to the affected distinct markets concerned. The Commission considered that due to the local character of the retail markets in the Czech Republic, the Czech Competition Authority was better placed to investigate the impact of the concentration.

For efficiency reasons and in order not to split the proposed transaction, the Commission decided to refer the case in its entirety to the Czech Republic. This included the remaining local retail markets and procurement markets for daily consumer goods.

Digital maps go vertical: TomTom/Tele Atlas and Nokia/NAVTEQ

Carles ESTEVA MOSSO, Michal MOTTL, Raphaël DE CONINCK and Franck DUPONT (1)

The Commission recently issued decisions in two vertical merger cases in the satellite navigation industry. In October 2007, TomTom notified the Commission of its acquisition of Tele Atlas. Four months later Nokia notified its acquisition of NAVTEQ. Both of these cases are important from a policy point of view. TomTom/Tele Atlas and Nokia/NAVTEQ are the first purely vertical second phase investigations after the adoption of the non-horizontal merger guidelines. They provide guidance on how the Commission is going to apply the non-horizontal merger guidelines in future cases, in particular in situations where there is a duopoly upstream and where both upstream players integrate vertically in a short period.

I — Digital map suppliers went for vertical integration simultaneously

Transactions

On 22 October 2007, TomTom N.V. ('TomTom', the Netherlands) notified the Commission of its acquisition of Tele Atlas N.V. ('Tele Atlas', the Netherlands) (2). A few months later, on 19 February 2008, Nokia Corporation ('Nokia', Finland) notified the Commission of its acquisition of Navteq Corporation ('NAVTEQ', USA) (3).

The **two transactions** were put together almost simultaneously. They resulted in the vertical integration of the navigable digital map providers Tele Atlas and NAVTEQ. Both purchasers, TomTom and Nokia, embed digital maps in the devices they manufacture in order to provide their customers with navigation solutions.

Tele Atlas and NAVTEQ are providers of navigable digital maps. They supply manufacturers of PNDs (Portable Navigation Devices), car manufacturers, navigation software producers, mobile handset manufacturers and location web companies (for instance, Google Maps) with the digital maps they need to operate navigation solutions. Other digital map suppliers are active on the market, but their product lines are not comparable to Tele Atlas or NAVTEQ's. They are not in a position, in particular, to provide similar geographic coverage and cannot offer sufficient functionalities, resulting in digital maps that are unsuitable for advanced navigation functions such as car navigation.

TomTom is a manufacturer of PNDs and a supplier of navigation software for use in navigation devices. It is the European leader in the PND market, way ahead of its competitors, Garmin, Mio Tech & Navman. Its activities as a supplier of navigation software to third parties are limited.

Nokia provides equipment, solutions and services for electronic communications networks. The company is principally known as a manufacturer of handsets for mobile telephony ('mobile handsets'). It also intends to develop mobile online services via its 'OVI' portal. Nokia is the world's largest supplier of mobile handsets, its main competitors being Motorola, Samsung and Sony Ericsson. The share of mobile handsets to incorporate navigation possibilities via the inclusion of a GPS chipset is expected to increase dramatically in the short term, and to account for considerably more than 50% of the mobile handset market within a few years.

Vertically affected markets

A digital map is a compilation of digital data and typically includes (i) geographic information containing the position and shape of each feature on a map, (ii) attributes containing additional information associated with features on the map (e.g. street names, addresses, driving directions, turn restrictions and speed limits) and (iii) display information. In addition to the core database, several layers of add-on information are provided by the suppliers of digital map databases. Maps are said to be navigable when they include sufficient functionalities to provide navigation services, such as real-time turn-by-turn navigation.

In both cases, the Commission considered the relevant upstream market to be the market for navigable digital map databases, where only Tele Atlas and Navteq are active, with market shares of approximately 50% each. Navigable digital map databases are one of the key structural components of dedicated navigation devices and other navigation applications. The relevant geographic

(1) Directorate-General for Competition, unit C-5. 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) COMP M.4854 *TomTom/Tele Atlas*.
(3) COMP M.4942 *Nokia/Navteq*.

market for the provision of navigable digital map databases was considered to be worldwide since geographic data can be sold to customers anywhere around the world and the transportation costs and other barriers to trade are minimal. The Commission also established that entry in this market was unlikely in the short- to mid-term.

In the *TomTom/Tele Atlas* case, the downstream markets affected were the market for PNDs and the market for the provision of navigation software. This type of navigation software can be sold to PND manufacturers, but also to mobile handset manufacturers, Mobile Network Operators (MNOs), or directly to end-customers for self-installation in their mobile handsets.

In the *Nokia/NAVTEQ* case, the downstream markets affected were the market for mobile handsets, and the market for the provision of navigation applications on mobile handsets (including on-board, off-board and hybrid solutions).

In both cases, PNDs and mobile phones with GPS were not considered to be part of the same product market. The market investigation revealed that there are significant differences between the two types of devices. Whereas the latest mobile phones are ultra-portable multi-function communication devices, PNDs are primarily designed for navigation. This is reflected in the larger screen sizes of PNDs and the fact that, with some exceptions, they do not offer the wide range of functions common in most smart phones. Consumers use mobile phones mostly for communication and PNDs mostly for navigation. However, the Commission did not exclude that, as technology evolves, both markets will increasingly converge.

II — Assessment of vertical foreclosure theory

Theory of vertical foreclosure

In both cases, the merger led to the vertical integration of one of the two suppliers of navigable digital maps to the downstream competitors of the purchaser. Both transactions therefore raised potential concerns of input foreclosure. Nevertheless, the two transactions had only a limited impact on each other in terms of competitive assessment, as TomTom and Nokia are essentially active in different downstream markets.

The theory of harm raised under *Tom Tom/Tele* Atlas was that the merged entity could foreclose its downstream competitors in the PND market and in the navigation software market, either via an increase in the price of its navigable digital maps, via a degradation of the map quality or via total foreclosure. Such strategies would strengthen the market power of the other supplier of navigable digital maps, namely NAVTEQ, which would, as a result, be likely to increase its prices. The theory of harm raised under *Nokia/NAVTEQ* was similar. The Commission found that the merged entity could attempt to foreclose its downstream competitors in the mobile handset market and in the market for the provision of navigation applications on mobile handsets.

In both cases, the theory of harm relied on the increase in market power of the remaining supplier of navigable digital maps, which was not party to the transaction, and its capacity to increase its prices. The Commission's assessment of the likelihood that such a theory of harm would materialise was based on the Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings ('the non-horizontal merger guidelines'). The Commission analysed the ability and in particular the incentive of the merged entities to foreclose their downstream competitors, as well as the overall effect in downstream markets.

Assessment — lack of incentive

In *TomTom/Tele Atlas,* the Commission concluded that the merged entity would have the ability to increase prices or degrade quality/delay access for some PND manufacturers and navigation software providers competing with TomTom. This conclusion was based on the following factors: (i) navigable digital maps are an essential input for PNDs and navigation software; (ii) it is unlikely that a market entrant could produce navigable digital maps in the short term; and (iii) the foreclosure strategy by one digital map database supplier could increase the market power of the other.

Conversely, in *Nokia/NAVTEQ* the Commission did not reach any conclusion with regard to the ability of the merged entity to foreclose its downstream competitors, for instance because navigation applications in handsets are only one application among others (video, mobile TV, music, design, etc.) and therefore constitute only one of the numerous factors triggering the purchase reflex of customers. The question whether the merged entity has the ability to foreclose was therefore left open.

In both cases, the Commission concluded that the merged entities would not have the **incentive** to foreclose their downstream competitors. Post-merger, TomTom and Nokia will look at how the sales of map databases to their downstream competitors affect their profits not only upstream via sales of Tele Atlas or NAVTEQ maps, but also on their respective downstream markets. Therefore, when considering the profitability of an input foreclosure strategy, the merged entities face a trade-off between the profit lost in the upstream market due to a reduction of input sales and the profit gained on their respective downstream markets by raising their rivals' costs.

The Commission conducted an in-depth qualitative and quantitative analysis ([4]) to assess the incentive of TomTom and Tele Atlas, and of Nokia and NAVTEQ, to foreclose their competitors in their respective downstream markets. The analysis led to the conclusion that, although the profits obtained by selling a PND (for TomTom) or a mobile handset (for Nokia) are much higher than the profits from the sale of a map database, neither merged entity would have the incentive to foreclose its downstream competitors.

In *Nokia/NAVTEQ,* for instance, the economic analysis conducted by the Commission concluded that, under a foreclosure strategy, the merged entity would only capture relatively limited sales downstream by increasing map database pricing to Nokia's competitors and the loss of revenue due to decreasing sales of map databases would not be replaced by additional sales of mobile handsets. A similar conclusion was reached in *Tom Tom/Tele Atlas* as regards limited additional sales of PNDs.

The Commission finally analysed the **effects of the merger in the downstream markets,** although it was not necessary as it had already concluded that the merging parties had no incentive to foreclose their competitors. In both cases, the Commission concluded that the effects would be relatively limited, in particular because the low percentage of the price of a map database in the PND or mobile handset prices, the evidence regarding limited pass-through, the limited switching costs and the competition with the other navigable digital map supplier all tended to limit the price increase that could be imposed by either Tele Atlas or NAVTEQ on their downstream competitors and eventually on consumers.

In addition, in *TomTom/Tele Atlas* the parties claimed that the transaction would bring about efficiencies. Whereas the Commission did not come to any conclusion on the merger specificity of the alleged efficiencies, which would allow the merged entity to make better maps in less time, it found that the alleged removal of double marginalisation was plausible and merger-specific.

Finally, the Commission declared both concentrations compatible with the Common Market and the EEA Agreement.

III — Impact on the application of the Non-horizontal Merger Guidelines

Both *TomTom/Tele Atlas* and *Nokia/NAVTEQ* have been examined by strict application of the non-horizontal merger guidelines. Point 29 of the non-horizontal merger guidelines formed the backbone of the theories of harm raised within the market investigations:

> 'A merger is said to result in foreclosure where actual or potential rivals' access to supplies or markets is hampered or eliminated as a result of the merger, thereby reducing these companies' ability and/or incentive to compete. Such foreclosure may discourage entry or expansion of rivals or encourage their exit. Foreclosure thus can be found even if the foreclosed rivals are not forced to exit the market: It is sufficient that the rivals are disadvantaged and consequently led to compete less effectively. Such foreclosure is regarded as anti-competitive where the merging companies — and, possibly, some of its competitors as well — are as a result able to profitably increase the price charged to consumers.'

