



EC COMPETITION  
POLICY NEWSLETTER

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- Antitrust — Merger control — State aid control



EUROPEAN COMMISSION

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## Green Paper on damages actions for breach of the EC antitrust rules

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### A. Introduction

The competition rules of Articles 81 and 82 EC can be enforced both by competition authorities (public enforcement) and by private parties who bring their case before a national court (private enforcement). Until recently, enforcement of the EC competition rules was largely limited to decisions taken by the Commission. That enforcement image led victims of competition law infringements to address themselves primarily to the Commission. This has some drawbacks. Complaints addressed to the Commission can not always be pursued, since the Commission can only handle a limited number of cases. It thus has to prioritise its case load. Moreover, the Commission only has the tools foreseen in Regulation 1/2003 to address and to restore competition law infringing behaviour.

In order to remedy these drawbacks the Commission proposed in 2000 to revitalise the joint responsibility it has together with national courts and national competition authorities (NCAs) to enforce the EC competition rules. The resulting Regulation 1/2003 clearly underlines that joint responsibility and gives the necessary tools to achieve the objective of an increased and coherent enforcement of the EC competition rules. With regard to public enforcement, the Commission and the NCAs now work closely together within the ECN (European Competition Network) to apply the EC competition rules. With regard to private enforcement, Regulation 1/2003 fully enables national courts to apply the EC competition rules by abolishing the Commission exemption monopoly, thus empowering national courts to apply Articles 81 and 82 EC in their entirety. As a result, victims of competition law infringements can now address themselves to the Commission, NCAs or national courts, depending on which authority they consider most appropriate to deal with the case. However, when it comes to awarding damages to the victims of competition law infringements, national courts have an exclusive competence.

### B. The Green Paper

Antitrust damages actions are the focus of the Green Paper the Commission adopted on 19 December

2005<sup>(1)</sup>. The Green Paper demonstrates the Commission's desire to facilitate damages actions for infringement of antitrust law. The Commission wishes to facilitate this kind of actions, because they serve a double purpose. Not only do damages actions allow victims of competition law infringements to be compensated, but they also create an additional incentive for undertakings to respect the EC competition rules. Indeed, damages actions are not only meant to toughen the finding of an infringement by a competition authority. They should first and foremost be an autonomous means of enforcement in the hands of the victims of competition law infringements. Seen in this light, private enforcement of the EC competition rules, particularly antitrust damages actions, is a tool to widen the scope of enforcement of Articles 81 and 82 EC. Moreover, by being able effectively to bring a damages claim, individual firms or consumers in Europe become directly engaged in the enforcement of the competition rules. Such first hand experience increases the direct relevance of the competition rules for firms and consumers. In its 2001 *Courage* judgement, the Court of Justice confirmed that victims of an infringement of the EC antitrust rules have a right to claim damages and that Member States have to provide for a procedural framework allowing for an effective system of redress<sup>(2)</sup>.

The Commission considered it appropriate to adopt a Green Paper on damages actions for breach of the EC antitrust rules because there have been very few damages awards for breach of EC antitrust law so far<sup>(3)</sup>. Many of the victims of antitrust infringements seem to refrain from bringing damages actions. Moreover, where they do bring damages claims, such actions often fail to be successful for a variety of reasons. The Green Paper identifies the main obstacles to a more efficient

(1) The Green Paper can be found at [http://europa.eu.int/comm/competition/antitrust/others/actions\\_for\\_damages/gp.html](http://europa.eu.int/comm/competition/antitrust/others/actions_for_damages/gp.html). It is accompanied by a Commission staff working paper, available at [http://europa.eu.int/comm/competition/antitrust/others/actions\\_for\\_damages/sp.html](http://europa.eu.int/comm/competition/antitrust/others/actions_for_damages/sp.html), which gives background to and elaborates the political options mentioned in the Green Paper.

(2) Case C-453/99 *Courage v Crehan* [2001] ECR I-6297.

(3) See the study that was commissioned by the Commission and published in 2004, available at [http://europa.eu.int/comm/competition/antitrust/others/actions\\_for\\_damages/study.html](http://europa.eu.int/comm/competition/antitrust/others/actions_for_damages/study.html).

system of damages claims and sets out, for further reflection and possible action, different options to remove or diminish these obstacles.

### C. The main issues

#### 1. Access to evidence

Actions for damages in antitrust cases regularly require the presentation of a broad and complex range of factual evidence. The particular difficulty of this kind of litigation is that the relevant evidence is often not easily available to the injured party, for example because it is held by the party committing the anti-competitive behaviour or by third parties. Questions of access by victims to such evidence are key to making damage claims more effective. The Green Paper presents several options aimed at facilitating access to such evidence or alternatively alleviating the claimant's burden of proving the infringement.

#### 2. Fault requirement

As a tortious action, damage claims in many of the Member States require fault to be proven. In some of these Member States, fault is presumed if an action is illegal under competition law. In other Member States, however, such a presumption does not exist. The Green Paper therefore considers both a rebuttable and an irrebuttable presumption of fault where illegality is shown. The Green Paper also invites comments as to the introduction of a legitimate defence in case of an excusable error on the side of the defendant.

#### 3. Damages

Several issues concern the actual scope of the damages claim. Firstly, the elements relevant to the definition of damage have to be identified. Several elements are possible, notably founded on the idea of compensation or recovery of illegal gain. The Green Paper also invites reflection on whether any damages award should include interest, as well as the level of interest to be paid. Furthermore, it mentions the possibility of doubling of damages for the most serious category of antitrust infringements, namely horizontal cartels. Finally, the quantification of damages is a key issue. The Green Paper presents several economic models in order to provide for the calculation of damages in complex situations.

#### 4. The passing-on defence and indirect purchaser's right to claim damages

The 'passing-on defence' concerns the legal treatment of the fact that a buyer which purchases from a supplier engaged in anti-competitive behaviour

may be in a position to mitigate its economic loss by passing on the overcharge to its own customers. The damage caused by anti-competitive behaviour may therefore be distributed down the supply chain or may even be suffered in its entirety by the ultimate purchaser, the final consumer. The Green Paper asks the question whether the infringer should be allowed to raise such a passing-on as a defence. Similarly, it addresses the issue of standing for the indirect purchaser and ultimately for the consumer, to whom the overcharge may or may not have been passed on.

#### 5. Defending consumer interests

The Green Paper also addresses the situation of claimants, in particular consumers, with usually small claims. The question is asked whether the recent Commission proposal for a European Small Claims Procedure is sufficient for such claimant to bring an antitrust damages action<sup>(4)</sup>. Alternatively, the Green Paper presents some options as to how their interests could be better protected by collective and representative actions. Beyond the specific protection of consumer interests, collective actions can serve to consolidate a large number of smaller claims into one action, thereby saving time and money.

#### 6. Costs of actions

Rules on cost recovery play an important role as incentives or disincentives for bringing an action. In view of the fact that Community law as well as the European Convention on Human Rights demand an effective access to courts for civil claims, the Green Paper considers how cost rules might facilitate such an access.

#### 7. Coordination of public and private enforcement

Since public and private enforcement of the EC antitrust rules have the same objective, namely increasing the respect of those rules, it is necessary to optimise the co-ordination between these two kinds of enforcement. This is especially true for the coordination between leniency applications in public enforcement and damage claims. The Green Paper presents various options with the objective of reconciling an increased enforcement of the competition rules via damages claims with a preservation of the effectiveness of the leniency programmes.

<sup>(4)</sup> Commission proposal for a Regulation of the European Parliament and of the Council establishing a European Small Claims Procedure, COM(2005)87 of 15 March 2005.

## 8. *Jurisdiction and applicable law*

The study referred to above has shown diversity amongst the procedural rules of the Member States. In order to reduce the forum shopping that may result from such diversity, one needs rules on jurisdiction and on applicable law. The rules on jurisdiction are laid down in Regulation 44/2001<sup>(5)</sup>, whereas the rules on applicable law are the subject of the Commission proposal for a Regulation which is currently being discussed in the European Parliament and in Council<sup>(6)</sup>. In order to assist the Commission in the latter discussions, the Green Paper invites comments on how to construe the rule on applicable law in the case of antitrust damages actions.

## 9. *Other Issues*

Finally, the Green Paper addresses a few more technical issues which are considered necessary to guarantee that damage claims can be brought more effectively: the use of experts in court, limitation periods and causation. Although damages cases may be unsuccessful because of the claimant's inability to prove a causal link between the infringement and the damage, rather than because of the requirement of causation itself, it was considered appropriate to address the issue separately. In doing so, the Green Paper becomes more comprehensive as it covers all three traditional elements

of a damages claim: fault, damage and a causal link between both.

## D. Conclusion

Facilitating actions for damages is a logical next step after Council Regulation 1/2003, which enhanced involvement of the national competition authorities and national courts in the enforcement of the EC antitrust rules. In addition, by being able to effectively bring a damages claim, the individual citizen in Europe, be that a firm or a consumer, is brought closer to the competition rules and will be more actively involved in the enforcement of these rules. Moreover, by increasing the level of enforcement of the EC competition rules, actions for damages contribute to the respect of those rules and thus to effective competition in Europe. They are thus important tools in creating and sustaining a competitive economy, a key element of the 'Lisbon strategy', which aims at making the economy of the European Union grow and create employment for Europe's citizens.

The Green Paper is meant to launch a wide reflection on how to improve the level of successful actions for damages caused by an infringement of the EC antitrust rules. On the basis of the responses received to the Green Paper, the Commission will assess what actions, if any, are necessary to promote further facilitation of actions for damages of EC antitrust law.

<sup>(5)</sup> Council Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ 2001 L 12/1.

<sup>(6)</sup> Commission proposal for a Regulation of the European Parliament and the Council on the law applicable to non-contractual obligations ("Rome II"), COM(2006) 83 of 21 February 2006.

## Commission publishes discussion paper on abuse of dominance

*Luc PEEPERKORN, Directorate-General Competition, unit A-1*

On 19 December 2005 the European Commission published a discussion paper on the application of the EC Treaty competition rules on the abuse of a dominant market position (Article 82). <sup>(1)</sup> The discussion paper is designed to promote a debate as to how EU markets are best protected from dominant companies' exclusionary conduct, conduct which is likely to limit the remaining competitive constraints on the dominant company. The Commission is consulting widely on the discussion paper. It has already discussed the paper with representatives of Member States and its publication opened the consultation to the public. Comments were to be submitted no later than 31 March 2006 <sup>(2)</sup>.

The paper suggests a framework for the continued rigorous enforcement of Article 82, building on the economic analysis carried out in recent cases, and setting out one possible methodology for the assessment of some of the most common abusive practices, such as predatory pricing, single branding, tying, and refusal to supply. The paper also contains a section on market definition, in particular on how to define markets where prices have been raised above the competitive level, and a section on the several factors that are most relevant when assessing dominance.

Article 82 of the EC Treaty prohibits the abuse of a dominant position. Abuses are commonly divided into exclusionary abuses, those which exclude competitors from the market, and exploitative abuses, those where the dominant company exploits its market power by — for example — charging excessive prices. The discussion paper deals only with exclusionary abuses. Exploitative abuses such as excessive pricing and discrimination will be the subject of further work by the Commission in 2006.

### Earlier developments

This review of the application of Article 82 is the logical next step after having 'modernised' the application of Article 81 and merger control over the last years. In these years the Commission adopted amongst others:

- the Vertical Restraints Block Exemption Regulation and Guidelines;
- the Horizontal Block Exemption Regulations and Guidelines;
- the Article 81(3) Guidelines;
- the Technology Transfer Block Exemption Regulation and Guidelines;
- the Horizontal Merger Guidelines.