An important aspect of the theory of harm was the existence of a duopoly in the market for digital map databases. The issue was therefore not only that downstream players could be foreclosed by the vertically integrated entity, but also that the market power of the remaining upstream player could be increased following the transaction. The non-horizontal merger guidelines indicate that, when competition in the input market is oligopolistic, a decision of the merged entity to restrict access to its inputs reduces the competitive pressure exercised on remaining input suppliers, which may allow them to raise the input price they charge to non-integrated downstream

([4]) In order to make an empirical assessment of whether an input foreclosure strategy would be profitable for the merged entity, the Commission conducted in each case an econometric demand system estimation of the relevant downstream market. In particular, a nested logit model was estimated using retail data covering monthly sales and volumes at stock-keeping unit level, and specific product characteristics were used as instruments to control for endogeneity. Using the estimated downstream own- and cross-price elasticities, together with industry data on prices and margins, the Commission then calculated in each case the critical price increase by the upstream competitor that would make a foreclosure strategy profitable for the merged entity. The Commission conducted numerous robustness checks in each case, concerning in particular the choice of instruments, the size of the outside good and the nest structure.

competitors (5). In essence, input foreclosure by the merged entity would expose its downstream rivals to non-vertically integrated suppliers with increased market power. For example, competitors of TomTom would have to buy from NAVTEQ, the only other supplier not integrated with a PND manufacturer.

In addition, in *TomTom/Tele Atlas* a number of third parties expressed a concern that the merged entity could use the confidential information obtained from the customers of the upstream map-making arm of the company to improve the competitive position of the downstream device-making arm. With regard to the question of confidentiality, the Commission based its findings on Point 78 of the non-horizontal merger guidelines, which addresses the issue of how access to confidential information could lead to competitive harm. *'The merged entity may, by vertically integrating, gain access to commercially sensitive information regarding the upstream or downstream activities of rivals. For instance, by becoming the supplier of a downstream competitor, a company may obtain critical information, which allows it to price less aggressively in the downstream market to the detriment of consumers [...]. It may also put competitors at a competitive disadvantage, thereby dissuading them to enter or expand in the market.'*

Companies contacted during the investigation indicated that they pass sensitive information on to Tele Atlas about their future conduct (prices, promotions, innovations), *inter alia,* in order to obtain better prices, ask for new map features or incorporate features developed by third parties, as well as to introduce innovative service concepts or penetrate new geographic markets.

The access by TomTom to confidential information supplied by customers to Tele Atlas may have two effects. On the one hand, TomTom will know what the competition is planning. This advance knowledge might allow it to compete less intensely. On the other hand, TomTom's competitors might choose not to purchase maps from their competitor. The merger might therefore significantly strengthen the market power of NAVTEQ, which would increase its ability to increase prices. As described in the following section, the Commission found that the merged entities in both cases would not have the incentive to degrade the quality of the product by, for example, leaking confidential information.

(5) Non-Horizontal Merger Guidelines, Point 38.

Incentive — vertical foreclosure

In examining the likelihood of the theories of harm raised during the market investigation actually materialising, the Commission focused in particular on the incentive of the parties to foreclose their downstream competitors. It is of interest to analyse how the criteria set out in the non-horizontal merger guidelines in relation to the incentive to foreclose access to inputs were addressed, and what conclusions can be drawn for future cases in this respect.

Point 40 of the non-horizontal merger guidelines states:

> *'The incentive to foreclose depends on the degree to which foreclosure would be profitable. […]. Essentially, the merged entity faces a trade-off between the profit lost in the upstream market due to a reduction of input sales to […] rivals and the profit gain, […], from expanding sales […].*

The non-horizontal merger guidelines provide guidance in assessing the incentive that the merged entity may have to foreclose its downstream competitors, by pointing to the main factors affecting this trade-off. These factors are discussed below, together with their relevance to both cases.

1. Upstream and downstream margins — Point 41 — *'[…] the lower the margins upstream, the lower the loss from restricting input sales. Similarly, the higher the downstream margins, the higher the profit gain from increasing market share downstream'.* In both cases, the percentage gross margins are higher upstream than downstream, since digital maps have very low marginal costs. In absolute terms, however, the gross margin achieved when selling a PND or a mobile handset with navigation functionalities can be 10 to 20 times higher than the gross margin achieved on the sale of a map, since maps make up a small percentage of the price of the downstream products.
2. Downstream demand likely to be diverted away from foreclosed rivals — Point 42 — *'The incentive […] further depends on the extent to which downstream demand is likely to be diverted away from foreclosed rivals.'* This refers to the own-price elasticity of rivals' demand, which was estimated econometrically in both cases, but also to the extent to which the price of the rivals' downstream product is expected to increase if the merged entity were to adopt an input foreclosure strategy. The guidelines state that *'[t]he effect on downstream demand will also be higher if the affected input represents a significant proportion of downstream rivals' costs or if the affected input represents a*

critical component of the downstream product.' In both cases, maps make up a small portion of the downstream product price, which means that map prices would have to increase very substantially to have a significant impact on downstream demand. One difference between the two cases is that, while in TomTom/Tele Atlas navigable maps were considered to be a critical component of portable navigation devices, in Nokia/Navteq navigable maps were not considered to be a critical component for handsets. Indeed, navigable digital maps are needed for navigation applications, but mobile handsets can also be sold without such navigation applications and other features of the mobile handset are equally important (mobile TV, music, camera, etc.). Even in the TomTom/Tele Atlas case, however, given the presence of Navteq in the upstream market, a foreclosure strategy could only lead to an increase of the input price, which would be likely to have limited effects downstream given the small share of the input cost in the total price.

3. Share of diverted downstream demand likely to be captured by the merged entity. — Point 42 — The guidelines further state that *'[t]his share will normally be higher the less capacity constrained the merged entity will be relative to non-foreclosed downstream rivals and the more the products of the merged entity and foreclosed competitors are close substitutes.'* In both cases, capacity constraints would not limit the downstream sales that could be captured by the integrated companies. Indeed, both Tele Atlas and NAVTEQ develop and update an original version of their digital map, which can be duplicated without any technical, legal or price restriction. With this point in mind, the extent to which the merged entity would capture sales from its downstream rivals was estimated econometrically in both cases. In particular, it was found that, on the basis of the estimated cross-price elasticities, the integrated companies would gain relatively limited sales from their downstream competitors by increasing their map prices.

4. Downstream market share — Point 43 — *'The incentive to foreclose actual or potential rivals may also depend on the extent to which the downstream division of the integrated firm can be expected to benefit from higher price levels downstream as a result of a strategy to raise rivals' costs. The greater the market shares of the merged entity downstream, the greater the base of sales on which to enjoy increased margins'.* In both cases, the merged entities have large market shares on their respective downstream markets. Indeed, TomTom is the leader on the PND market in Europe, far ahead of Garmin. Similarly, Nokia is the world leader in the market for mobile handsets, far ahead of Motorola.

It is remarkable to observe that, in both cases, several of the issues discussed above tend to make the incentive to foreclose more likely. However, a mere checklist interpretation of the guidelines would not be productive, as some factors invariably make the incentive to foreclose more likely while others make it less likely. Instead of relying on a checklist, the Commission therefore conducted a detailed empirical assessment of the profit trade-off described in the guidelines, and concluded that in both cases the parties would not have the incentive to foreclose their downstream competitors. In *Nokia/NAVTEQ*, for instance, the Commission estimated that a foreclosure strategy could only be profitable for the merged entity if Tele Atlas increased its prices by more than 200% as a result. Such a price increase was found to be unrealistic, and in addition NAVTEQ may have an economic interest to undercut Tele Atlas with price increases well below 200%. A similar conclusion was reached in the *TomTom/Tele Atlas* case. Key characteristics limiting the incentive to foreclose in both cases are the small percentage of the input cost with respect to the price of the downstream product, and the presence of a second input supplier in the upstream market that is not vertically integrated in the same downstream markets.

The decisions show the willingness of the Commission to examine all factors mentioned in the guidelines, pointing both to harm and to the absence of any harm. In both cases, the Commission concluded that, on balance, the merged entity would not have any incentive to foreclose its competitors. While the Commission would be likely to apply a similar analysis to other markets with comparable characteristics, it is important to keep in mind that each case is specific and therefore needs to be assessed on its own merits.

Rewe/Adeg — Food for thought — Austrian markets for daily consumer goods

Michael KÖNIG, Yvonne SIMON, Emmanuel TERRASSE and Sandra KIJEWSKI (1)

1. Introduction

The *Rewe/Adeg* merger case concerned the Austrian markets for the retail sale of daily consumer goods and the respective procurement markets. It raised a number of interesting legal and economic issues. In particular, the Commission had to assess whether and to what extent discount chains effectively constrain full-range supermarkets in Austria. Also, the Commission clarified the circumstances under which strength on procurement markets may harm end-customers.

In 1999 the Commission had already taken a close look at the Austrian daily consumer goods markets when it assessed the merger between Rewe and Meinl (2). In the recent case of *Rewe/Adeg* the Commission found that the competitive landscape had changed in that discounters, in particular the discount chain Hofer (Aldi group), have become stronger than at the end of the 1990s. Apart from that, the Commission found that this time the target was a weak player. However, due to the parties' strength in some Austrian districts the Commission was not able to rule out the possibility that their combined strength in these districts might influence Rewe's national price setting and consequently overall price levels in Austria. Since Rewe offered commitments reducing local strength the Commission concluded that competition would not be significantly impeded on the retail market because of the merger.

Concerning procurement, the Commission found that Rewe was already a strong player in many procurement markets and that Adeg did not appreciably increase Rewe's strength on the procurement side. In the case at hand, the Commission found that strength on the procurement side was likely to be beneficial for consumers since it could be expected that Rewe would have to pass on any improved purchasing conditions to consumers.

2. The parties and the operation

Rewe is a German-based group active in food and non-food wholesale and retail, travel and tourism in a number of European countries. In Austria, Rewe is active in food and non-food retail. It has only marginal activities in food and non-food *wholesale* in Austria. Apart from that, Rewe is active on the Austrian procurement markets as a purchaser of food and non-food products.

In Austria, Rewe operates 1 000 supermarkets under the brand name Billa, 108 hypermarkets under the brand name Merkur and 258 discount stores under the brand name Penny.