All these regulations and guidelines have in common that they have brought a more effects based approach to the respective parts of competition policy. This effects based approach, with the help of general economic principles, has enabled the Commission to bring more consistency in and between these various parts of EU competition policy. The current review concludes this modernisation of the application of Articles 81 and 82. In the area of Article 82 it is of course not possible to work with block exemption regulation type instruments but use can be made of guidelines. Whether or not the currently started review will result in guidelines on the application of Article 82 will depend amongst others on the outcome of the debate on the discussion paper.

### Criticism on the current approach

The main criticism on the current application of Article 82 is that, although the relevant case law on 82 may be clear in certain areas, it is fragmented and focuses too much on form whereby effects are too easily being presumed. To the extent that this would cause Article 82 to be applied to cases in which there is no likely or actual restrictive effect on the market, this would be wrong as it would lead to false convictions. Likewise it would be wrong if because of the formal approach, Article 82 would not be applicable to situations in which there is an actual or likely effect on the market, as this would lead to false acquittals.

In general a pure form-based approach may provide certainty and timely enforcement, but at (too high) a cost of false positives and false negatives. A pure effects-based, case by case, approach on the other hand may provide a correct outcome in each individual case, but risks creating uncertainty and may result in too little and too slow enforcement. There is a trade-off between legal certainty/predictability and 'getting it right', as well as between 'getting it right' and getting things done in a timely way.

<sup>(1)</sup> [http://europa.eu.int/comm/competition/antitrust/others/article\\_82\\_review.html](http://europa.eu.int/comm/competition/antitrust/others/article_82_review.html)

<sup>(2)</sup> Over a hundred submissions were received, available on the website referred to in the previous footnote. At the time of writing of this article the submissions had not yet been analysed and are not further dealt with here.

It is considered that at the moment there is scope in the application of Article 82 for both increased predictability and a more effects-based approach. The policy will have to be more firmly based on general principles derived from economic theory and strike the right balance between general rules/safe harbours/bright lines and a full effects analysis on a case by case basis. It is important that the discussion paper will not only lead to more consistent decisions, but also that it leads to workable rules that allow for timely decisions, with a strong focus on those abuses of dominant positions most likely to harm consumers.

### The general framework of analysis

The common objective of Article 82 and Article 81 is to protect consumer welfare by protecting competition. The underlying well tested and justified assumption is that effective competition on the market benefits consumers. Conduct by companies that harms effective competition is thus in principle prohibited unless it can be shown that it brings about efficiencies which, from the perspective of consumers, outweigh the identified harm to competition. This is the prohibition principle on which the EU competition rules are based.

The discussion paper describes the general framework for analysing abusive exclusionary conduct by a dominant company. Where a dominant company is present on a market, competition on that market is already weak. The concern is therefore to prevent conduct by that dominant company which risks weakening competition still further.

In case of exclusionary abuses the central concern is foreclosure, whether upstream or downstream. Foreclosure of residual and potential competitors is *prima facie* abusive conduct where such foreclosure is significant enough to hurt competition. Such harm to competition may take place in the short, medium or long term.

Conduct that is likely to exclude only clearly less efficient competitors that are not able to have a restraining effect on the dominant company should in general not be considered a competition problem. Protecting such inefficient companies does not safeguard but disturb the competitive process: it protects competitors but not competition. Also dominant companies should be allowed to compete effectively and fiercely. Competition policy enforcement should not subdue aggressive competition, even by dominant companies and if it hurts competitors, as long as it ultimately benefits consumers. This links in well with the famous phrase from case law that dominant companies may compete on the merits. It may not always have

been clear what was meant with that phrase, but with the help of economic principles the discussion paper wants to give it a precise meaning.

### The general test

The general framework of analysis will involve in practice for most cases a three step general test. The first step would be to establish whether the conduct 'tends to restrict competition' or 'is capable of having a restrictive effect'. This will depend in good part on the form or nature of the conduct in question. For certain conduct, such as a single branding obligation not to purchase competing products, this may be relatively straightforward. For other types of conduct, such as a rebate or tying, often a more in depth analysis of the capability to exclude will be required.

In particular for price based exclusionary conduct it is not always easy to distinguish between on the one hand abusive pricing which is capable to foreclose and thereby harm competition and on the other hand pro-competitive pricing based on the merits. For price based conduct the discussion paper proposes to apply the 'as efficient competitor test'. Principles are provided to evaluate whether a competitor, which is as efficient as the dominant company, can compete against the price schedule or rebate system of the dominant company. The question is asked whether the dominant company itself would be able to survive the exclusionary conduct in the event that it would be the target. The exact formulation of these principles varies from abuse to abuse, depending on, for instance, considerations about whether potentially abusive low prices or rebate schemes are offered to the whole market or only a part of it and whether low prices apply to all of a customer's requirements or only a part of them. If examination of a dominant company's price schedule or rebate system according to these principles leads to the conclusion that an as efficient competitor can compete with the dominant company, the Commission will normally reach the conclusion that the dominant company's price schedule or rebate system is not abusive (safe harbour). If, however, an as efficient competitor cannot compete with the dominant company, the Commission will consider the conduct to have the capability to foreclose competitors and therefore examine the likely market impact of the price schedule or rebate system. This is of course not new: such an approach can already be found in the case law on predation and margin squeeze and is a proper operationalisation of what is meant with competition on the merits.

To apply the as efficient competitor test means in general applying a price-cost test. For instance in case of predation the paper proposes, in line with

previous case law, to apply a presumption of predation for pricing below average avoidable cost but to require additional elements of proof for pricing above average avoidable cost. In case of conditional rebates on all purchases (so-called roll-back rebates) the price-cost test is applied by calculating the effect of the rebate on the price over a relevant range of the purchases and by comparing the resulting effective price for this range with the costs of the dominant company.

To apply the as efficient competitor test the authority in principle needs to have reliable information on the pricing conduct and costs of the dominant company. A number of remarks are made in the paper on the use of a price-cost test. Firstly, it is practical for the dominant company, which, in order to assess its own behaviour and prevent abuse, can look at its own costs and revenues. Secondly, it may be necessary to look at revenues and costs of the dominant company in a wider context. It may not be sufficient to only assess whether the price or revenue covers the costs for the product in question, but it may be necessary to look at incremental revenues in case the dominant company's conduct negatively affects its revenues in other markets or of other products. Similarly, in case of two sided markets it may be necessary to look at revenues and costs of products on both sides of the market. Thirdly, in case reliable information on the dominant company's costs is not available it may be necessary to apply the as efficient competitor test using cost data of apparently efficient competitors.

The *second step* would be to establish the likely or actual foreclosure effects. To establish a market distorting foreclosure effect, it is in general necessary to consider the incidence of the conduct, i.e. the extent to which the dominant company is applying it in the market, including the market coverage of the conduct or the selective foreclosure of customers to newcomers or residual competitors. Other market characteristics including the existence of network effects and economies of scale and scope may also be relevant to establish a foreclosure effect. Also evidence of actual foreclosure can play a role and occasionally, where it is well documented, the explicit intention to foreclose. In addition the degree of dominance will be a relevant factor. In general, a high capability of conduct to foreclose, a wide application of that conduct and a strong dominant position are factors which all lead to a higher likelihood that an anticompetitive foreclosure effect results.

The *third step* concerns the application of possible defences. Exclusionary conduct may escape the prohibition of Article 82 in case the dominant undertaking can provide an objective justification

for its behaviour or can demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition. Whereas the burden of proof for the first two steps falls normally on the authority or plaintiff, the burden of proof for such an objective justification or efficiency defence will be on the dominant company. It should be for the company invoking the benefit of a defence against a finding of an infringement to demonstrate to the required legal standard of proof that the conditions for applying such defence are satisfied.

The first type of objective justification is where the dominant company is able to show that the otherwise abusive conduct is actually necessary conduct on the basis of objective factors external to the parties involved and in particular external to the dominant company ('objective necessity defence'). The dominant company may be able to show that the conduct concerned is objectively necessary, for instance because of reasons of safety or health related to the dangerous nature of the product in question. Such necessity must be based on objective factors that apply in general for all undertakings in the market. On the basis of these factors the dominant company must be able to show that without the conduct the products concerned can not or will not be produced or distributed in that market.

The second type of objective justification is where the dominant company is able to show that the otherwise abusive conduct is actually a loss minimising reaction to competition from others ('meeting competition defence'). The Community Courts have considered that defending its own commercial and economic interests in the face of action taken by certain competitors may be a legitimate aim. This automatically implies that an objective justification is not possible if the dominant company is not able to show that its conduct is only a response to low pricing by others or if the Commission, for instance through documents seized at the company, has been able to demonstrate that the objective aim of the conduct is to directly foreclose competitors. The meeting competition defence is only applicable in relation to behaviour which otherwise would constitute a pricing abuse. The dominant company will have to show that its reaction is suitable, indispensable and proportionate.

In relation to the efficiency defence the dominant company must be able to show that the efficiencies brought about by the conduct concerned outweigh the likely negative effects on competition resulting from the conduct and therewith the likely harm to consumers that the conduct might otherwise have. Articles 81 and 82 of the Treaty both pursue, with regard to exclusionary practices, the aim of maintaining effective competition on the market and,



according to settled case law, can be applied simultaneously. There is also a large overlap in practice to the kind of situations where both can be applied. Consistency requires that Article 81(3) be interpreted as precluding any application of this provision to restrictive agreements that constitute an abuse of a dominant position. However the opposite also holds. A company holding a dominant position may benefit from an exemption under Article 81(3) of the EC Treaty when its conditions are fulfilled. Therefore, if the conduct of a dominant company generates efficiencies and provided that all the other conditions of Article 81(3) are satisfied, such conduct should not be classified as an abuse under Article 82 of the EC Treaty. However, obviously the level of market power needs to be taken into account. When market power grows, and hence the likely impact of exclusionary conduct increases, it will become increasingly difficult to defend that there are efficiencies, that there is sufficient pass-on to consumers and that competition will not be eliminated.

## Conclusion

The paper and the approach described therein are meant to strengthen the enforcement of the EU competition rules. The aim is not to fundamentally alter the direction or content of the policy but to add clarity and consistency. The discussion paper proposes an approach focusing on likely and actual effects. It aims at distinguishing those kinds of behaviour that are likely to harm competition and thereby consumers and the circumstances in which such harm is likely to occur from kinds of behaviour and circumstances where such harm is unlikely. It presents a framework for analysis of competitive harm and proposes relevant questions to be asked, tests to be applied and distinctions to be made in actual cases.

It is still too early to say what the next steps will be. After the consultation on the discussion paper and evaluating its result, it will be decided whether to propose draft guidelines to the Commission.

## The European Competition Network Achievements and challenges – a case in point: leniency

Céline GAUER and Maria JASPERS, Directorate-General Competition, unit A-4

### 1. Introduction

Council Regulation 1/2003<sup>(1)</sup> entered into force on 1 May 2004 and with that a new antitrust enforcement regime in the EU. This article will look at the first achievements of the European Competition Network (ECN), set up as the vehicle to ensure effective and coherent application of Community competition rules in the modernised enforcement system. Special focus will be given to the work undertaken in the leniency field, as a good example of how the ECN can foster a common competition culture beyond the coherent application of EC competition law in a particular case.<sup>(2)</sup>

The foundation of the new antitrust enforcement regime under Regulation 1/2003<sup>(3)</sup> is a system of parallel competences and flexible case-allocation rules. In practical terms, this means that any well placed authority can take action in a case. Indicative, non-binding rules explaining when an ECN member is well placed to act are set out in the Commission Notice commonly referred to as the Network Notice.<sup>(4)</sup> The Commission is always well placed to act and in certain circumstances even particularly well placed to do so.<sup>(5)</sup>

Regulation 1/2003 sets out three mechanisms to ensure a coherent application of the Community antitrust rules; namely the obligation to apply Community law whenever there is an effect on trade in a manner that ensures convergence between national and Community law (Article 3), the obligation to inform the Commission at least

30 calendar days before an envisaged decision (Article 11(4)) and the possibility for the Commission to intervene if there is a risk of incoherence, by relieving the national competition authority of its competence to act (Article 11(6)).