Adeg is active in food and non-food wholesale and retail in Austria. It has three own wholesale distribution centres and 19 cash & carry stores. In the retail market it operates 83 own retail shops, of which 15 are hypermarkets under the brand name Magnet. In addition, it supplies 582 shops that belong to independent Adeg merchants.

Pre-merger Adeg was owned by the independent Adeg merchants' organisation AÖGen (37.6%), Edeka Chiemgau (37.5%) and Rewe, which held a minority shareholding of 24.9% (3).

The notified transaction consisted in the acquisition of sole control by Rewe over Adeg through the acquisition of shares. Rewe bought all of Edeka Chiemgau's shares and part of AÖGen's stake, corresponding to 12.6% of the equity. As a result, Rewe owned 75% of the shares, giving it sole control over Adeg. AÖgen retained 25% of the shares.

3. Retail market for daily consumer goods

The relevant product market

In recent cases concerning the Czech and Polish markets, the Commission defined the retail market for daily consumer goods as comprising 'all modern distribution channels' including supermarkets, hypermarkets as well as discount chains (4). In earlier cases, in particular *Rewe/*

(1) Directorate-General for Competition, units 02, B-3 and F-4. 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 3 February 1999, Case M.1221 *Rewe/Meinl.*

(3) In 2002 the Commission cleared the acquisition of sole control by Edeka over Adeg (Case M.2739). In 2006, Rewe acquired the minority shareholding in Adeg and entered into supply and other agreements with Adeg. The minority shareholding and the agreement did not, in the view of DG Competition, give Rewe control over Adeg.

(4) M.4590 *Rewe/Delvita;* M.4522 *Carrefour/Ahold Polska.*

Meinl, the question was left open (5). Concerning other retail formats such as specialised outlets, petrol station shops, cash & carry stores etc. the Commission found that these retailers are active in separate markets (6).

The Commission carried out a market investigation to examine to what extent the different retail formats in Austria compete with each other. In particular, it was examined whether discounters form part of the relevant product market.

The Commission found that in discount stores, in particular 'hard discounters' that offer only a very limited range of branded goods, the number of different goods offered is much lower than in full-range supermarkets. However, the market investigation shows that the hard discounters (Hofer, Lidl) in principle sell the full range of daily consumer products including fresh products. It is the choice within the product range that is more limited in discount shops than in full-range supermarkets. 'Soft' discounters, like Rewe's chain Penny, offer a broader range of branded goods than hard discounters and have a higher number of diversified articles on their shelves.

As to competitive constraints exercised by discounters, the market investigation indicated that in principle all competitors monitor price moves by discounters. Also, it revealed that Rewe and its most important competitor Spar Austria are considered to be constrained by the hard discounter Hofer. It was confirmed that most competitors would react to price reductions by discounters, and that they gain customers if a discounter increases prices.

In addition, discounters have increased sales at the expense of full-range supermarkets. In this context the Commission referred to the fact that according to AC Nielsen the market share of the discounters Hofer and Lidl in the market for daily consumer goods increased in the period between 1995 and 2007 from approx. 11% to approx. 24%. This suggests that discounters do indeed constrain full-range supermarkets.

The Commission also examined how the turnover of Rewe outlets developed when the discounter Hofer entered a local market. Rewe submitted 32 examples for the years 2006 and 2007 showing that the sales of the nearest Billa shop decreased in the six months after the opening compared with the six months before the opening of the Hofer outlet. This points to a competitive constraint by the hard discounter Hofer.

The market investigation indicated, however, that hard discounters exercise less pressure on full-range stores than so-called soft discounters that offer branded products. Hard discounters exercise competitive pressure first on the private label products. The market data indicated that full-range supermarkets react immediately to price movements with their private label products but also with other relatively low priced 'entrance products'.

The Commission considered that, with some delay, the price reaction also affects prices for branded products. This is because higher prices for branded goods can only be maintained if their image or their quality differs substantially from private label products. However, to the extent that private label or entrance price products represent substitutes for branded products, a price reduction for the entrance price product exercises competitive pressure on branded goods in a supermarket (7). It is quite possible that some customers consider certain branded goods as not at all interchangeable with private label products. However, some customers will consider switching to unbranded products if the price discrepancy between the two products increases in the long term. A large durable difference in prices therefore makes it difficult for sellers of branded products to justify and/or maintain the high price compared with the non-branded goods. In addition, supermarkets increasingly position private label products similarly to branded goods. This blurs the borders between manufacturer and private label products.

On the basis of this competitive interaction between discounters and full-range supermarkets it was justified to consider all types of discounters in Austria as part of the retail market for daily consumer goods. The Commission therefore found that the relevant product market comprises sales by supermarkets, hypermarkets and discounters.

The relevant geographic market

The geographic scope of retail markets for daily consumer goods is delineated by the boundaries

(5) Whether discounters are to be included in the product market was left open in Cases COMP/M.1684 *Carrefour/Promodes,* para 12 and COMP/M.1221 *Rewe/Meinl,* para 17. In Case COMP/M.3905 *Tesco/Carrefour,* para 12, the market investigation confirmed that with regard to pricing policy hypermarkets seem to be closer to discount stores than supermarkets.

(6) E.g. the Commission's decisions in Cases IV/M.784 *Kesko/Tuko,* paras 19, 20; COMP/M.1221 *Rewe/Meinl,* paras 12, 16; COMP/M.1684 *Carrefour/Promodes,* para 9 and M.3646 *Kesko/ICA/JV,* para 10 et seq., in which the product market definition was left open.

(7) The Commission found a similar effect in Case M.4533 *SCA/P&G European Tissue Business,* concerning the Austrian market for tissue paper: branded articles lose market shares if they do not react to the lower prices of private label products.

of a territory where the outlets can be reached easily by consumers. The Commission generally applies a radius of approximately 20 to 30 minutes driving time ([8]). However, the geographic market may be larger, for instance, where different local areas are connected in such a way that they result in overlapping circles ([9]). Under these circumstances competitive conditions typically do not differ from one area to another and therefore do not represent a separate geographic market.

In the *Rewe/Meinl* case the Commission defined the Austrian retail market as national. The Commission argued that there are many overlapping areas and that the big market players cover the whole inhabitable part of Austria. Also, the Commission found that all competitors offered an identical or similar range of products throughout Austria, that they advertised their products country-wide and that prices did not differ appreciably from one part of Austria to another.

In the *Rewe/Adeg* case the investigation showed that most competitors set their prices uniformly for the whole company and for the whole of Austria, and that there are no significant regional or local differences in retail prices, which are comparable all over Austria. As a result, the Commission confirmed the findings of *Rewe/Meinl* as far as the geographic scope of the market is concerned and considered that the geographic market for retail of daily consumer goods is national.

Assessment

Market shares

Based on a market survey by AC Nielsen ([10]) the market shares for 2007 on the Austrian market for the retail sale of daily consumer goods are as follows:

Companies	Market share
Rewe	29.7%
Spar	27.9%
Hofer	19.6%
Adeg	5.4%
ZEV Merchants	5.1%
Zielpunkt	4.5%
Lidl	3.2%
MPreis	2.7%
Any other business	< 2%
Total market value	€15 961 million

Taking into account recent shop closures and sales of Adeg shops, Adeg's overall market share falls below 5% ([11]). The revised combined market share for Rewe/Adeg was thus [30-35]%. In comparison to the *Rewe/Meinl* case, the market shares of Rewe and its most important competitor Spar Austria remained stable while the market share of the hard discounters (Hofer and Lidl) increased significantly — between 1998 and 2007 from 11.7% to 23.8%.

Therefore, the combined market shares remained moderate after the merger, and there are a number of important competitors, so that the market shares as such do not give rise to competitive concerns.

Low competitive pressure from Adeg

The market investigation pointed towards particularly low competitive pressure from Adeg. The prices in Adeg shops were perceived as the highest in the market. A price comparison carried out by the Austrian Arbeiterkammer based on a basket of products showed that Adeg was the most expensive supermarket chain in Austria. This result is also confirmed by AC Nielsen data when comparing the prices of all products sold in Rewe, Spar Austria, Zielpunkt and Adeg own stores (i.e. with the exception of the independent merchants for which AC Nielsen did not have individual price data). As regards the independent Adeg merchants the data provided by Rewe indicates that most of the Adeg merchants follow the price recommendation by Adeg. It should also be noted that Adeg has lost half of its market share in Austria over the last ten years ([12]).

The fact that Adeg hardly constrained Rewe was further illustrated by the effect on Rewe's sales in the event of Adeg shop closures. The turnover data submitted to the Commission showed that the sales of Rewe outlets scarcely increase after an Adeg shop closure.

Furthermore, Adeg shops are, with the exception of the Magnet hypermarkets, often local supply supermarkets in rural areas. In contrast, Rewe's

([8]) E.g. decisions in Cases IV/M.1085 *Promodes/Catteau,* para 14, COMP/M.1221 *Rewe/Meinl,* para 18 and COMP/M.1684 *Carrefour/Promodes,* para 24.

([9]) E.g. see COMP/M.1221-721 *Rewe/Meinl,* para 18 and COMP/M.1684 *Carrefour/Promodes,* para 25.

([10]) AC Nielsen data include non-food products.

([11]) Adeg's market share results from sales by Adeg own stores as well as those by independent Adeg merchants. Rewe agued that the independent merchants should not be included for the calculation of Adeg's market shares since Adeg was not able to control the merchants. However, the Commission established that there are several linkages (the merchants being a shareholder in Adeg, cooperation agreements, supply relationships, loans, etc.) which lead to the conclusion that the Adeg merchants cannot be considered as a competitive constraint on Adeg but should be included in Adeg's market share.

([12]) Adeg's market share amounted to 11.3% in 1996 and was only 5.4% in 2007 (AC Nielsen data).

Billa stores are supermarkets that are mostly located in urban areas. Rewe's hypermarket chain Merkur or its soft discounter Penny Adeg could be regarded even less as comparable in terms of size, price and typically also location.

In view of the above, the Commission arrived at the conclusion that Adeg exercised low competitive pressure on Rewe in the Austrian retail market for daily consumer goods.

Buyer power

The merger leads to higher purchase volumes for Rewe. This can lead to improved buying conditions. Improved buying conditions may harm competition by giving a company the ability to behave independently of its competitors ([13]).

The Commission's market investigation did not support a significant purchasing advantage for Rewe. The investigation in fact showed that Rewe already had a strong buying position in Austria pre-merger and that the acquisition of Adeg did not lead to appreciable additional leveraging power on the part of Rewe. Most suppliers explicitly stated that they would not accept any demands for price reductions from Rewe and that they expected to be able to sell to other customers. Consequently, the Commission considered unilateral effects resulting from increased buying power unlikely. The situation concerning buyer power is further dealt with below in the context of procurement markets.

Price increases due to strength at district level

Despite finding a national geographic market, the Commission assessed the competitive situation at the level of the 121 Austrian political districts in order to establish whether Rewe might be able to avoid substantial market share losses following a price increase due to local strength of the combined entity. The Commission considered that, in the districts in which Rewe and Adeg are particularly strong, influence on national price setting by Rewe could not be ruled out since Rewe might be able to compensate market share losses due to price increases by the higher revenues in regions where it is particularly strong.

On this basis, the Commission applied a filter to determine the districts where the combined entity would be substantially stronger than at national level. According to this filter districts were deemed critical where the combined turnover share exceeded 45% with an increase in turnover due to the merger, or where the combined turnover share was between 35% and 45% and with an overlap of at least 5% due to the merger.

It has to be emphasised that these 'thresholds' did not represent market shares and were not supposed to give guidance on whether the Commission considers market shares likely or unlikely to raise competition concerns. The purpose of the turnover share at district level was to establish the regions in which the merging parties are stronger than at national level. The thresholds were a tool to evaluate any risk of influencing price setting in the national market.

On this basis, the Commission found 24 critical districts. The 24 districts represented a very substantial part of Rewe's retail turnover in Austria and corresponded to a population share of approximately 20%. The Commission therefore could not rule out in phase I of the merger procedure the possibility that strength at district level might influence national price setting since Rewe might be able to compensate market share losses in other districts by increased prices in the districts where it was particularly strong. The Commission therefore had serious concerns that the merger could cause a significant impediment of effective competition on the Austrian retail market.

The commitments

In response to the Commission's findings in phase I, Rewe committed to reducing the combined turnover shares below the critical level in the affected districts through the divestiture of Adeg-owned shops in the relevant districts and to using its best efforts to make a sufficient number of Adeg merchants leave the Adeg network. In the event that too few merchants left the Adeg network, Rewe made a commitment to sell Rewe outlets instead. The Commission was satisfied that the general reduction of the position of Rewe and Adeg by the commitments eliminated all potential competition concerns due to unilateral effects on the retail market.

Coordinated effects

It should be mentioned that in the market investigation the Commission found very high transparency regarding the price setting of the different market participants. AC Nielsen provides detailed price information on a monthly basis for a very high number of products sold by the major market players. The Commission arrived at the conclusion that the merger would not result in any significant change regarding this price transparency. In addition, the market investigation made it clear that Adeg did not play a role in the retail market such that potential coordination between the two

([13]) Commission guidelines on the assessment of horizontal mergers, OJ C 31, 5.2.2004, p. 5, at para 62.

market leaders Rewe and Spar Austria would be noticeably facilitated as a consequence of Adeg's disappearance. Moreover, the merger would lead to increased asymmetry of the market shares of Rewe and Spar Austria, which reduced the incentive for possible coordination. Consequently, the Commission considered that the merger would not trigger coordinated effects on the retail market.

4. Procurement markets

The product market

Procurement markets cover the sale of daily consumer goods of producers to wholesale dealers, retailers (in particular supermarkets) or other companies [14]. As in previous cases the Commission considered that separate procurement markets exist for different product categories, in order to take into account the fact that producers usually manufacture an individual product or an individual product category, and that therefore the flexibility to switch to alternative products for these producers is limited. In the *Rewe/Meinl* decision the Commission determined 19 product categories. The same categories were examined in the case of Rewe/Adeg.

The geographic market

The exact geographical market definition of the procurement markets could be left open, since — even on the basis of the narrowest (national) market definition — the merger did not impede effective competition.

Assessment

The *Rewe/Meinl* decision mentions a threshold of 22% market share for when a customer becomes unavoidable, a 'must have', for a supplier. When looking at the share of purchases by the retailers of daily consumer goods, Rewe was already pre-merger a 'must have' customer for many suppliers.

Despite this, in the market investigation many suppliers explicitly stated that the merger was not a source of concern for them since the acquisition of Adeg would not appreciably increase Rewe's power. It should be noted that this was the case also for suppliers whose addresses the Commission received from competitors of the parties.

It is also worth noting that even those few suppliers or suppliers' organisations that expressed concerns about the procurement side of the merger did not consider that prices for end-consumers would rise as a result of the merger or that choice for end-customers would be reduced. In fact, most respondents actually expected a strengthening of competition on the downstream market should Rewe be able to achieve better purchasing conditions.

This situation led the Commission to reiterate its position, as expressed in the guidelines on the assessment of horizontal mergers [15], that buyer power may be beneficial for competition where it lowers input costs without restricting downstream competition or total output. As long as powerful buyers are constrained to pass on the improvement of their purchasing conditions to the end-consumer, buyer power is beneficial for consumers.

That the acquisition of Adeg by Rewe did not restrict downstream competition was ensured by the commitments submitted. However, the Commission still had to assess whether the merger could lead to an output reduction or whether Rewe was likely to use its buyer power to foreclose its rivals on the retail market [16].

Output restriction

Buyer power can be harmful for end-customers when the pressure of a powerful buyer leads to a situation where suppliers prefer not to sell at a lower price but choose to supply lower quantities. As a consequence total output can be reduced and this can lead to price increases at the downstream level.

However, if end-customers have sufficient possibilities to switch to other suppliers the strategy of the powerful buyer is defeated since this buyer loses customers in the downstream market. In the Rewe/Adeg case a sufficient number of alternative supermarkets remain, which can serve additional customers; this also means that suppliers would be able to sell more to these alternative supermarkets and the total output in the market would remain the same. Therefore the Commission concluded that the merger would not give rise to competitive concerns as a result of potential output restrictions.

Foreclosure

Better purchasing conditions may enable a powerful buyer to undercut its competitors in the downstream market and drive these competitors out of the market. This can result in reduced competition at the downstream level and, as a consequence,

(14) M.1221 *Rewe/Meinl*, para 75 *et seq.*

(15) Commission guidelines on the assessment of horizontal mergers, OJ C 31, 5.2.2004, p. 5, at para 62.

(16) Foreclosure is mentioned as a potential source of harm in para 61 of the Commission guidelines.

harm end-customers. In this context a so-called 'waterbed effect' is very often also mentioned. The waterbed effect assumes that purchase prices will increase for the powerful buyers' competitors at the downstream level, since the suppliers would recoup the better purchasing conditions given to the powerful buyer by raising prices for the smaller buyers.

The waterbed effect is proven neither in reality nor in economic theory. In any event, several arguments speak against the ability for Rewe to drive its competitors out of the retail market. First of all, Rewe is already a strong buyer pre-merger. The acquisition of Adeg does not add much to Rewe's pre-existing buyer power and the vast majority of suppliers stated that they would not give better purchasing conditions to Rewe following the merger. Moreover, while some respondents indicated that intensity of competition on the downstream retail market was likely to increase after the merger, there were no plausible indications that major competitors would have to exit the retail market in the foreseeable future.

Accordingly, the Commission concluded it unlikely that the merger would lead to competition concerns on the market for retail of daily consumer goods on the basis of increased buyer power in the procurement markets.

5. Conclusions

The Rewe/Adeg case illustrates that in an environment of rising food prices the Commission closely examines whether concentrations in the retail sector may lead to detrimental effects for the European consumer. It is determined to take necessary measures, which have to be tailored and proportionate regarding the particular case and the competitive environment in the country concerned, in order to prevent potential anti-competitive effects in this sector while at the same time preserving efficiencies that lead to better conditions for the consumer.

Funding of public service broadcasting and State aid rules — two recent cases in Belgium and Ireland

Nóra TOSICS, Ronald VAN DE VEN and Alexander RIEDL (1)

Introduction (1)

The present article illustrates the Commission's State aid assessment practice concerning funding for public service broadcasters on the basis of two recent cases which were both concluded in February 2008. The cornerstones of the Commission's assessment of the State financing of public service broadcasting were set out in the 2001 Broadcasting Communication (2) and further developed in its decision making practice (3).

The basic requirements of the EC State aid rules for the funding of public service broadcasters are the following:

- A clear and precise definition of the public service remit;
- Proper entrustment with the public service mandate and supervision that public service tasks are provided as required;
- Separation of the accounts for commercial and public service activities (in accordance with the Transparency Directive);
- Limitation of public funds to the net public service costs and adequate ex post control mechanisms;
- Respect of market conform behaviour in the public service broadcasters' commercial activities.

These rules aim at ensuring transparency, proportionality and accountability of the funding regimes for public broadcasters. In both the Belgian and the Irish cases, one of the main issues was to enable public service broadcasters to meet the challenges posed by the new media environment, while ensuring a proper definition of the public service mandate also in the field of new media services.

In view of the challenges brought by technological progress, and building on the experience gained in more than twenty decisions since 2001, the Commission also launched a process of modernisation of the Broadcasting Communication in early 2008.

State financing of the Flemish public service broadcaster VRT

Background

In 2004, the Commission received complaints against various aspects of the State financing granted by the Flemish Community of Belgium to the public service broadcaster VRT (Vlaamse Radio- en Televisieomroep) (4). Private competitors argued that the definition of the public service remit was not sufficiently precise and that there were no effective control mechanisms. The complainants also claimed that the public financing received by VRT for the fulfilment of its public service tasks was not proportionate to the net costs of carrying out these tasks.

The Commission initiated a preliminary investigation and requested further information from the Belgian authorities, who had meanwhile initiated a number of modifications to the applicable legal framework. In July 2006, DG Competition informed the Belgian government, by means of

(1) Directorate-General for Competition, unit C-4 and Task Force Pharmaceuticals Sector Inquiry. The authors would like to thank Alexandra Antoniadis and Jan Gerrit Westerhof 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) Communication from the Commission on the application of State aid rules to public service broadcasting, OJ C 320, 15.11.2001, pages 5-11

(3) See, for instance, EC Competition Policy Newsletter 2004, number 2: 'The Commission's State aid policy on activities of public service broadcasters in neighbouring markets', EC Competition Policy Newsletter 2006, number 3: 'State aid in the broadcasting sector: two decisions regarding ad hoc aid to public service broadcasters in Portugal and the Netherlands' and EC Competition Policy Newsletter 2007, number 2: 'Increased transparency and efficiency in public service broadcasting. Recent cases in Spain and Germany'.