The ECN neither decides which cases should be pursued nor which authority/authorities would be well placed to do the investigation. It is a forum in which the competition authorities can exchange information, share experiences, support and assist one another in fact-findings and investigations.

### 2. First achievements: an efficient handling of individual cases

As far as individual cases are concerned, the ECN provides a flexible framework for an efficient allocation of cases, a mutual assistance between competition authorities in their investigations and a consistent application of EC competition rules. From this triple perspective, the first two years of experience of the system are extremely promising.

#### 2.1. Allocation of cases

The ECN can present an impressive result of enforcement actions during the first two years. More than 560 cases have been reported in the common ECN case-management system and the Commission has within this time period reviewed more than 130 envisaged decisions pursuant to Article 11(4).<sup>(6)</sup>

The first experiences of the work-sharing within the Network have confirmed that the flexible and pragmatic approach introduced by the Regulation and the Network Notice functions very well in practice. There are relatively few cases where case-allocation discussions have at all been needed and even less occasions where a case has changed hands. The situations where work-sharing has played a role to date, is typically where a complainant or a leniency applicant have chosen to contact both the Commission and one or more national competition authorities. The experiences have shown that the ECN is well equipped to identify attempts of forum-shopping and likewise equipped to

(1) Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 1, 4.1.2003, p. 1, hereinafter referred to as 'the Network Notice'.

(2) For a detailed analysis, see also 'Antitrust Reform in Europe: a year in practice', IBA 2005.

(3) For more information on the modernisation reform and the ECN cooperation, see Gauer, Céline/Kjølbbye, Lars / Dalheimer, Dorothe/ de Smijter, Eddy/Schnichels, Dominik/Laurila, Maija, 'Regulation 1/2003 and the Modernisation Package fully applicable since 1 May 2004', *Competition Policy Newsletter*, No 2, summer 2004, page 1-6.

(4) Commission Notice on cooperation within the Network of Competition Authorities, OJ C 101, 27.4.2004, p. 3 (paragraphs 8-13).

(5) This would for example be the case where the infringement has effects in more than three Member States or where there is a need to adopt a Community act to develop EC competition policy (Network Notice paragraph 14-15).

(6) DG Competition publishes aggregated statistics of cases reported in the common ECN case-management system on its website [www.europa.eu.int/comm/competition](http://www.europa.eu.int/comm/competition).

avoid unnecessary duplication of work. It has also manifested the ECN members' readiness to solve case-allocation issues in a manner that ensures the most efficient work-sharing arrangement for a particular case.

## 2.2. Mutual assistance

The instruments created by Regulation No 1/2003 in order to foster mutual assistance between Network members have also had a promising start. There have already been numerous cases where national competition authorities have assisted each other in different fact-finding measures. This greatly enhances the overall efficiency of all ECN members. Exchanges of market information and intelligence at an early stage have also enabled the ECN to uncover European-wide cartel arrangements that might otherwise have remained undetected.

## 2.3. Consistent application of EC competition law

The practical experience with the information obligations under Article 11(4) has been very encouraging. The Commission has to date not used the possibility of relieving a national competition authority from its competence by initiating formal proceedings under Article 11(6) following a consultation pursuant to Article 11(4). The Commission has, however, on several occasions used the possibility provided for in the Network Notice to submit observations on a case. This has proven to be a useful tool that has triggered creative, informative and productive dialogues with the concerned national competition authority. It is however important to underline that every case is investigated and decided under the full and sole responsibility of the authority dealing with the case.

## 3. Towards a greater degree of convergence of procedural rules? The example of leniency

The first two years have shown that the ECN cooperation mechanisms also contribute to fostering a common competition culture within the ECN and work as a catalyst for further convergence.

A significant level of convergence of national laws towards Community law — over and beyond legal obligations of implementation — has already been achieved. The trend towards the abolition of the notification system at national level is a clear example thereof. Another area where a considerable convergence has already taken place is the alignment of national investigative powers to

those of the Commission. <sup>(7)</sup> But the most prominent example of how the sharing of experiences within the ECN can influence national policy considerations and streamline national procedures is certainly the current developments in the field of leniency.

The Commission and 18 Member States operate leniency programmes in the EU today. <sup>(8)</sup> Seven of these programmes were adopted after Regulation 1/2003 entered into force. There are moreover ongoing reflections in four of the remaining six Member States. This trend can only be wholeheartedly welcomed by both competition authorities and the business community. Leniency programmes have proven to be efficient and successful tools in the ECN members' fight against hard core cartels. Despite this very positive evolution, the current system could still be improved.

### 3.1. The current system: strict safeguards for leniency related information <sup>(9)</sup>

Regulation 1/2003 did not introduce an EU-wide leniency policy and did not harmonise the substance and procedures of existing programmes. The new possibilities under the Regulation to exchange and use information in evidence did, however, require certain measures to ensure that the leniency applicant remains protected when information is shared within the ECN. For that reason, two sets of special safeguards were introduced in the Network Notice concerning leniency related information. <sup>(10)</sup>

The first ensures that leniency related information submitted to the ECN pursuant to Article 11 of Regulation 1/2003 cannot be used by other ECN members to start an investigation. It is understood by the ECN members that this commitment covers all forms of communications about such cases, not

<sup>(7)</sup> This concerns different aspects such as the power related to on the spot investigations (power to seal business premises, books and records; power to inspect non-business premises), as well as the power to adopt interim measures, commitment decisions or to make general sector enquiries.

<sup>(8)</sup> A list of all ECN authorities which operate a leniency programme is published on DG Competition's website ([www.europa.eu.int/comm/competition](http://www.europa.eu.int/comm/competition).)

<sup>(9)</sup> For more information, see Blake, Stephen/Schnichels, Dominik, 'Leniency following Modernisation: safeguarding Europe's leniency programmes', *Competition Policy Newsletter*, No 2, summer 2004, page 7. See also Céline Gauer, « Les programmes de clémence au regard du droit communautaire », *Concurrences* n°3/2005.

<sup>(10)</sup> See paragraphs 39-42 of the Network Notice. Leniency related information covers not only the leniency application itself, but all information that has been collected following any fact-finding measures that could not have been carried out except as a result of the leniency application.

only the specific information which is submitted to the common case-management system in order to comply with the information obligation in Article 11(3) of Regulation 1/2003. The obligation not to use leniency related information to start an investigation applies irrespective of whether the authorities intend to apply EC competition law, national competition law or any other provisions.

ECN members that want to use leniency related information from other ECN members either as intelligence or as direct use in evidence have to request it under Article 12 of the Regulation and start their investigation upon receipt of the information. Such request will trigger the second set of safeguards in the Network Notice. Pursuant to these safeguards, information submitted by a leniency applicant or collected on that basis, may only be exchanged between two authorities in the following circumstances:

- The applicant consents to the exchange;
- The applicant has applied for leniency with both authorities in the same case;
- The receiving authority commits in writing not to use the information received or any information collected after the date of the transmission to impose sanctions on the applicant, its subsidiaries or its employees. A copy of the written commitment is sent to the applicant.

In practice, these safeguards enable the authorities to exchange and use in evidence leniency related information without jeopardizing their respective programmes. The first experiences show that all ECN members apply the rules strictly and with caution. A leniency applicant can therefore rest assured that it will not expose itself to any additional risks by voluntarily disclosing information to a Network member.

### 3.2. *Current system – deficits and scope for improvements*

The current system protects adequately leniency applicants but entails however certain deficits, both from the perspective of the applicant and from the perspective of the authority.

As mentioned above, the enforcement system under Regulation 1/2003 is a system of parallel competences with flexible case-allocation rules. This has certain consequences for the handling of leniency cases within the ECN. First, in the current system, an application for leniency to a given authority is not to be considered as an application for leniency to any other ECN member.<sup>(11)</sup> Secondly, the fact that an authority would, according to the case-

allocation criteria, appear particularly well placed to deal with a case does not prevent another well placed authority from acting. In order to be fully protected, an applicant must therefore apply for leniency with all authorities that could realistically pursue a case against it. It should be underlined that Regulation 1/2003 has in this respect not created any risks for the immunity applicant that did not already exist before 1 May 2004.

Apart from the fact that such multiple filings impose a certain burden on both applicants and authorities, there are currently also a number of discrepancies between the various ECN programmes. Such discrepancies relate to the conditions to obtain immunity or leniency, to procedural aspects as well as to the level of protection afforded under the respective programmes. Since a potential applicant might be hesitant to go lenient if the leniency policy in one jurisdiction is not sufficiently attractive, these discrepancies can have important consequences for both applicants and authorities.

### 3.3. *Next steps – towards a uniform leniency system?*

The ECN members are working ambitiously together to guarantee that discrepancies between the various programmes and the flexible enforcement system do not dissuade applicants from coming forward.

Some results have already been achieved in this respect. To start with, the ECN members have agreed on a mechanism that should ensure that applicants are not exposed to conflicting demands under the various programmes. The only example of a truly conflicting demand that has so far been detected is where one authority would require the applicant to immediately stop its cartel activities whereas another would request it to continue in order not to endanger the investigation. Should this materialise in an individual case, the ECN members have agreed that the authorities would use their discretion to order termination in such way that a conflicting demand would not arise in the concrete case.

The sharing of experiences of the practical handling of leniency cases has also streamlined and improved the procedure applied by individual authorities in their contact with leniency applicants, for example with regard to oral applications and access to file issues. Such discussions have also fine-tuned the handling of leniency cases within the ECN to ensure that parallel leniency cases are dealt with in the most efficient manner.

<sup>(11)</sup> See paragraph 38 of the Network Notice.

The next step would be to reduce the burden associated with multiple filings, to reduce the discrepancies between the existing leniency programmes and to ensure that all NCAs operate such programmes. All these issues are currently being thoroughly discussed within the ECN.

As concerns the issue of multiple filings, it would appear feasible to design a system that would allow leniency applicants to protect their position within the Network without having to provide full and complete information to all Network members that could pursue a case against it. Indeed, some national competition authorities already accept short form pro forma applications in cases where the Commission is investigating the case. This does not mean that one Network member would be designated to receive all applications with binding effects for the rest. In a system of parallel competences, multiple filings are to a certain extent necessary, since more than one authority may decide to investigate the case and would need the information upfront. The level of information that must be given to such authorities that will in the end not deal with the case is, however, a different issue.

Apart from streamlining the filing process within the ECN, it would also appear useful to align, to the extent possible, the conditions and procedures of the different programmes. This would help potential applicants in deciding whether to come

forward and would facilitate their applications once they have decided to do so.

## Conclusion

The first experiences of the competition authorities' cooperation within the ECN have been very positive. The work-sharing and information exchanges have resulted in an enhanced, strategic and coherent application of Community competition rules. The ECN members have shown a readiness to hear and learn from other competition authorities and to openly discuss general policy issues as well as individual cases. One can already observe the influence that the ECN has had on policy reflections beyond what is required under Regulation 1/2003. The growing convergence of national procedural rules and the work in the leniency field are good examples of this. By sharing the knowledge of a particular sector or the experiences of a particular competition issue, the ECN members will continue to shape a common competition culture and to stream-line the way their respective investigations are carried out.

The ECN has proven to be well-equipped and ready to deal with the opportunities and the challenges of the new antitrust enforcement regime. The achievements reached so far give an indication of the enormous potential that this unique and revolutionary cooperation form can have when it is used to the fullest.

## European Energy Sector — Quo Vadis? First results of the Sector Inquiry

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*The energy sector is of fundamental importance to the European economy, and to the well-being of citizens of the European Union. Debate about the future direction of European energy policy has been vigorous for most of the last decade, and will likely be intense during 2006. Within the framework of the decision by the Commission to open a sector inquiry in the gas and electricity markets, DG Competition has carried out an investigation into the state of competition in those markets. This paper reviews the most important issues currently under discussion, and sets out the preliminary conclusions that can be drawn from the sector inquiry. It highlights the role of competition as a key mechanism to deliver a range of energy-related policies. In particular, it points out that failure to secure effective competition in energy markets will not only lead to expensive energy, but also to failure to secure other policy objectives such as supply security and environmental protection.*

### Introduction

The European Union is one of the most important energy blocs in the world, and its economy is largely dependent on a secure and competitive energy supply. Historically, the state played an important role in sponsoring and overseeing the development of the energy sector in most European countries. State-sponsored development within national borders often led to the creation of monopolies in sectors that were potentially competitive. However, the European Union has in recent years adopted a number of measures aiming at liberalising energy markets and addressing other important issues of common European interest. The development of competitive market is not only an objective in itself, but also constitutes an unavoidable context for meeting other vital policy goals, and is indeed the major mechanism for their fulfilment.

Most notably, two directives from 2003 <sup>(1)</sup> require all gas and electricity end-user markets to be open for competition by 2007, and lay down a number of

conditions for competition to evolve, such as non-discriminatory access to transport and storage infrastructure. These directives also require Member States to ensure high standards of consumer protection, and set minimum standards for protection of household customers, while making clear that consumer protection should be delivered through and in the context of competitive markets. In 2004 and 2006, two further directives laid down conditions to ensure minimum standards for security of supply, clear responsibilities and monitoring requirements <sup>(2)</sup>. The Directives set out to create a security regime appropriate to a liberalised market, and make clear that market actors have major roles to play <sup>(3)</sup>. As regards environmental protection, European legislation exists on energy efficiency <sup>(4)</sup>, and on promotion of electricity generation from renewable energy sources <sup>(5)</sup>; again, these rules set out to meet their objective through the operation of competitive markets. Of key significance for the electricity sector is the emissions trading scheme established in 2003 <sup>(6)</sup>, under which generators have to secure permits to issue greenhouse gases, and can do this through trading permits.

<sup>(1)</sup> Directives 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity (OJ L 176, 15.7.2003, p. 37); and 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas (OJ L 176, 15.7.2003, p. 57).

<sup>(2)</sup> Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply (OJ L 127, 29.4.2004, p. 92); and Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment (OJ L 33, 4.2.2006, p. 22).

<sup>(3)</sup> Security of supply is no small task: the International Energy Agency estimates that the OECD countries of Europe will need to invest around 2,000 billion US dollars by 2030 to secure their energy supplies.

<sup>(4)</sup> A number of measures exist. For a summary and latest proposals, see the Commission's proposal for a Directive of the European Parliament and of the Council on energy end-use efficiency and energy services, Brussels, COM(2003) 739 final of 10 December 2003; and the 2005 Green paper on energy efficiency, COM(2005) 265 final of 22 June 2005.

<sup>(5)</sup> Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market (OJ L 283, 27.10.2001, p. 33).

<sup>(6)</sup> Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC (OJ L 275, 25.10.2003, p. 32).

## Markets as mechanisms to deliver other policy objectives

With respect to security of supply, the key challenges of the last decade have related mostly to the electricity markets, and the focus has been mainly on whether network infrastructures and generation capacity were adequate to meet demand. Experience shows that competition is wholly consistent with proper network security. For instance, network security has consistently improved since competition was introduced into the UK market <sup>(7)</sup>. Network failures (such as the Italian black-out of 2003) have arisen from failures in system operation — and are perhaps indirectly related to regulatory issues — rather than as a result of competition. In the field of gas, the key concerns relate to the EU's declining ability to produce its own gas and the ensuing increased dependency on gas imports. Since the EU is surrounded by gas producing regions (Norway, Russia, Caucasus, Middle East, North Africa, West Africa, and the Caribbean), such an import dependency is not in itself a cause for alarm. However, there is a need to determine the best means to attract necessary investment so as to extract and transport these gas reserves to EU markets.

Investors are likely to require clarity about management of the inevitable risks associated with investment in energy networks or production. Historically, long-term contracts have been a key means of sharing risk. Where the downstream counterparty had retail market power or a monopoly, the arrangement also enabled the risks to be passed to customers. Alternatively, vertical integration has been used to create a natural hedge and facilitate on-balance-sheet financing of investments. Competition now offers an alternative means to sustain investment — which is simply the normal mechanism in market economies. The creation of deep and liquid markets inherently reduces stranding risk, and enables price risks to be managed through trading of forward products. Indeed, the investment signals arising from well-designed competitive markets may be more accurate than the planning of vertically integrated companies, leading to more efficient investment.

Experience with liberalised energy markets in Europe is still short, but at this stage gives reasons for confidence that markets can provide sufficiently clear signals and risk-hedging tools to guide and support investments in generation. The UK has experienced an important investment boom in gas

fired generation since liberalisation. Equally, high electricity prices on the Italian peninsula have led in recent years to considerable amounts of generation capacity being built. A substantial number of generation plants have also been constructed in Spain as a result of market signals. As for gas, competitive pricing in the UK has sent signals that are leading to large investments in new import infrastructure.

Finally, market mechanisms are being given an important role in reducing the environmental impacts of the energy industry. Many Member States have experimented with boosting the value of renewable electricity by allocating tradable certificates to green generators, which have value because suppliers are obliged to acquire a certain number of certificates each year. More widely, all large combustion facilities must now acquire certificates to emit greenhouse gases, and the cost of securing certificates is now widely included in the price of electricity. Analysts do not yet agree whether the emissions trading scheme has had a major impact on the cost of electricity. Electricity prices have risen, and so have the costs of emissions permits, but the causal link is not wholly clear. Although it is therefore perhaps too early to establish exact patterns of causality, it seems clear that using a market mechanism to limit emissions has created the potential for this environmental measure to take account of external events, like rising gas prices. This inherent flexibility should make it more efficient than a centrally planned carbon-reduction strategy.

## Preliminary results from the energy sector inquiry

Given the importance of competitive markets, DG Competition has set itself to determine how well competition in the energy sector has been functioning. The overall objective is to address the barriers to competition currently impeding the development of fully functioning open and competitive EU-wide energy markets.

As part of the inquiry DG Competition has met with several dozen market participants, and sent out over 3,000 questionnaires. The inquiry has published a brief 'issues paper' setting out key findings, and also a longer Preliminary Report <sup>(8)</sup>. The inquiry's Final Report is expected to be published later in 2006. In the first phase of the inquiry important competition distortions were identified in gas and electricity markets.

<sup>(7)</sup> As networks are regulated natural monopolies, it is strictly speaking regulation combined with effective system operation that ensures security of supply, rather than competition.

<sup>(8)</sup> See [http://europa.eu.int/comm/competition/antitrust/others/sector\\_inquiries/energy](http://europa.eu.int/comm/competition/antitrust/others/sector_inquiries/energy).

The key preliminary findings as regards these categories can be summarised as follows:

### *Gas*

At the wholesale level, markets generally maintain the high level of concentration of the pre-liberalisation period. Wholesale trade has been slow to develop, and the incumbents remain dominant on their traditional markets, by largely controlling up-stream gas imports and/or gas production. Incumbents trade only a small proportion of their gas on hubs. With little new entry in retail markets, customer choice is limited and competitive pressure reduced. The overall picture for potential new entrants is one of dependency on vertically integrated incumbents for services throughout the supply chain.

Lack of liquidity and limited access to infrastructure mean that markets are foreclosed and new entrants are prevented from offering their services to the consumer. The network of long term supply contracts between gas producers and incumbent importers makes it very difficult for new entrants to access gas on the upstream markets. Additionally, certain features of these contracts limit incentives for incumbents to provide liquidity on wholesale markets. Gas infrastructure (transmission networks and storage) is to a large extent owned by the incumbent gas importers, and the insufficient separation of this infrastructure from supply functions results in insufficient market opening. Despite EU rules on third party access and legal/functional unbundling, new entrants often lack effective access to networks, the operators of which are alleged to favour their own affiliates.

A lack of market integration means that cross-border sales do not presently exert any significant competitive pressure. Incumbents rarely enter other national markets as competitors and available capacity on cross-border import pipelines is limited. New entrants are unable to secure transit capacity on key routes. The primary capacity on transit pipelines is controlled by incumbents based on legacy contracts that derogate from normal third party access rules. The foreclosure effect is reinforced by ineffective congestion management mechanisms, which can make it hard to secure even small volumes of short-term, interruptible capacity on the secondary market. In most cases, new entrants have not even secured capacity when there have been expansions of transit pipeline capacity.

Network users request more transparency on access to networks, transit capacity and storage, going beyond the current minimum requirements

set by EU legislation. For instance, confidentiality rules risk being used to impede effective transparency when given too wide an interpretation. To ensure a level playing field, users require information to be made available on an equal footing with the network owner.

More effective and transparent price formation is needed in order to deliver the full advantages of market opening to consumers. At this stage, gas import contracts use price indices that are linked to oil products and recent price increases have, therefore, closely followed developments in oil markets. This results in wholesale prices that fail to react to changes in the supply and demand for gas, which distorts incentives to invest, for instance in gas storage and transit facilities. No clear trend towards more market based pricing mechanisms can be observed in long-term import contracts. Gas prices on existing gas hubs have also been rising recently, and ensuring liquidity is crucial to improving confidence in price formation on gas hubs.

### *Electricity*

Most wholesale markets remain national in scope with high levels of concentration in generation, which gives scope for exercising market power. Analysis of trading in power exchanges shows that, in a number of them, generators have the scope to raise prices, a concern also expressed in the inquiry by many customers. Analysis of generation portfolios also indicates that the main generators have the ability to withdraw capacity to raise prices. Further assessment will be needed, however, in order to determine whether operators have unduly used these possibilities to raise prices.

Vertical integration of generation, supply and network activities has remained a dominant feature in many electricity markets, which creates risk that markets are foreclosed for new entrants. Vertical integration of generation and retail reduces the incentives to trade on wholesale markets. Low levels of liquidity on such markets are an entry barrier. Furthermore, the strong links between supply and network companies reduce the economic incentives for the network operators to grant access to third parties. Many respondents are highly critical of the efficiency of existing unbundling obligations, believing that discrimination continues in favour of affiliates, and call for stricter measures.

The low level of cross-border trade is insufficient to exert pressure on (dominant) generators in national markets. Integration is hampered by insufficient inter-connector capacity and long-term capacity reservations predating liberalisation. Improving



access to inter-connectors requires better methods of congestion management. There is also a lack of adequate incentives to invest in additional capacity to eliminate long-established bottlenecks. Differences in market design between Member States hamper market integration.

There is a serious lack of transparency in the electricity wholesale markets, which is widely recognised by the sector. Improved transparency would minimise risks for market players and thereby reduce entry barriers to generation and supply markets, while improving trust in the wholesale markets and confidence in its price signals. Users request more information on technical availability of inter-connectors and transmission networks, on generation, on balancing and reserve power, and on load. Rules on proper market conduct and supervision differ significantly between Member States.