(4) In 1971, due to changes in the organisation of the Belgian State, the Flemish authorities became responsible for radio and television broadcasting in the Flemish Community of Belgium.

a so-called Article 17 letter ([5]), of its preliminary view that the financing regime in favour of VRT was no longer compatible with EU State aid rules, initiating a so-called existing aid procedure. In such a procedure, which concerns aid measures already in place before the entry into force of the EC Treaty rules in the respective countries ([6]), the Commission aims to establish a compatible legal framework for the future in line with the State aid requirements in cooperation with the Member State. In the Article 17 letter, Belgium was requested to clarify a number of points, in particular concerning the definition of the public service remit, especially in relation to new media services, the effective supervision and control of VRT´s fulfilment of its public service obligations, as well as the prevention of overcompensation for public service activities.

In late 2007, the Belgian authorities submitted proposals by the Flemish government to amend the legal framework during 2008. The Commission assessed these commitments and concluded that the modifications would be suitable to ensure compliance with EC State aid rules. On this basis, the Commission concluded on the case in February 2008, issuing a decision ([7]) that the public funding of VRT was compatible with Article 86 (2) of the EC Treaty, conditional on the implementation of the commitments proposed by February 2009. The Commission will monitor the implementation of these commitments.

The acceptance of these commitments by the Commission was, *inter alia,* based on the following considerations.

Definition of public service mission including new services

The Flemish authorities will amend the legal framework to introduce a provision which will clarify that the VRT may not launch new services or activities which are not covered by the on-going five-year management contract without a prior *('ex ante')* evaluation and an explicit entrustment by the Flemish government. The authorities will set out the criteria which will be used to determine whether a service will be considered as a new service not covered by the current management contract and hence subject to an evaluation. These criteria may also be helpful in assessing whether new media services and activities serve the same democratic social and cultural needs of society as do traditional broadcasting services.

Before deciding on an entrustment, the authorities will request the advice of the Flemish Media Council *(Raad voor Cultuur, Jeugd, Sport en Media),* an independent specialist advisory body. The Media Council will look at developments in the Flemish media market and in technology, the evolution of the Flemish media landscape and the role of the VRT therein. The Council will also take observations of third parties into consideration and its advice will be made public. The need to include the observations of third parties pre-supposes that these parties have had the possibility to see the proposal for a new service or activity. This will also entail public consultation during the evaluation procedure.

Furthermore, to ensure a maximum degree of transparency in the procedure leading to the definition of the public service mission of the VRT in future management contracts, the Flemish authorities will conduct a public consultation of all stakeholders to be performed when a new management contract is prepared every five years. The consultation will result in a recommendation by the Media Council to the Flemish government which will also be made public.

An updated framework for merchandising and related activities of the VRT will further clarify which services can be considered as commercial and are clearly outside the public service remit. The public availability of this framework will further increase transparency and enhance the ability of commercial operators to plan their own activities.

The provisions outlined above will allow the supervisory authorities to check that the VRT does not extend its activities at its own discretion and — where necessary — to enforce the entrustment requirement.

(5) Article 17(2) of Council Regulation (EC) N° 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty provides the following: '*Where the Commission considers that an existing aid scheme is not, or is no longer, compatible with the common market, it shall inform the Member State concerned of its preliminary view and give the Member State concerned the opportunity to submit its comments within a period of one month. In duly justified cases, the Commission may extend this period.*'

(6) With regard to those Member States which have acceded in 2004 and 2007, special rules apply. In the case of these countries, the cut-off date for existing aid is 10 December 1994. In addition, those measures included in the lists annexed to the Treaties of Accession, and those approved under the so-called 'interim procedure' are also considered existing aid.

(7) Commission decision of 27 February 2008 on State aid E 8/2006, see under: http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_e2006_0000.html.

Proportionality of public financing

The Flemish authorities also committed themselves to strengthening the annual monitoring and correction mechanisms concerning the control of possible overcompensation. As from the financial year 2008, any possible overcompensation of the VRT is capped at a maximum of 10% of the annual public financing received by the VRT in any particular year. If the 10% threshold is exceeded, the VRT must repay the surplus to the Flemish Community where the funds will be held in a special account. These funds may be used by the authorities to compensate for eventual funding deficits related to the public service mission in subsequent periods of the ongoing management contract period.

Any accumulated net surplus at the end of a five-year management contract period will be taken into account in the calculation of the public financing needs for the next management contract period and will be deducted from the State funds to be received by the VRT.

The overseeing of these mechanisms to monitor any overcompensation and possible repayments will be carried out by the *Inspectie van Financiën* on the basis of the annual accounts of the VRT. The *Inspectie van Financiën* is an independent body which exercises an *ex ante* control over the budget of the VRT and all funds granted by the Flemish Community to the VRT.

State financing of Irish public service broadcasters RTE and TG4

Background

The Commission's existing aid procedure concerning the financing of the Irish public service broadcasters RTÉ *(Radio Teilifís Éireann)* and TG4 *(Teilifís na Gaeilge)* was, as in other cases, prompted by a complaint. The complainant argued that the legal provisions did not contain a proper definition of the public service remit, and that the public broadcasters were not properly entrusted with public service obligations. Furthermore, the complainant claimed that the use of public funds lacked the necessary transparency to verify that the level of funding was proportionate and to make sure that public funds were not used for commercial activities.

On the basis of this information, and of further exchanges with the Irish authorities and the complainant, the Commission initiated the existing aid procedure by means of an Article 17 letter in March 2005.

In the Article 17 letter, the Commission considered that the funding system which dated from before Ireland's accession to the EU could be considered as existing aid. At the same time, the Commission raised concerns regarding the compatibility of the scheme. The Commission considered that the definition of the public service remit in particular in fields other than broadcasting was not sufficiently clear. Furthermore, it expressed concern that there were no satisfactory *ex-post* controls to verify whether State funding exceeded the net public service costs (overcompensation), whether commercial activities had unduly benefited from licence fee revenues (cross-subsidisation) or whether the public service broadcasters' commercial activities were in line with market principles.

In May 2005, the Irish government submitted observations and informed the Commission of plans to reform the Broadcasting Act. Following discussions between the Commission and the Irish authorities regarding the changes necessary to remove competition concerns, Ireland formally submitted in January 2008 its commitments to amend the current financing system and to bring it in line with the State aid rules. In its decision of February 2008 ([8]), the Commission concluded that the commitments were adequate to remove the concerns regarding the current funding regime. As in the case concerning Belgium, the main changes to the funding system related to the definition of the public service remit on the one hand, and to the fulfilment of the requirement for proportionality on the other.

Definition of public service mission including new services

The Irish authorities committed themselves to determining the scope of the public service remit of the public broadcasters in a more precise manner, by enumerating their respective objects and duties in the broadcasting legislation. These objects also include so-called new media activities, such as web-based services in connection with the public broadcasting activities, and non-linear audio-visual media services.

The Irish authorities also foresee a number of complementary measures to improve transparency and to further specify the public service objectives, such as the adoption of a Public Serv-

([8]) Commission decision of 27 February 2008 in the State aid case E 4/2005, available at: http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_e2005_0000.html#4.

ice Broadcasting Charter every five years, and the preparation of annual statements of commitments.

A salient feature of the proposed amendments is the introduction of a public value test and a sector-based impact test for any significant new activities by public broadcasters, as well as for any alterations of the statutory public service remit (e.g. variations of the number of channels, introduction of non-linear audiovisual media services, etc.).

The Irish authorities also specified indicative criteria for carrying out these tests. For example, the public value assessment would consider the extent to which the proposed service will contribute to meeting the democratic, cultural, linguistic, educational and social needs of Irish society, of individual groups within Irish society, and of Irish communities outside Ireland; the extent to which the proposed service is accessible to the public; the extent to which it reaches under-served audiences, or the contribution to media plurality. The criteria used for the sector-based impact test would cover considerations such as impact on availability, choice, quality and accessibility of services, as well as on related markets, on sector development, innovation and investment.

The reform entails the establishment of a new, independent Broadcasting Authority, which plays a central role in ensuring respect with the State aid requirements. This new regulatory body is to become the main expert body for assessing the impact of any new activities by public broadcasters, and plays a central role in supervising the fulfilment of the public service obligations by the broadcasters.

Proportionality of the public financing

The Irish authorities also provided commitments to ensure that there is no overcompensation, no cross-subsidisation of commercial activities, and that broadcasters respect the market principles in their commercial activities. They also committed themselves to putting in place regular control mechanisms for this purpose.

The Irish authorities made clear that public funding and surpluses generated by commercial exploitation of public broadcasting activities may only be used for the financing of public service activities. Moreover, they committed themselves to ensuring separate accounting of public service and commercial activities, as provided in the Transparency Directive. On that basis, public service broadcasters are to report on an annual basis on the use of their public funding. The independent Broadcasting Authority was entrusted with the task of controlling the level of funding and making recommendations to the Minister, if necessary, to adjust the financing. The public funding will be subject to annual reviews, and the financial situation of the public broadcasters will be assessed in depth every five years.

The Irish authorities also committed themselves to ensuring that the commercial transactions (commercial activities, investments, etc.) of the public broadcasters are clearly distinguishable from public service activities and carried out on market terms, taking into account the 'arms-length principle'. Compliance with market principles is also subject to the control by the independent Broadcasting Authority.

Conclusions

Following the April 2007 decision concerning public service broadcasting in Germany ([9]), the decisions concerning public service broadcasters in Belgium and Ireland illustrate further possible ways of complying with the EU State aid requirements in the rapidly changing new media environment. These examples also illustrate the variety of possible solutions aimed at respecting the requirements of transparency and proportionality while safeguarding the specificities of the individual broadcasting systems of each Member State.

In both cases, the Member States were granted a transitional period for the implementation of their commitments. In this period, the Commission's task is to monitor the proper implementation of the decisions ([10]). In parallel, the Commission services are working towards a revised Broadcasting Communication which meets the challenges of the present and future media environment, reaping the benefits of the recent decision-making practice in individual cases such as the two presented in this article.

([9]) Commission decision of 24 April 2007 in the State aid case E 3/2005, available at: http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_e2005_0000.html#3.