Price formation is complex, and many users have limited trust in the price formation mechanisms. Analysts cannot yet agree on the extent to which the EU emissions trading scheme has affected electricity prices. The co-existence of regulated and free market prices on several national markets has an adverse effect on the development of competitive markets.

### Conclusion

It therefore does not come as a surprise that the Commission's 2006 communication to the Spring Council recognises the need to reinforce the internal energy market, in particular by taking steps to address: the continued dominance of national incumbent operators; insufficient market transparency; inadequate unbundling of network and supply activities; and barriers to cross-border supply preventing a truly integrated EU energy market.

### First lessons from the sector inquiry for competition and other policy areas in energy

#### Market concentration

Market concentration has been identified as a fundamental problem. The natural consequence of this situation is non-competitive pricing, which is clearly prevalent in gas, and may exist in electricity. So far, the strength of historic monopolies has not been challenged. Companies themselves, however, have reacted swiftly to liberalisation through mergers and acquisitions. These have included proposals to integrate powerful gas and electricity compa-

nies in a number of Member States<sup>(9)</sup>. Such mergers can reduce fuel-sourcing risk for gas-powered electricity generators, and reduce volume risk for gas companies. However, as the sector inquiry has confirmed, they may equally reduce the number of potential competitors and sterilise parts of otherwise contestable markets. Effective application of the merger regulation is therefore essential and the results from the inquiry will help identifying the most relevant criteria and the most efficient remedies in the given market environment.

While merger control has thus a key role to play, it remains necessarily reactive: the Commission only deals with transactions that are notified to it. Moreover, merger control cannot effectively address competition problems caused by already existing dominant position. Articles 81 and 82 therefore also have an important role to play in terms of preventing companies from using illicit means to restrict actual or potential competition.

#### Market integration

Lack of access to cross-border gas pipelines, to gas storage and to electricity inter-connectors has been found to be a major stumbling block towards more market integration and should be another immediate priority for review in terms of anti-competitive conduct. There are substantial indications that the remaining 'grandfathered rights'<sup>(10)</sup> seriously impede effective entry of competitors and therefore undermine the pro-competitive operation of the market.

If inter-connections between Europe's national markets were adequate in size and not congested by legacy contracts, market power in national markets would be diluted into larger regional or pan-European markets. Incumbents therefore have pricing power partly because inter-connection is inadequate. They would in general not have an interest in investing in infrastructure to facilitate the coupling of national energy markets. Such disincentives to expand inter-connection are of particular concern, since increasing inter-connection could have wide benefits. As we have seen, it

<sup>(9)</sup> For instance, the merger of E.ON and Ruhrgas in Germany; Centrica's acquisition of substantial generation capacity in the UK; the proposed merger of Endesa and Gas Natural in Spain; and, of course, the merger that was proposed between ENI / EDP / GDP in Portugal but was prohibited by the Commission in its decision of 9 December 2004 in Case No COMP/M.3440. This prohibition decision was upheld by the CFI in its judgement of 21 September 2005 in Case T-87/05 EDP — Energias de Portugal SA.

<sup>(10)</sup> Capacity rights stemming from pre-liberalisation contracts.

could benefit competition. It could also substantially increase system security by enabling gas or power to flow from new sources. Also, in the shorter term, it could enable new players to offer the ancillary services or flexible gas that are necessary to help maintain network balance, and so reduce the costs of network operation.

The inadequacy of incentives to invest in inter-connection arises also from the 'regulatory vacuum' that exists for the international segments of the gas and electricity grids. There are a number of schemes between national regulators in place or being set up to strengthen coordination in this area. However, the findings raise questions about whether purely voluntary cooperation schemes between regulators will suffice to provide the investment certainty and regulatory protection that are needed to develop international pipelines and inter-connectors in a stable environment, and to keep them open.

### *Unbundling*

A further root cause of negative investment incentives is that such investment decisions are generally in the hands of transmission system operators which are frequently in common ownership with incumbent generators or suppliers. A real breakthrough towards effective competition in the gas and electricity markets will not be possible unless the systemic conflicts of interest resulting from vertical integration are effectively addressed. Such conflicts make the Community's energy system less receptive to the introduction of new forms of energy production, such as renewables, owing to the stake holders' interest at all three levels of the value chain; and they hinder an effective diversification of supply, which is an indispensable element towards more security of supply.

The sector inquiry's preliminary findings suggest that only structural change would be an ultimately effective remedy. The basic impediment to more competition and market integration is structural: the incumbents' vertical integration of supply, transmission and distribution that persists in many Member States. It therefore seems unavoidable that full structural unbundling in all Member States should be part of the ensuing policy debate. Structural unbundling (i.e. effective separation of the supply and retail business from the monopoly infrastructures), while not solving all the observed problems in the market, would seem to decisively enhance non-discriminatory treatment of competitors, entry opportunities, as well as investment incentives.

### *Prices and investment signals*

Even if the Preliminary Report does not yet allow us to draw final conclusions on the oil-gas price link, this feature of the gas markets certainly requires further attention. The current extensive use of oil-linked contracts appears to be over-stating the extent of the real economic link between these two energy sources <sup>(11)</sup>. This introduces into gas pricing an element of volatility, which is quite unrelated to the actual supply-demand balance of gas in Europe.

In consequence, companies considering an investment in producing gas need to take a view on the likely price evolution of a different commodity, with radically different supply-demand dynamics <sup>(12)</sup>. This introduces substantial (and unnecessary) risk into these investment decisions. The risk may depress overall investment, which could endanger supply security. It could also lead to inefficient investments, which might further magnify the price volatility, or undermine the financial stability of the European gas industry. Evidently, as most new-built generation is gas fired, distorted price signals from the gas market are bound to spill-over into power markets.

In addition, the actual operation of indexation clauses tends to eliminate the natural seasonality of gas prices (arising from higher demand in the winter). This reduces incentives to build storage near the location of demand, which reduces supply security.

### *Impact on related policy goals*

The barriers to effective competition on energy commodity markets need to be addressed urgently also because they present dangers for other market-based mechanisms, such as emissions trading, trading of renewables certificates, or management of network congestion through auctions. In general, market mechanisms rest on an assumption that the most efficient price for a good will emerge from each party offering to pay a price related to how valuable the good is to the buyer. However,

<sup>(11)</sup> Of course, to the extent that gas is in fact competing with oil, the prices of the two commodities would be linked. However, we might expect the amount of gas-oil substitution in Europe to be limited, given the relatively marginal role of oil-fired power generation here, and the significant costs of switching space- or water-heating between the two fuels.

<sup>(12)</sup> Oil is a global commodity, and a mature industry which is likely to be close to the peak of production; gas is a regionalised commodity, with substantial untapped reserves and new reserves being discovered.

market power creates the possibility to generate more margin from market activity, which means a company with market power on energy markets will be willing to pay more for inputs necessary to such activity, such as rights to inter-connector or transit capacity. This creates a potential distortion of the market mechanism which, if uncorrected, could undermine its ability to generate the most efficient outcomes.

## Conclusion

The European energy industry operates now within a legal framework that is organised around market economy principles. Market mechanisms are envisaged as delivering not only competitive prices, but also investments to underpin supply security, high levels of public service, and environmental measures.

Nevertheless, energy policy continues to be debated. Particular topics of debate include the relationship between competition and supply

security, and what company and market structures are appropriate for a competitive market.

DG Competition's sector inquiry has shown that serious distortions in energy competition continue to exist. Given the importance of market mechanisms for delivering policy objectives, these distortions can be expected to have a negative influence on progress towards these other policy goals. In particular, trading mechanisms cannot be relied upon to deliver efficient progress if they are distorted by market power, and supply security is undermined by perverse incentives to limit market integration and a lack of clear price signals.

In summary, being 'half-liberalised' is a dangerous position to be in, and if Europe stays half way to fully competitive energy markets, it cannot be confident of securing any of its main policy objectives: neither competitive prices, nor the investment required to secure supplies, nor an efficiently-delivered reduction in environmental impacts. Action is needed quickly to deliver on the promises of a competitive internal energy market.

## New guidelines on national regional aid for 2007 – 2013

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### 1. Introduction

The compatibility of regional aid with the EC Treaty is governed by the Commission's regional aid guidelines. The current regional aid guidelines were adopted in 1998 for an unlimited period of time. In April 2003, the Commission decided to apply these Guidelines until 2006, and to proceed to their review for the period after 2006, 'in due course in order to give the Member States and the Commission time before the end of 2006 to draw up, notify and approve the regional aid maps for the period after 1 January 2007'. These new guidelines should apply for the whole of the next structural fund programming period, from 2007 to 2013.

In order to prepare new guidelines, the Commission has undertaken an extensive consultation process, which began in April 2003. Several discussion papers have been circulated to Member States and placed on the web and two multi-lateral meetings with experts from the Member States, EEA countries, Romania and Bulgaria were organised in February and September 2005, and numerous meetings have taken place at all levels with representatives of the regions concerned. The Committee of the Regions and the Economic and Social Committee have given an opinion on the review of the guidelines, which has been very largely taken into account. The European Parliament has adopted an own initiative report on the guidelines on 15 December 2005, which was also largely taken into account.

The Commission adopted the Guidelines on national regional aid on 21 December 2005. The provisional text is published on DG Competition website and the final text is published in the *Official Journal of the European Union* in all official languages <sup>(1)</sup>.

### 2. Key features of the review of the Guidelines

Two principles have been of fundamental importance, in drafting the Guidelines:

- the need to provide a solid contribution to the cohesion policy of the Union, by ensuring the maximum possible coherence with the structural fund regulations;

- the need to give effect to the conclusions of successive European Councils calling for less and better-targeted aid, following the general approach set out in the State aid action plan.

In line with these principles, the three key features of the new Guidelines are:

- (1) The need to re-focus regional aid on the most deprived regions of our Union of 25, and soon to be 27 Member States, whilst allowing sufficient flexibility for the Member States themselves to designate other regions as eligible for support based on local conditions in terms of wealth and unemployment.
- (2) The need to improve the overall competitiveness of the Union, its Member States and its regions by means of clearly differentiated and well-balanced aid intensity ceilings, to reflect the importance of the individual regional problems as well as concerns about the spill-overs to the non-assisted areas, and
- (3) The need to ensure a smooth transition from the present system to the new approach that gives enough time to adjust and does not put at risk what has been achieved in the past.

In regions which are not eligible for support under the regional aid guidelines, other forms of aid can be given to promote regional development (such as support for R&D, risk capital, training and environmental aid, etc.). As announced in the State Aid Action Plan, these horizontal aids are being reformed, and should allow ample scope for the Member States to implement the regional competitiveness and employment objectives set out in the structural fund regulations, and to address specific market failures that can occur within those regions.

### 3. Summary of the Guidelines

#### 3.1. Population coverage

The overall population coverage to be eligible for regional aid during 2007-2013 is fixed at 42% of the population of the Community of 25 Member States (EU 25), made up as follows:

- Areas with less than 75% average EU 25 GDP per capita (*i.e.* areas covered by Article 87(3)(a) of EC Treaty);

<sup>(1)</sup> OJ C 54, 4.3.2006, p. 13.

- Statistical effect regions (those regions with less than 75% average EU 15 GDP per capita, but more than 75% average EU 25 GDP);
- Economic development regions (regions which are today covered by Article 87(3)(a), but which would no longer qualify, even on an EU 15 basis) and low population density areas (regions with less than 12.5 inhabitants/km<sup>2</sup>);
- Additional Article 87(3)(c) allocation to allow flexibility for Member States.

In addition, a safety net will be applied to ensure that each Member State maintained a minimum of at least 50% of its current total population coverage for (a) and (c) regions combined. This increases the total coverage to 43.1% of EU-25 population, or 46.6% for EU-27. The total additional 87(3)(c) coverage of 7.8% (6.7% plus the safety net) is allocated between the Member States according to a distribution key that takes variations in GDP and unemployment at national level into account.

The allocations for each Member State are set out in Table 1.

### 3.2. Aid intensities

In accordance with recent case law, and in order to simplify and improve the transparency of the system, all aid intensities should in future be expressed in terms of gross grant equivalents, in exactly the same way as all other forms of State aid.

The effects of the changes in aid intensity are summarised in Table 2.

#### 3.2.1. Article 87(3)(a)

Because of the huge variation in the relative wealth of the regions eligible under Article 87(3)(a), ranging from 32.2% to 74.9% of EU-25 GDP/cap in order to reflect these differences three distinct categories of 87(3)(a) regions are introduced. The new maximum aid intensities for aid to large companies are:

- < 75% EU-25 GDP/cap: 30%
- < 60% EU-25 GDP/cap: 40%
- < 45% EU 25 GDP/cap: 50%.

The outermost regions (ORs) also receive Article 87(3)(a) status irrespective of their GDP. The ORs with greater than 75% EU-25 average GDP/cap receive an aid intensity of 30% plus a 10% bonus. The others receive the relevant aid intensity above plus a 20% bonus.

In case any region will have an aid intensity reduction of more than 15% net to gross, the reduction may be phased in two stages.

#### 3.2.2. Statistical effect regions

The regions with less than 75% EU-15 GDP/cap (de facto 82.2% EU-25 GDP/cap) will benefit from Article 87(3)(a) status, and a 30% aid intensity for aid to large companies, until 31.12.2010 as well as having the possibility of granting operating aid. The situation of these regions will be reviewed in 2010. If their GDP has declined below 75% EU-25 GDP/cap, they will continue to benefit from Article 87(3)(a). Otherwise, they will be eligible under Article 87(3)(c) with an aid intensity of 20%, as from 1.1.2011. They will have the possibility of granting operating aid until 31.12.2012.

#### 3.2.3. Article 87(3)(c) regions

Low population density regions (<12.5 inhabitants/km<sup>2</sup>) and regions bordering an Article 87(3)(a) region are always eligible for an aid intensity of 15%. In the case of bordering regions, this may be increased where necessary to ensure that the differential between the two neighbouring regions does not exceed 20%. Other Article 87(3)(c) regions, including both the economic development regions and regions designated by Member States are eligible for an aid intensity of 10% or 15% depending on the relative wealth of the region.

Member States are allowed a wide margin of discretion in designating regions to be eligible for aid under Article 87(3)(c). However, apart from economic development regions and low population density areas, only regions that have a certain minimum size or homogeneity or face particular challenges (e.g. islands and border zones) will be eligible for aid for large companies. Other regions, which do not meet these conditions, will only be eligible for higher rates of aid for SMEs.

#### 3.2.4. SME bonuses

A bonus of 20% will be allowed for aid for small enterprises and 10% for medium-sized enterprises in all assisted areas.

#### 3.2.5. Transitional provisions for the economic development regions

Since these regions may have the highest reductions in aid intensity (in some cases from 40% net to 10% gross) the necessary reductions are to be implemented in two stages, on 1.1.2007 and 1.1.2011.

#### 3.2.6. Transitional phasing out for existing Article 87(3)(c) regions

A further transitional provision allows the Member States concerned the possibility to continue to give regional aid in up to two-thirds of the

regions which will otherwise lose their eligibility under Article 87(3)(c) at an intensity of 10% until 1.1.2009.

### 3.3. *Changes to the rules on investment aid*

A number of other detailed changes introduced to the current rules on regional investment aid, in particular to improve the effectiveness of such aid, clarify the current rules, or in some cases, to simplify them. The main changes are presented hereinafter:

#### (1) Definition of investment and eligible expenses

The notions of 'initial investment' and 'eligible expenditure' have been clarified. Thus, an investment will be eligible for investment aid if there is a diversification of the output of the existing establishment into new, additional products or if there is a fundamental change in the overall production process of an existing establishment <sup>(2)</sup>.

As far as the eligible expenditure is concerned, the eligibility conditions for assets under lease have been clarified <sup>(3)</sup> and the consultancy costs for SMEs have been included in the Guidelines <sup>(4)</sup>. Furthermore, the Guidelines provide for more generous conditions for the eligibility of investments in intangible assets by large companies <sup>(5)</sup>.

#### (2) Incentive effect

The new Guidelines introduce stricter rules on the incentive effect of the aid, in order to ensure that regional aid produces a real incentive effect to undertake investments which would not otherwise be made in the assisted areas. Aid may only be granted under aid schemes if the beneficiary has submitted an application for aid and the authority responsible for administering the scheme has subsequently confirmed in writing that, subject to detailed verification, the project in principle meets the conditions of eligibility laid down by the scheme before the start of work on the project. An express reference to both conditions must also be included in all aid schemes. If work begins before these conditions are fulfilled, the whole project will not be eligible for aid.

#### (3) Integration of the MSF 2002 into the Guidelines

The provisions of the multi-sectoral framework have been integrated in the Guidelines, with a more flexible approach to the assessment of large-scale projects. In the context of improving the economic

approach to state aid cases, in particular to large investment projects, not only in traditional but also in more innovative sectors, the rules for the assessment of these projects have been amended. In particular:

- A safe harbour will exist for individually notifiable projects, provided that the Member State can demonstrate that they meet the conditions of the RAG and remain below the cut-offs in terms of market share and capacity increase as defined in point 68 of the new Guidelines.
- Where a project exceeds the cut-offs defined in point 68 of the new Guidelines, or where serious difficulties arise in defining the relevant market, the Commission will systematically open a formal investigation to collect information for a detailed economic assessment of the aid. The Member State concerned will be expected to provide at least:
  - a demonstration of the necessity and incentive effect of the aid on the localisation of the investment;
  - a justification of the contribution of the project to regional development, for example in terms of job creation, clustering effect, value added, and other positive spill-over effects for the assisted region, the Member State or the Community as a whole;
  - the information necessary to analyse the distortions of competition created by the measure and its effects on trade between Member States.

If the overall proportionality assessment of the measure is positive, the Commission can approve the aid, although possibly with a lower aid intensity than the maximum allowed under the Guidelines. The Commission would aim to close the procedure within six months, provided all parties involved cooperated fully with the investigation. The Commission will issue Guidance on the criteria it will take into account during this assessment during 2006.

This dynamic approach will give more flexibility to Member States and to the Commission and is in line with the Commission's commitment in integrating more economics in its analysis.

#### (4) Cumulation of aid

More detailed rules on cumulation of aid are introduced in the new Guidelines. In particular, regional investment aid may not be cumulated with de minimis support in respect of the same eligible expenses in order to circumvent the maximum aid intensities laid down in the guidelines.

<sup>(2)</sup> Paragraph 34 of the RAG.

<sup>(3)</sup> Paragraph 53 of the RAG.

<sup>(4)</sup> Paragraph 51 of the RAG.

<sup>(5)</sup> Paragraph 55 of the RAG.

(5) Border regions

The new Guidelines foresee that regions or parts of regions adjacent to Article 87(3)(a) regions are eligible for support. Thus, the aid differential in border regions is limited to 20%, regions adjacent to 87(3)(a) regions are eligible for support and the investment has to be maintained in the assisted region for 5-years. With these provisions Member States can tackle the problem of border regions and in particular the risk of local delocalisation, which might be induced by too high aid differentials in adjacent regions.

3.4. *Operating aid*

The forms of operating aid allowed under the current guidelines will continue to apply, and a new form of operating aid will be permitted to combat depopulation in the lowest population density

regions (<8 inhabitants km<sup>2</sup>). In addition, a safe harbour is created for operating aid in the outermost regions of up to 10% of the turnover of the company.

Regions which lose eligibility to grant operating aid will be allowed a period of two years from the date of loss of eligibility in which to phase out the aid.

3.5. *Aid for newly created small enterprises*

A new form of aid is envisaged to encourage business start-ups in the assisted areas. This will allow aid to be given to support costs of starting a business that are not currently eligible for aid. The aid will be limited to the establishment and expansion phases of small enterprises for the first five years and can be combined with investment aid.

TABLE 1 — REGIONAL AID COVERAGE, 2007 – 2013

In %	Be	Dk	De	Gr	Esp	Fr	Irl	It	Lux	NI	Ös	Port	SF	Sv	UK	EU-15	Cs	Hu	Cy	Slk	EU-25	EU-27
Art. 87(3)(a)	0	0	12.5	36.6	36.2	2.9	0	29.2	0	0	0	70.1	0	0	4.0	15	88.6	72.2	0	88.9	27.7	32.2
Stat. effect	12.4	0	65.1	55.5	5.8	0	0	1.0	0	0	3.4	3.8	0	0	0.6	4.3	0	0	0	0	3.6	3.4
Ec dvlp + lpd	0	0	0	7.9	16.6	0	26.5	2.9	0	0	0	23.7	13.1	4.4	4.0	0	27.8	0	0	0	4.0	3.7
Other (c)	13.5	8.6	11.0	0	1.1	15.5	23.5	1.0	16	7.5	19.1	2.8	9.3	2.3	14.9	9.3	0	0	50	0	7.8	7.1
<b>Total</b>	<b>25.9</b>	<b>8.6</b>	<b>29.6</b>	<b>100</b>	<b>59.6</b>	<b>18.4</b>	<b>50</b>	<b>34.1</b>	<b>16</b>	<b>7.5</b>	<b>22.5</b>	<b>76.7</b>	<b>33.0</b>	<b>15.3</b>	<b>23.9</b>	<b>32.5</b>	<b>88.6</b>	<b>100</b>	<b>50</b>	<b>88.9</b>	<b>43.1</b>	<b>46.6</b>

NB: Estonia, Latvia, Lithuania, Malta, Poland and Slovenia all have 100% coverage under Article 87(3)(a) and are therefore omitted from the table, but are included in the EU-25 total. Bulgaria and Romania will also have 100% coverage under Article 87(3)(a) and are included in the EU-27 totals. Transitional phasing-out provisions apply for existing 87(3)(c) regions.

TABLE 2 — REGIONAL AID INTENSITIES

	2000-2006 NGE #	2007-2013 GGE
Article 87(3)(a) Large companies		
< 75% EU-25 GDP/cap	40-50%	30%
< 60% EU-25 GDP/cap	50%	40%
< 45% EU-25 GDP/cap	50%	50%
Outermost regions Large companies	50% – 65%	40% – 60%
Statistical effect Large companies	40%	30% → 20%
Economic development Large companies	40%	15/10%* (subject to transitional provisions)
Low population density Large companies	30/20%	15%*
Other Article 87(3)(c) Large companies	20/10%	15/10%*
Small enterprises	+ 15% (a) + 10% (c)	+ 20%
Medium enterprises	+ 15% (a) + 10% (c)	+ 10%

# These are the maximum intensities theoretically possible under the 1998 RAG (taking account of regional disparities in the EU-15). Actual aid intensities, as laid down in the approved regional aid maps, are frequently lower.

\* Subject to special provisions for border regions.





## The Commission's state aid policy on the digital switchover

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### 1. Introduction

Several Member States are currently introducing digital television transmissions which will ultimately replace analogue television transmissions. This process is known as the digital switchover and concerns all the commonly available transmission platforms for television signals, i.e. terrestrial, cable and satellite.