([10]) The 2008 Broadcasting Bill has been published by the Irish authorities in May 2008, see: http://www.dcenr.gov.ie/Broadcasting/Broadcasting+Legislation/.

The principle of incentive effect applied to training aid — Some recent cases

Loredana VON BUTTLAR and Salim MEDGHOUL (1)

1. Introduction

Continuing training of workers is part of the investment in human capital that is central to the Lisbon agenda's objective for growth and jobs. The Community has adopted detailed provisions setting out the conditions on which training aid can be authorised as contributing to its economic development.

These provisions are to be found in the General Block Exemption Regulation (2) (GBER), which entered into force on 29 August 2008. The GBER's training aid provisions are largely identical to the earlier provisions of Regulation 68/2001 (3) which applied until 30 June 2008. They exempt training aid of less than €2 million from the notification requirement in Article 88(3) of the Treaty, provided a number of formal criteria (regarding e.g. what costs are eligible and the maximum intensity of aid) are met. If the aid exceeds the €2 million threshold, the aid has to be notified to the Commission, which will asses its compatibility with the common market on the basis of Article 87(3)(c) of the Treaty. This assessment will be made in accordance with the conditions set out in the GBER.

In addition to the specific compatibility criteria of the GBER (and previously Regulation 68/2001), the Commission will also assess whether the aid has an incentive effect, which is a general condition for the compatibility of any state aid. Put in simple terms, this means that state aid can only be approved if it is a necessary condition for the activity it is financing, i.e. if this activity would not take place without the aid (if the training would occur in any case, the aid cannot be said to '*facilitate* the development of certain economic activities' within the meaning of Article (87)(3)(c) of the Treaty).

The incentive effect requirement has been explicitly laid down in the GBER (which, under Article 8, exempts only aid 'which has an incentive effect') (4). Although not explicitly spelled out in Regulation 68/2001 it was applied also under these earlier rules as a general principle of compatibility (as for all state aid, irrespective of purpose) (5).

Starting in 2006, the Commission — reacting to changes in the behaviour of undertakings — has made closer assessments of the incentive effect in a series of training aid cases (which, coincidentally, have all concerned the car industry). The two first cases, *Ford Genk* and *General Motors Antwerp,* have been covered in an earlier edition of this newsletter (6). In these cases the Commission concluded that a significant part of the aid did not incite the beneficiaries to provide additional training since it funded training that was necessary for the normal operation of the companies (i.e. required either by the introduction of a new model or by other core business activities) and would have been undertaken by the companies in any event, on the basis of market incentives alone. Consequently, the Commission found that the training aid would not contribute to the Community objective of compensating for underinvestment in workers' training, but would simply cover normal operational costs.

(1) Directorate-General for Competition, unit E-3. 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 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) (OJ L 214, 9.8.2008, p. 3).

(3) Commission Regulation (EC) No. 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid (OJ L 10, 13.1.2001, p. 20).

(4) The rationale for this provision is given in recital 28 to the GBER: 'In order to ensure that the aid is necessary and acts as an incentive to develop further activities or projects, this Regulation should not apply to aid for activities in which the beneficiary would already engage under market conditions alone. '

(5) The recitals to Regulation 68/2001 stated that '… enterprises in the Community generally underinvest in the training of their workers' and that 'State aid might help to correct this market imperfection and therefore can be considered under certain conditions to be compatible with the common market …' (recital 10) and also indicated that, in pursuing this Community objective state aid should be 'limited to the minimum necessary to obtain the Community objective *which market forces alone could not make possible*…' (recital 11, emphasis added).

(6) Commission Decision 2007/612/EC of 4 April 2007, training aid to General Motors Belgium in Antwerp (OJ L 243, 18.9.2007, p. 71) and Commission Decision 2006/938/EC of 4 July 2006, training aid to Ford Genk (OJ L 366, 21.12.2006, p. 32). See Andrés Garcia Bermudez and Christophe Galand, 'Recent training aid cases in the car industry', EC Competition Policy Newsletter, 2007 — Number 1, p. 104.

The purpose of the present article is to give an overview of two recent decisions which have elaborated on the incentive effect requirement in a training aid context.

2. Recent training aid cases

Training aid for Vauxhall Motors Ltd (C 23/2007) (7)

The car manufacturer Vauxhall Motors, part of General Motors, planned an extensive training programme for the staff at its production facility in Ellesmere Port in the UK. The training programme would benefit some 2 200 workers at a total of GBP 16.6 million of eligible costs. The UK notified GBP 8.7 million (approx. €11 million) of training aid in the form of a direct grant.

The training programme was divided into five different projects covering different aspects of activity at the plant (there was also some training for which the UK did not claim any eligibility for training aid, including training for changes of car models, which indicates that the UK had already taken on board the Commission's conclusions in *Ford Genk* and *GM Antwerp*). In its decision of 10 July 2007 to open a formal investigation under Article 88(2) of the Treaty, the Commission raised doubts about the incentive effect of the aid in relation to three of the training projects as mentioned below (8).

— Production System Training, i.e. training in production and quality controls systems. The Commission considered that this training appeared necessary to ensure normal operations at Vauxhall, in which case there should be sufficient incentive to undertake the training without aid.

— Integrated Training Plan, which concerns implementation of the 'Global Manufacturing System' incorporating best practices and technologies into a manufacturing system for General Motors' operations. Here too, the Commission doubted *prima facie* that the training was necessary for normal operations at the plant. In addition the Commission noted that Vauxhall appeared to need to meet a higher level of compliance with the Global Manufacturing System in 2008 than in 2007 in order to meet General Motors' group standards, assessed on an annual basis. This requirement, although internal to the group, also appeared to provide Vauxhall with an incentive to undertake additional training.

— Undergraduates, a programme whereby Vauxhall organises 12-month courses for young university students, combining learning and work experience under the supervision of a mentor (the programme covered such job profiles as for example 'Body Planning Engineer' and 'Finance Analyst'). The Commission noted that this training had been provided for a number of years without state aid and consequently questioned the necessity of the aid for the future.

In the course of the investigation the UK submitted detailed comments which satisfied the Commission that the aid did indeed have an incentive effect on the specific training projects:

For the Production System Training, the UK showed that that the training necessary for the operation of the Vauxhall plant is provided as part of a continuous routine training programme. The Production System Training, although it also relates to manufacturing skills, deepens the routine training and expands it to include categories of staff that are not covered under the routine training and goes beyond what is necessary for normal operations. In this respect, the Commission also noted that Vauxhall's annual routine training budget had remained stable during the period from 2002 to 2007, which indicated that the normal level of routine training was sufficient for the needs of Vauxhall's normal operations.

Regarding the Integrated Training Plan, the UK showed that Vauxhall had been able in the past to meet General Motors' internal compliance standards within its annual routine training budget. Although the need to meet a higher standard in 2008 might give Vauxhall an incentive to provide additional training, the Commission noted that the marginal improvement required was unlikely to provide a sufficient incentive for a training programme which would entail an increase in Vauxhall's yearly routine training budget of about 60% (when comparing the planned spending to the normal annual training budget).

Finally, as regards the Undergraduates programme, the UK explained that, because of budget constraints, Vauxhall had failed to hire any of the 60 trainees that had undergone the Undergraduate programme since 2002. The UK further indicated that the Undergraduate pro-

(7) The decision to open the formal investigation under Article 88(2) EC was taken on 10 July 2007 (OJ C 243, 17.10.2007, p. 3). The final decision was taken on 16 April 2008 (OJ L 236, 3.9.2008, p. 50). The decisions are also available on the European Commission's Competition website: http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_c2007_0000.html#23.

(8) The Commission also raised doubts about the distinction between general and specific training made in the notification, but these points are not addressed here as they fall outside the scope of this article.

gramme was under budgetary review and liable to be cut. The Commission accepted that Vauxhall's inability to internalise the benefits of the training and recoup its training costs strongly reduced its incentive to provide this training solely from its own resources ([9]).

On the basis of the additional information gathered in the investigation, the Commission was satisfied that the aid provided an incentive effect for the training.

Training aid for DHL at Leipzig-Halle Germany (C 18/2007) ([10])

Following the relocation of DHL's European delivery and airfreight centre from Brussels to Leipzig-Halle, Germany planned to grant €7.7 million of aid to DHL for a training project amounting to €13.8 million ([11]). The planned training activities had to be analysed in the context of the entire investment project amounting to €250 million, for which the Commission approved about €70 million regional investment aid in April 2004. This aid reached the maximum aid intensity of 28%.

The training measures related to four careers: (1) Ramp Agents II, responsible for the ground handling of airfreight, including loading and unloading of airplanes as well as preparation for take-off; (2) Security Agents, responsible for safety and security at the airport; (3) mid-level managers, who are singled out after the first training to obtain additional training in leadership and management; and (4) mechanics for pre-flight and ramp maintenance of airplanes.

On 27 July 2007, the Commission initiated a formal investigation procedure because it had doubts regarding the necessity of the aid. Following an in-depth assessment, the Commission concluded that for the majority of the training measures the aid was not necessary because the beneficiaries would be sufficiently incited to provide the training by market forces alone (the training being necessary for the operational needs of the company) or by the fact that the training was required by law.

First, the Commission found that most of the training measures were mandatory under national or European legislation. Given the nature of the services provided by DHL, which involve security risks, there are several minimum standards as well as conditions or safety requirements under national or European legislation for handling of freight and checks on aircraft. Consequently, these training measures need to be provided by the beneficiary in any event, even in the absence of aid.

Second, the Commission considered that the remaining training measures (i.e. those not required under national or European legislation) were necessary for the successful operation of the new delivery and airfreight centre. The relocation of DHL to Leipzig-Halle produced effects similar to the creation of a new undertaking in the sense that the company had to employ new workers in order to start operating. Since DHL could not find an already skilled workforce on the local market, nor envisage subcontracting certain services (because of its business strategy as well as for cost reasons), it was compelled to employ new workers who had to be trained. The aid therefore did not incite DHL to provide more training but simply relieved it of a normal cost that it should have borne in the course of its activities.