In recent months, the Commission has adopted four decisions — two of which are summarised in this Newsletter — on state support for the digital switchover. <sup>(2)</sup> While these decisions concern rather different types of state support, they indicate how similar measures would be assessed under the state aid rules. In this article, the authors propose an overview and interpretation of the Commission's framework of analysis, which builds on the refined economic approach to state aid presented in the State Aid Action Plan. <sup>(3)</sup>

### 2. Background

#### 2.1. The market for the transmission of TV signals

Television channels are delivered primarily through three technological platforms: terrestrial, cable and satellite. A more recent development is

that television can also be received via the Internet (for example by users with a DSL connection) <sup>(4)</sup> or wireless technologies. The use of different transmission platforms varies considerably across countries. For example, terrestrial TV has an audience share of less than 10% of households in the Benelux countries and Germany, compared to more than 80% in Italy and Greece. <sup>(5)</sup>

In antitrust cases, the business model (pay TV vs. free TV) characterises the markets, not the platform. Terrestrial, cable and satellite platforms compete with each other at retail level and the potential shift of viewers from one to another exercises a certain constraint on retail conditions. <sup>(6)</sup> Looking at the market for supplying transmission services to broadcasters (the wholesale market), the platforms are not regarded as belonging to the same market. From a broadcaster's point of view, the platforms are complementary and broadcasters may have an interest in being present on all of them to reach a greater audience. <sup>(7)</sup>

There are two modes of transmission: the traditional analogue mode and the more recent digital mode. Digital transmission allows better picture and sound quality and better use of frequency spectrum. However, it obliges broadcasters and network operators to update their transmission equipment and viewers must use set-top boxes. <sup>(8)</sup> Digitisation is most advanced for satellite trans-

<sup>(1)</sup> The authors work for the European Commission, Directorate-General for Competition. The present document only reflects their personal opinions and should not be held to represent the views of the European Commission or of the Directorate-General for Competition. The authors wish to thank all the colleagues involved in assessing the issues discussed in this article and in particular Eric Van Ginderachter, Alexander Riedl, Matteo Salto and Jan Gerrit Westerhof. They also wish to thank Obhi Chatterjee and András Inotai for their valuable comments. The final responsibility for the content of the paper rests solely on the authors.

<sup>(2)</sup> Three final decisions: N622/03 Digitalisierungsfonds — Austria of 16 March 2005, see OJ C 228, 17 September 2005, p.12, C25/04 Einführung des digitalen terrestrischen Fernsehens (DVB-T) in Berlin-Brandenburg — Germany of 9 November 2005 and NN64/2005 Digital Replacement Licences — United Kingdom of 25 January 2006. One decision to initiate the formal investigation procedure: C52/05 (ex CP101/04) Contributi ai decoder digitali — Italy, of 21 December 2005, see: [http://europa.eu.int/comm/competition/state\\_aid/decisions/additional\\_docs.html](http://europa.eu.int/comm/competition/state_aid/decisions/additional_docs.html)

<sup>(3)</sup> This article focuses on the compatibility assessment under Article 87(3)(c) and does not discuss the potential application of other Treaty rules.

<sup>(4)</sup> Digital Subscriber Line.

<sup>(5)</sup> European Commission, 9<sup>th</sup> report on the implementation of the telecommunication regulatory package. Annex 1: market overview, SEC (2003)1342.

<sup>(6)</sup> See the discussion in Commission decision *Teleor/Canal+/Canal Digital* (case COMP/C2/38.287) of 29/12/2003, in particular para. 50. It appears however that even the distinction between pay TV and free-to-air TV is becoming increasingly blurred, see Commission decisions *BSkyB/Kirch Pay TV* (case COMP/JV.37) of 21 March 2000 and *Newscorp/Telepiù* (case COMP/M.2876) of 2 April 2003.

<sup>(7)</sup> In some cases under Art. 7 of Directive 2002/21/EC (Framework Directive), the Commission has not, however, contested a finding by national regulatory authorities that wholesale broadcasting transmission markets should be defined on a platform-specific basis (FI/2004/0076, UK/2004/0111, SE/2005/0188, ES/2005/0252 and NL/2005/0270).

<sup>(8)</sup> Such set-top-boxes are required to transform the digital signal to an analogue signal, since nowadays TV sets are not able to transform these signals by themselves. Future TV sets will most likely have the functionalities of such set-top boxes built in.

mission, where it was financed entirely by private operators. Both cable and terrestrial transmission networks are still largely operating in the analogue mode.

## 2.2. *The case for the analogue switch-off*

Numerous Member States are preparing the switchover from analogue to digital transmission of television. Since analogue terrestrial TV broadcasts use scarce frequencies which could have better alternative uses, the termination of analogue terrestrial transmissions has a public interest aspect that is not present for the switch-off of cable or satellite analogue transmission. This is the so-called 'digital dividend' from the more efficient use of the frequency spectrum allowed by the digital technique.

The Commission has recognised the importance of the digital switchover in its Action Plan eEurope 2005 and in three Communications relating to the digital switchover.<sup>(9)</sup> In particular, the Commission is committed to the goal of analogue TV switch-off in Europe by 2012.

The 2003 Switchover Communication mentions market failure as a possible justification for public intervention. However, digitisation must take place in a framework of technological neutrality. According to the Communication, national authorities should ensure 'a regulatory level playing field. In principle, each network should compete on its own strengths. Any public support for one particular option cannot be excluded but should be justified by (1) well-defined general interests and (2) implemented in a proportionate way. Otherwise it would appear discriminatory and could jeopardise investments in other networks.'<sup>(10)</sup>

## 2.3. *Not all state measures constitute state aid*

Public authorities are using various means to facilitate and encourage the digital switchover, including regulatory means, financial support and information campaigns. Not all of these measures involve state aid and fall under European state aid rules. Moreover, the types of measures that involve state aid vary considerably and thus require a case-by-case assessment.

<sup>(9)</sup> COM(2002)263 final, 'eEurope 2005: An information society for all', COM(2003)541 final, "Communication from the Commission on the transition from analogue to digital broadcasting (from digital 'switchover' to analogue 'switch-off')", COM(2005)204 final, 'Communication from the Commission on accelerating the transition from analogue to digital broadcasting' and COM(2005)229 final, 'i2010 – A European Information Society for growth and employment'.

<sup>(10)</sup> COM(2003)541 final.

An example of a measure which the Commission did not consider to constitute state aid was the review of the financial terms of the Digital Replacement Licences ('DRLs') in the United Kingdom.<sup>(11)</sup> In December 2004, Ofcom, the regulator for the UK communications industries, issued these DRLs to the terrestrial broadcasters Channel 3 (better known as ITV), Channel 4, Channel 5 and Public Teletext. These licences replaced existing analogue licences and contained various obligations related to the digital switchover. In view of these obligations and of the diminished 'scarcity' value of the broadcasting licences, the regulator reduced the broadcasting licence fees — the so-called 'additional payments'.

The Commission considered that the reassessment of the additional payments was an intrinsic element of the licensing process, aiming to bring the fee into line with the market value of the DRLs, and not a discretionary measure relieving licensees of their normal operating costs. The revision of licensing arrangements is an example of how the transition to the digital mode can be encouraged and organised without relying on subsidies that could distort competition and taking into account both the advantages and the disadvantages that the operators derive from the switchover.

## 3. **The Commission's analytical framework for assessing compatibility**

### 3.1. *General approach*

The Commission recognises that the digital switchover may be delayed if the process is left entirely to market forces. So it has no objection to the principle of public intervention in this field. In its recent State Aid Action Plan, the Commission explained its general approach to state aid geared to support sustainable growth, competitiveness and cohesion. The Action Plan points out that Member States may use state aid to overcome a specific market failure or to ensure social or regional cohesion. However, in such cases, the Member State must demonstrate that state aid is the appropriate instrument to address the issue, that it is limited to the minimum necessary and that it does not unduly distort competition.<sup>(12)</sup>

It is generally recognised that the switchover to digital television may be hindered by certain market

<sup>(11)</sup> See footnote 2.

<sup>(12)</sup> These long-standing basic principles of EU state aid policy have recently been confirmed in the State Aid Action Plan: Less and better targeted state aid: a roadmap for state aid reform 2005–2009. [http://europa.eu.int/comm/competition/state\\_aid/others/action\\_plan/](http://europa.eu.int/comm/competition/state_aid/others/action_plan/)

failures. Moreover, there is a risk that not all parts of the population would benefit from the advantages of digital television (problem of social cohesion). These problems are more acute in the case of *terrestrial* TV because of the scarcity of available frequencies: running digital and analogue transmission in parallel — so-called ‘simulcast’ — to ensure a smooth transition is rather costly. Moreover, the terrestrial TV network has so far been used in many Member States to fulfil universal coverage obligations. This means that a high coverage of the population through digital transmissions must be achieved before contemplating the analogue switch-off.

### 3.2. Potential market failures related to the digital switchover

To decide whether a given state aid scheme for the digital switchover is necessary and proportionate, the Commission ought to examine the possible presence of market failures in the switchover process. The Commission should first assess whether there are genuine market failures which prevent the market from achieving economic efficiency. Next, whether state aid is the appropriate remedy for such market failures. Finally, whether the aid granted is the minimum necessary to achieve the objective. It is only if these conditions are met the state aid scheme can be considered to be necessary and proportionate, the criteria to be met for approval of the aid under Article 87(3)(c). The coordination problem, positive externalities, market power and uncertainty are examples of possible market failures in this field.

#### *Coordination problem*

The development of digital terrestrial broadcasting may be hampered by a coordination problem between market players. The problem may arise because broadcasters need to agree on common dates for switching off analogue transmission and for switching on digital transmission so as to overcome the lack of frequency spectrum and to minimise the costs of parallel transmission. Consumers may not be willing to shift to a digital platform until it carries a large number of programme channels. Accordingly, broadcasters might wish to await the arrival of other broadcasters before investing in moving to a digital platform themselves. In the absence of coordination, this approach might delay the switchover. There is therefore an interest in making broadcasters switchover simultaneously and in limiting the duration of the simulcast phase.

Broadcasters typically do not own the frequency spectrum occupied by their analogue transmissions but operate on the basis of licences. Often, the

licences for analogue terrestrial transmission are awarded for a limited period. <sup>(13)</sup> So the authorities could solve the coordination problem by setting a common expiry date for all analogue licences or by fixing a mandatory switchover date. <sup>(14)</sup> This seems sufficient to help broadcasters to plan a coordinated move into the new platform and consumers to adapt to the new transmission technology. State aid does not seem to be the most appropriate tool to address the coordination problem.

#### *Positive externalities*

The switchover may have positive externalities due to the better use of the frequency spectrum, i.e., the *social* benefit of more channels and services may exceed the *private* benefit of the incumbent broadcasters since the expected gains in terms of increased audience and advertising may not be large. Consequently, broadcasters may be reluctant to participate in the switchover. So, in principle, accelerating the analogue switch-off process to reap the benefits of the better use of the freed-up spectrum is a valid justification for public intervention.

However, to assess the appropriateness of granting state aid, all factors which are relevant in determining the economic position of the operators with respect to the switchover should be considered. What is the economic value of the digital licences that replace the analogue licences and that are awarded to broadcasters? What are the technical costs of digital transmission? What are the investments to be made for digitisation?

It appears that digital technology allows for greater transmission capacity at lower transmission costs and that the costs of upgrading the transmission equipment are not prohibitive. In connection with the transition to digital terrestrial TV, operators may also offer new interactive services and exploit different business models such as pay-per-view. As a result, the need for economic incentives to be given to operators in connection with the digital switchover should be carefully assessed. Regulatory intervention might be a sufficient and less distortive means of achieving the same goal.