The Commission rejected the argument that training aid is automatically necessary whenever a beneficiary relocates activity to a new site. Germany claimed that the final decision for the relocation of DHL was conditional on the possibility of obtaining state support for comprehensive training; thus, it was argued, without training aid DHL would not have been incited to relocate to Leipzig-Halle and would consequently not have provided any training at all. However, the Commission observed that (re)location of undertakings is a normal feature of business in the European Union by which the undertakings attempt to reduce costs and increase their profitability. Undertakings considering relocating their production often put several sites in different Member States into competition. The decision on the location is not only influenced by forecasts concerning operating costs (including training costs for newly recruited, often unskilled employees) and other economic advantages or disadvantages (i.e. local rules on air flight schedules), but may also depend on the possibility of governmental support (i.e. regional aid and/or training aid). However, unlike regional investment aid, the objective of training

([9]) A similar point was accepted in the *General Motors Antwerp* case: see point 44 of the final decision in that case.

([10]) The opening decision was adopted on 27 June 2007 (OJ C 213, 12.9.2007, p. 28). The final decision was adopted on 2 July 2008 and has not yet been published. The opening and final decisions are available on the European Commission's Competition website: http://ec.europa.eu/comm/competition/state_aid/register/ii/by_case_nr_c2007_0000.html#18.

([11]) DHL is one of the major express parcel operators with a worldwide turnover of €18.2 billion in 2005. The delivery and airfreight centre is operated by the two beneficiary companies, DHL Hub Leipzig GmbH and European Air Transport Leipzig GmbH, which are fully owned through other subsidiaries by Deutsche Post AG. DHL Hub will provide ground handling services related to the airfreight operation, whereas DHL EAT will provide technical inspections for the DHL air fleet.

aid is not to influence the choice of the location, but to increase the pool of skilled workers and to remedy the underinvestment in training in the Community.

Furthermore, the Commission considered that regional disadvantages, such as lower skills levels of the local workforce in comparison to other Member States, do not automatically render training aid necessary. Such regional disadvantages are part of the regional handicap and considered to be compensated by regional investment aid and not by training aid.

The Commission considered that only the aid for training mid-level managers provided a necessary incitement, since this training was not required by law and went beyond what was necessary for the successful operation of the airfreight centre. In addition, the in-depth investigation showed that a smaller number of Ramp Agents II would suffice for the successful operation of the hub, so that training for an additional 76 Ramp Agents II went beyond what was required by law or by the operational needs of the company. Consequently, the Commission approved €1.5 million of aid for these training measures.

In conclusion, the Commission found that a significant part of the training aid was not necessary and did not incite the beneficiary to provide additional training beyond what it would have provided in any event, and notably in the absence of aid.

3. Conclusions

Both *Vauxhall* and *DHL* integrate the obvious lessons of the first cases, i.e. that state aid can only be compatible if it has an incentive effect and that this is not the case where market forces alone give the beneficiary sufficient incentive to provide the training. Such market incentives exist in particular where the training is necessary for the normal commercial activities of the beneficiary and thus indispensable to allow it to stay in business. It seems safe by now to consider this principle a matter of stable decision-making practice in training aid cases.

DHL makes some interesting additions. First, it confirms what might seem obvious, namely that if market forces can provide an incentive to perform certain training, a legal obligation to ensure that your staff has certain skills will provide an incentive *a fortiori*. Second, the case confirms that any activity which is part of normal business life, i.e. which a company has to undertake in order to stay viable, will normally provide sufficient incentive for corresponding training; this is as true for the regular changes of car models in the first decisions as for relocations of production driven by the need to cut costs or to move close to markets. Finally, *DHL* makes an interesting point about the different rationales behind regional aid and training aid. Whereas the purpose of the former is to attract investments to certain areas suffering from certain regional handicaps (such as a lower general level of professional skills), the objective of training aid is to increase to overall skills pool in the Community. The necessity of training aid is therefore not automatically demonstrated by the fact that it is linked to training in a particular place which the beneficiary would not need to provide in some other location.

Vauxhall on the other hand provides some practical guidance. The case shows that the incentive effect requirement should not be taken to the absurd conclusion that only training which is useless to the beneficiary's business can qualify for aid. On the contrary, *Vauxhall* illustrates that state aid may provide an incentive for training which is highly relevant to the beneficiary's operations, provided that it can demonstrate that the training goes above and beyond the basic needs of its business. In this respect, the decision gives some useful indications of the kind of evidence that can be relevant to demonstrate the incentive effect. In order to show what level of training is 'necessary', annual training budgets over a longer period can provide the Commission with a benchmark to assess what could be considered a 'normal' level to be compared with the planned training programme. In addition, an element of cost/benefit reasoning can also be relevant: even if the proposed training would provide the beneficiary with an advantage in its business, is it commensurate to the cost and is it reasonable to expect that a prudent business operator would be prepared to bear the cost alone?

The Hellenic Shipyards decision: Limits to the application of Article 296 and indemnification provision in privatisation contracts

Christophe GALAND (1)

On 2 July 2008, the Commission closed its investigation concerning 16 state measures implemented in favour Hellenic Shipyards S.A. ('HSY') by ordering Greece to recover aid in excess of EUR 230 million from the firm. A summary of this long decision (2) would be of limited interest to most readers, as many parts of the assessment are specific to the case or involve the customary application of the State aid rules. This article will therefore focus on two specific issues which the Commission had to deal with in this case, and which may be of relevance for other cases, namely: the application of Article 296 of the EC Treaty and the existence of aid in an indemnification provision written into a privatisation contract.

1. Limits to the application of Article 296 of the EC Treaty

Each time the Commission starts investigating alleged support in favour of a firm producing war material, Member States are keen to invoke Article 296. Indeed, this Article provides with a broad exemption to the other rules laid down in the Treaty, including the State aid rules, by allowing the Member States not to disclose certain security-related information and to support the production of military products3. The Commission therefore has the difficult task of verifying whether the claims of the Member State concerned are reasonable or whether it is manifestly asking for too broad an application of this Article.

In previous decisions regarding HSY (4), the Commission consistently accepted Greece's claims that its financial support to the military production of HSY fell within the scope of Article 296 and was thereby exempted from State aid rules. It should be recalled that HSY's military production has consisted of war ships and — more recently — submarines for the Hellenic Navy and is therefore manifestly related to the security of Greece.

In the framework of the procedure closed by the decision of 2 July 2008, Greece also invoked Article 296. On the basis of this claim, and in accordance with its past practice, the Commission decided not to include within the scope of the formal investigation procedure all the measures which were clearly financing the military production of HSY (5). This investigation and the final decision adopted on 2 July 2008 therefore concerned only 'problematic' measures, in the sense that following an initial investigation the Commission still had doubts as to whether the measures were financing the military or the civil activities of HSY, or both. To understand the problem, one should keep in mind that, over the period during which these measures were granted, HSY did not keep separate accounts for military and civil activities, which made it virtually impossible to trace the use of a given financing.

A first group of controversial measures concerned capital, loans and guarantees granted by Greece and by a State-owned bank. These funds were not assigned to finance a particular activity. They were financing the yard as a whole, and the management was free to decide how to use them. Greece claimed that, since the majority of HSY's activities were military, this financing falls within the scope of Article 296. In its final decision, the Commission has adopted the following approach. It calculated the average size accounted for respectively by the military and the civil activities. This division was based on sales and man-hours figures of the two activities over several years. The Commission

(1) Directorate-General for Competition, unit E-3. 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 16/2004 — Commission decision on the measures implemented by Greece in favour of Hellenic Shipyards. (Not published yet).

(3) Article 296 provides that '*The provisions of this Treaty shall not preclude the application of the following rules: (a) no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security; (b) any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material.*'

(4) Decision of 15 July 1997 closing the procedure C 10/1994 (OJ C 306, 8.10.1997, p.5), decision of 5 June 2002 on the case N 513/2001 (OJ C 186, 6.8.2002, p.5).

(5) See the decision of 4 July 2006 by which the current procedure was extended (OJ C 236, 30.9.2006, p.40), in which the Commission founds that certain measures falls within the scope of Article 296 and therefore can not be assessed under State aid rules.

concluded that military activities accounted for three quarters of HSY's activities. On that basis, and in view of the absence of separate accounts for military and civil activities which would have allowed a more refined approach, the Commission considered it reasonable that three quarters of the capital injections, loans and guarantees at stake have financed military activities and are exempted from State aid rules on the basis of Article 296. Conversely, the Commission considered that the remaining quarter financed civil activities and had therefore to be assessed under Article 87.

A second group of controversial measures consisted of loans granted by a State-owned bank and which were (partially) secured by HSY's receivables from the military Navy. Greece claimed that, in view of the type of securities provided to the lending bank and the already mentioned fact that HSY was mainly active in the defence sector, these measures fell within the scope of Article 296. In the final decision adopted on 2 July 2008, the Commission partially rejected this claim. First, the Commission observed that it cannot automatically be assumed that because a loan is secured by receivables coming from a military contract it will be used to finance these military activities. The Commission further noted that, contrary to other loans contracts which were concluded between HSY and the state owned bank and which precisely defined the use of the funds lent, Greece did not adduce any evidence that there were any contractual provisions under which HSY was obliged to use these funds to finance the production of war material ([6]). Conversely, Greece indicated that the loans were granted to cover HSY's needs for working capital and were not assigned to the financing of a particular activity. In these circumstances, the Commission decided to apply the approach described in the previous paragraph; namely, it considered that one quarter of these loans financed the civil activities of HSY and may be assessed under State aid rules.

A third group of problematic measures took the form of advance payments paid by the Hellenic Navy to HSY in the framework of military contracts. According to HSY's own statements, these funds, immediately after they were received by the yard, were used at least during several quarters to finance activities other than the execution of the contracts on the basis of which they had been paid. Greece claimed that these advance payments clearly fall within the scope of Article 296 since they were paid in the framework of military contracts. In the final decision, the Commission considered that these advance payments, in the period during which they were not used for the execution of the contracts in question (estimated to be one year), did not automatically fall within the scope of Article 296. In particular, since according to HSY itself these funds were not used to finance the execution of these military contracts during that period, the Commission inferred that they were not deemed *'necessary for the protection of the essential interests of* [Greece's] *security'*, as indicated in Article 296. The Commission therefore considered that the excess advance payments are equivalent to a one-year interest-free loan from the Greek government. It then applied the reasoning outlined above, concluding that three quarters of this loan was financing military activities and one quarter civil activities. As regards the existence of aid in this 'interest-free loan' to the civil activities, it could have been claimed that, if the State purchases products in a way which would be acceptable to a private firm, the purchase contract — including the terms thereof, such as advance payments — cannot confer a selective advantage on the producer. In particular, advance payments are regularly included in shipbuilding contracts between private parties. In its final decision on the investigation, the Commission did not accept this claim and concluded that these advance payments convey a selective advantage to HSY. The Commission noted that under the military contracts awarded to HSY, the State has never behaved in a manner that would be acceptable for a market economy firm wanting to purchase goods. In particular, a market economy firm would have sought to pay the lowest price possible by considering all potential suppliers in the world. Greece, on the contrary, has always limited its choices to Greek producers (or to consortia having a Greek component), in order to support employment in Greece and in order to maintain the capacity of production of military products in Greece. Therefore, a private firm would not have concluded these purchase contracts.

A fourth and last issue related to Article 296, which is dealt with in the final decision, is the cross subsidisation of civil activities by military activities which would take place if aid was recovered from HSY. As explained above, the Commission has accepted that if State financing was provided to the yard without being earmarked to finance a specific activity, it is possible to take the view that three quarters of the support benefited the military activities and one quarter benefited the civil activities. This conclusion follows from

([6]) A similar approach was followed in the case of a loan for which the internal documents of the state owned bank shows that the latter was concerned about the continuation of the military activities of the yard. In its assessment, the Commission similarly observes that no provision of the loan contract forces HSY to use that loan exclusively for the financing of its military activities.

the fact that HSY has no separate accounts, and therefore the use of the funds cannot be traced. However, if the Commission accepts that three quarters of any inflow of State money will finance the military activities of the yard, it must also conclude that three quarters of any outflow of money from the yard will be provided by the military part of HSY. In other word, 75 eurocent of every euro recovered from HSY would be paid by the military part of HSY. The Commission considers that, since the State has repeatedly provided large amounts of financial support and financing to the military activities of HSY, the use of funds — which otherwise would have financed the military activities — in favour of the civil activities of HSY is akin to a transfer of State aid to the civil activities of the yard. In other words, a part of the financial support granted by the State to the military activities would in fact support the civil activities of HSY, and therefore does not fall within the field of application of Article 296 of the Treaty. Indeed, these funds cannot be deemed to be necessary for the financing of war material production because they are not used for that purpose. In the case of recovery without further conditions, the original situation in the civil markets would therefore not be restored and, moreover, additional incompatible aid would be automatically granted to the civil activities of HSY. Asking HSY to reimburse the aid received by the civil activities will restore the initial situation of the civil activities of the yard only if this reimbursement is financed *exclusively* by the civil part of the yard. Consequently, the final decision lays down that Greece will have to ensure that the aid is recovered exclusively from the civil part of the yard. (It can be expected that this may only be ensured by legal separation, or at least by the introduction of separate accounts.)

The four issues discussed above illustrate the difficulty of applying State aid rules to firms that have both military and civil activities, especially in the absence of separate accounting between the two activities. They also demonstrate the sharp contrast between the civil markets, where all the EC competition rules are applicable, and military activities in the context of the protection of national essential interests, which are exempted from these rules on the basis of Article 296 of the EC Treaty.

2. Indemnification provisions in privatisation contracts

Another complex issue that is also dealt with in the decision adopted on 2 July 2008 was whether or not a refund guarantee granted by the State to the purchaser of HSY at the time of the privatisation of the yard in 2001-2002 contained an aid component of any kind. With this provision, the State, as seller of HSY, had committed to refund the consortium HDW/Ferrostaal (the purchaser of HSY) any State aid which would be reimbursed by HSY following the potential adoption of a recovery decision by the Commission.

In the final decision, the Commission assessed whether this guarantee fulfilled all the conditions to qualify as State aid. The Commission first analysed whether the State had acted as a market economy seller or not and, second, assessed who was the beneficiary of this guarantee ([7]). The following paragraphs summarize the claims of the parties and the line adopted by the Commission on these two issues.

a. *Market economy seller*

Some parties claimed that, by granting this guarantee, the State acted as a normal seller. Indeed, they pointed out that indemnification provisions are normal practice in private contracts for the sale of a firm. It is common for the seller to contractually agree to take responsibility for future liabilities of the firm being sold which could arise as a consequence of past operations of the firm. In the present case, these parties were claiming that it was financially more favourable for the State to sell the yard and to issue this indemnification guarantee in favour of the seller, rather than to put the yard into liquidation. They asserted in particular that the risk for the State of the guarantee being called was very low, whereas, at the same time, in the event of liquidation, the State would lose the entire value of the tens of millions of euro of loans and guarantees granted to HSY. They concluded that, by deciding to privatise the yard and to grant the guarantee to HDW/Ferrostaal, the State had acted as a well-advised shareholder and, as a consequence, this guarantee would not constitute aid.

In its assessment, the Commission makes the following points.

First, the State owned and sold only 51% of the shares of HSY, the remaining 49% being sold by HSY's employees. However, the State agreed to refund HDW/Ferrostaal 100% of any aid which would be recovered from HSY. A well-advised investor would not have accepted to take full responsibility alone for potentially very large past liabilities of the firm. It would have asked the other shareholders to commit to finance a part of the potential refund to HDW/Ferrostaal.

([7]) The decision also analysed in detail the imputability of the measure to the State, since the guarantee had been granted by ETVA and not by the State directly.

Second, when calculating the costs which were to be supported by the State in the case of liquidation, the costs supported as *public authority* should be distinguished from those which place a burden on the State as *market economy operator* ([8]). Only the latter costs, which constitute the normal costs of winding up a firm, should be taken into account when assessing whether the State had acted as a market economy seller. In the present case, all the loans and guarantees granted by the State either constituted State aid to the civil activities or were measures to protect the security of Greece under Article 296. Since they have been granted by Greece as the *public authority,* they do not constitute a normal cost of winding up a firm and should not be taken into account in the assessment. For that reasonthe costs for the State as *market economy operator* in the case of liquidation of HSY would have been very limited. Conversely, the sale price received by the State amount to only a few million euro and, by issuing this refund guarantee, the State runs the risk of having to pay tens of millions. The Commission also observes that the risk of the guarantee being invoked was not negligible or very limited, since a well-advised investor like HDW/Ferrostaal insisted on being protected against the repayment of the State aid by HSY and made the closing of the sale agreement conditional on the receipt of the refund guarantee. On the basis of all of the foregoing, the Commission concludes that a market economy seller would have preferred to let the firm go bankrupt rather than sell it.

Third, the Commission considers that the indemnification guarantee cannot be analysed independently of the other interventions of the State at the time of the privatisation. The Commission notes that the State granted several large aids in 2001 to facilitate the sale of the yard to a private investor. All these elements illustrate that, when the entire intervention of the State is considered, it is clear that during the sale of HSY it did not behave with the objective of maximising its revenues and minimising its costs, but with the aim of facilitating the sale of HSY and the continuation of the yard's activities.

On the basis of the three foregoing considerations, the Commission dismissed the claim that a market economy seller would have agreed to issue such an indemnification guarantee.

b. Identification of the beneficiary

The guarantee has been contractually concluded between the State and HDW/Ferrostaal, which would be the formal beneficiary of any indemnification payment. On that basis, one party was claiming that, in addition to HSY, HDW/Ferrostaal was also a beneficiary of the guarantee. Conversely, several parties, in addition to contesting the existence of any advantage to HDW/Ferrostaal, were also contesting the presence of any advantage to HSY, since the latter was not even a party to the guarantee contract and would never receive any indemnification payment from the State.

In its assessment, the Commission started by recalling that no investor would have purchased HSY in its entirety (i.e. including its civil activities) without receiving such a guarantee. This conclusion was confirmed by a consultant report, which indicates that no rational investor would have been prepared to acquire HSY and, in parallel, assume any additional risk related to potential recovery of State aid. In addition, in a letter to the Commission, Greece had also acknowledged that point and indicated that it was the reason why, in all the documents submitted to potential bidders, it had been made clear that the State would take responsibility for any issues related to past aid. The Commission notes that, since aid can only be recovered from the civil activities, the guarantee was necessary in order to find a purchaser for the civil activities. If the yard was entirely military, no such guarantee would have been necessary in order to find a purchaser.

In the second step of its assessment, the Commission observed that the financial situation and the efficiency of HSY were so bad that, if no investor had purchased the firm, it would have rapidly gone bankrupt.

On the basis of the two foregoing considerations, it was concluded that the beneficiary of the State guarantee is HSY and the advantage received is, as a result of the take-over, the continuation of the civil activities. The claim that HDW/Ferrostaal was a beneficiary of the guarantee was also dismissed, since all the documents submitted by Greece to potential bidders indicated that the purchaser of the yard would be indemnified in the event of recovery of the aid. This means that when HDW/Ferrostaal made its bid for HSY, it was already relying on the receipt of such a guarantee and included it in the proposed price. In other words, HDW/Ferrostaal paid the State for receiving this guarantee.

Since the guarantee constitutes aid and there is no legal basis to find it compatible, the guarantee had to be stopped immediately.

([8]) Case C-334/99, Federal Republic of Germany v Commission, Paragraphs 133 to 141.

This case illustrates how difficult it is for investors, who understandably wish to be protected against the recovery of aid from the firm in which they invest, to design a refund mechanism which is compatible with State aid rules. In fact, it is far from certain that such a mechanism exists.

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17 July: **The way ahead for the Broadcasting Communication** — Neelie KROES — Strasbourg, France (Broadcasting conference)

11 July: **New developments in European State Aid Policy** — Neelie KROES — Berlin, Germany (Joint Conference BDI / Berliner Gesprächskreis)

07 July: **General Block Exemption Regulation for State Aid — Introductory remarks at press conference on adoption of General Block Exemption Regulation for State Aid** — Neelie KROES — Brussels (European Commission)

10 June: B**eing open about standards** — Neelie KROES — Brussels (OpenForum Europe — Breakfast seminar)

09 June: **State aid for broadcasting** — Neelie KROES — Cologne, Germany (Medienforum)

27 May: **State Aid and climate change — creating the right incentives for business** — Neelie KROES —Brussels (Round Table on Environmental Protection and Climate Change)

Speeches by Directorate-General staff, 1 May 2008 — 31 August 2008

12 June: **New developments in European State Aid Law 2008** — Herbert UNGERER — Brussels (The European State Aid Law Institute)

12 June: **The State aid action plan: delivery on track** — Lowri EVANS — Brussels (6th EStALI Experts' Forum on new developments in European state aid law)

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