The existence of positive externalities is also claimed for the development of interactive services, allowing viewers to benefit from such services as e-learning or e-government not only via personal computer, but also through the more ‘familiar’ TV set. The Austrian funding scheme for digi-

<sup>(13)</sup> In Berlin-Brandenburg, the licences are granted for up to seven years.

<sup>(14)</sup> As an example, Italy defined 31 December 2006 as the mandatory date for switchover.

tisation<sup>(15)</sup> included support for research activities and for the development of new services for digital TV, which the Commission found compatible with state aid rules. An important element for compatibility was the fact that funding was available to operators on all transmission platforms and was not limited to terrestrial TV. The 'public good' character of research and development activities is not a specific feature of terrestrial TV, but rather a general feature of these types of activities.

#### *Market power*

The presence of market power may prevent the market from securing the full benefits of competition between operators. Incumbent *broadcasters* might have an interest in delaying the launch of digital transmissions, given the likelihood that new operators enter the market and that they would be exposed to more competition for audience and advertising. *Network operators* might not feel sufficient competitive pressure to carry out the necessary investment to carry digital TV transmissions.

Under these circumstances, the emergence of new market players would certainly benefit consumers. However, there could be preferable alternatives to state aid for achieving this goal, such as regulated access to basic infrastructure<sup>(16)</sup> and open procedures for the licensing of operators. State aid might be appropriate only if antitrust control and regulatory intervention do not prove effective or sufficient and, for example, high investment or start-up costs prevent the launch of new services or act as a barrier to entry in the market.

#### *Uncertainty*

Uncertainty might sometimes prevent innovation and the development of new services. It has been argued that the digital terrestrial network could have significant advantages for consumers in terms of portability and mobility and could promote innovative services, but market players hesitate before launching digital terrestrial TV due to the uncertain response of consumers. Network operators are particularly concerned about the uncertainty that the platform will be able to reach a sufficient critical mass of viewers to make the infrastructure investment financially viable.

The relevance of this argument depends on the specific market circumstances. In countries with high penetration of analogue terrestrial TV, there is no particular reason to believe that insufficient demand hinders the development of digital

terrestrial TV. The issue may be more pertinent in areas where the digitisation concerns a platform that has a small penetration to start with. However, the successful launch in the past of entirely new, privately-financed transmission platforms such as satellite and DSL shows that the market can cope with this type of risk. There are also specific examples of digital terrestrial TV being launched without state aid in areas without a large audience for analogue terrestrial TV, for instance, in the German Rhine-Main region.

The risk associated with the launch of a new service can also be reduced by giving consumers some time to discover and adapt to the new service. Contrary to other platforms like satellite and cable, which are less constrained in terms of transmission capacity, terrestrial transmission suffers from the technical limits and the higher costs of parallel transmission of analogue and digital signals ('simulcast'). In this case, providing some financial assistance to broadcasters may be justified. Indeed, in the Austrian decision, the Commission took account of the above considerations and did not object to grants intended to co-fund the directly-attributable, additional costs of broadcasters during the simulcast phase.<sup>(17)</sup>

### *3.3. Social and regional cohesion objectives in relation to the digital switchover*

The digital switchover process also involves aspects of social cohesion: it is important to ensure a wide access to digital TV before contemplating analogue switch-off. Since the digital switchover entails some costs for consumers for the purchase of decoders, Member States may want to assist, in particular, disadvantaged groups of society such as elderly people or low-income households. Member States may also consider measures to ensure that all geographical areas continue to have appropriate TV coverage by imposing obligations on and possibly providing compensation for network operators. Public authorities also fund the transmission costs of public service broadcasters to ensure their presence in different platforms.

All these measures have to be assessed in their specific context. The methodology should be the usual one: firstly, to assess whether there are sufficient elements to indicate the presence of a social and regional cohesion issue; secondly, to assess whether state aid is the appropriate instrument to address the issue and, if so, whether the aid is limited to the minimum necessary.

<sup>(15)</sup> See footnote 2.

<sup>(16)</sup> On the basis of a finding of significant market power by the national regulatory authority under Directive 2002/21/EC (Framework Directive).

<sup>(17)</sup> See footnote 2.

#### 4. Examples of public support unlikely to conflict with state aid rules

On the basis of the above, there are certain forms of public support for digital switchover which appear less problematic from a competition point of view. <sup>(18)</sup> Member States may, for example, consider granting:

- (1) subsidies to consumers for the purchase of digital decoders. Such subsidies should be technologically neutral and not exclude specific platforms. In granting subsidies, the authorities may encourage the use of open standards for interactivity. Open standards enable consumers to benefit from interactive services offered by different operators. Examples of interactive services are electronic programme guides, news search, e-government and e-commerce services.
- (2) funding for the roll-out of a transmission network in areas where there would otherwise be insufficient TV coverage;
- (3) financial means to public service broadcasters to enable them to broadcast via all transmission platforms to reach the entire population. In this context, Member States have to set out clearly obligations on the public service broadcasters as to which transmission platforms should be used;
- (4) financial support as fair compensation to broadcasters which are required to give up the use of their analogue spectrum before their licences expire. The compensation should take into account the actual costs of the switchover to broadcasters, including the cost of adapting equipment for digital transmission and

of broadcasting in another channel/multiplex where applicable, as well as costs for frequency spectrum. When calculating spectrum costs, the granting of digital transmission capacity should be taken into account.

#### 5. Conclusion

The Commission has recently assessed various public initiatives to support the switchover to digital TV under state aid rules. The Commission could not base its decisions on any of the existing regulations or guidelines and had to refer to the general principles of necessity and proportionality of aid. In the cases of *DVB-T in Berlin-Brandenburg* and of *Italian Decoders*, the necessity and proportionality analysis followed the refined economic approach presented in the State Aid Action Plan. This approach aims to provide a more structured and more economics-based assessment of the investigated measures. It tries to identify whether the aid is targeted at a market failure or an objective of social or economic cohesions, whether the aid is properly designed to achieve these objectives and whether, on balance, it has positive welfare effects.

The decisions in these cases show that, even when public intervention is in principle justified, — and indeed the Commission is firmly committed to encouraging the transition to digital TV — the granting of state aid should always follow a process of clearly identifying the problem to be addressed and of choosing the least distortive means of solving it. Only well-targeted aid is in line with the overall objective of ensuring fair competition and promoting competitiveness and technological development in Europe.

<sup>(18)</sup> The examples are taken from Commission decision DVB-T Berlin-Brandenburg, see footnote 2.

## How to strengthen competition advocacy through competition screening

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### I. Introduction:

#### The role of competition advocacy

Competition advocacy is together with competition law enforcement in individual infringement cases a very important pillar relied upon by competition agencies around the world when protecting effective competition. It is generally accepted that competition enforcement and advocacy are complementary since fighting private restrictions can only be successful if supported by advocacy removing or preventing public restrictions. By way of example, pursuing price fixing by private operators or the abuse of a dominant position can only be effective long term if the regulatory framework itself does not facilitate behaviour contrary to Articles 81, 82 of the EC-Treaty. Advocacy and enforcement are further mutually enhancing. The experience and market knowledge obtained by a competition agency through the handling of merger or antitrust cases may support its advocacy efforts and make them more credible. <sup>(1)</sup> The most evident example demonstrating the importance of competition advocacy is the process of liberalisation experienced by developing and developed countries all over the world. The gradual opening to competition of traditionally regulated sectors, which often used to be monopolised and where incumbents often retain a fair degree of market power, revealed the need to completely adapt the regulatory framework governing the different sectors (e.g. energy, telecoms, postal sector, transport, etc.).

Depending on the objectives competition advocacy measures may take the form of publications of guidance aimed at improving the understanding and acceptance of the competition rules by the addressees. One particular effective form of advocacy, on which this article will focus, consists in the active involvement of competition agencies in the regulatory impact assessment (RIA) process leading to the adoption of new laws and regulations or in the involvement of competition agencies in hearings before sector regulators or parliamentary committees, or as *amicus curiae* in court proceedings.

<sup>(1)</sup> The sector know-how gained in large merger cases is particular relevant in this respect. Competition authorities have to analyse competition impacts *ex ante*, which is also required in the assessment of draft legislation.

### II. The interface between legislation and competition: possible conflicts

Although most regulation is neutral to competition, conflicts may arise in individual cases. The most evident kind of restrictions is represented by outright restrictions or even elimination of competition, which may arise if a whole sector is exempted from the application of the competition rules. Examples are rules excluding the defence industry from the application of the competition regime for reasons of national security or rules imposing retail price maintenance for reasons of consumer protection. A prominent example is further that of certain regulations in professional services, such as services provided by architects, lawyers, notaries, engineers, which constrain these providers in the parameters of competition they can use. Regulation may further restrict competition by determining certain parameters of the competitive process, e.g. by setting minimum quality standards for certain products or services. These rules may reduce the degree of differentiation between suppliers and decrease their incentives to compete vigorously as competitors align their offer towards the minimum quality. <sup>(2)</sup> Last but not least, the regulatory framework may also contain provisions which allow state subsidies which distort competition.

Restrictive regulation as outlined above may for example cause higher market concentration, e.g. if it leads to asymmetric costs, thus forcing certain players to exit the market. It may also increase entry or exit costs with the effect that new entrants may take too long to achieve the minimum efficient scale to operate on the market. Furthermore, certain types of regulation may reduce the vigour of competition or even induce competitors to collude, e.g. through increased transparency. National regulation may also grant 'advantages' to certain companies, which may not legally qualify as State aid, but have the same effect. Finally, regulation may reduce consumers' or suppliers' choice, e.g. by rising switching costs or by affecting innovation, or diminish the offer of new products, e.g. by too stringent product standards.

<sup>(2)</sup> See 'A guide to Competition Screening', <http://europa.eu.int/comm/competition/publications/advocacy/>

### III. How to address conflicts through competition screening

One particularly effective means to influence economic regulation and legislation is the participation of competition authorities in the drafting of legislative proposals in particular through regulatory impact assessment (RIA). This form of competition advocacy is sometimes also referred to as 'competition screening'. As part of their screening activities competition agencies typically provide comments, opinions and suggestions on draft bills or the conditions of privatization projects. The advantage of this method is that it establishes a constant dialogue between legislators and competition authorities and that it allows the former to intervene and influence legislative proposals with a view to avoiding or mitigating the effects of unnecessary or excessive restrictions of competition from the start (upfront approach).

The need to screen regulation as to its impact on competition has been widely discussed at international level. The OECD Council on 15 March 2005 adopted the 'OECD Guiding Principles on Regulatory Quality and Performance'<sup>(3)</sup> replacing the 1995 Recommendations<sup>(4)</sup>. The guidelines start by recommending that new and existing regulation should be systematically reviewed with a reference to competition and that RIAs should be used to assess the effects of regulation on competition objectives and market openness. Important research into competition screening has also been undertaken by the International Competition Network (ICN). In its 2003 report to the Annual Conference in Seoul on 'Competition Advocacy in Regulated Sectors: Examples of Success'<sup>(5)</sup> the Capacity Building and Competition Policy Implementation subgroup (CBCPI) evaluated the degree of success of specific competition advocacy initiatives in six different sectors: electricity, gas, telecommunications, railways, air services and maritime transport. The most effective advocacy tools used by competition authorities were found to be their

advice to regulators on e.g. market definition and specific competition impacts, their ability to issue binding or non-binding opinions on draft laws and to authorise participants in the bidding process (e.g. in the context of privatisation).

There are also many national competition authorities in the EU, which are active in competition advocacy and screening. Member States must not adopt any legislation which requires, favours or reinforces the effects of agreements, decisions or concerted practices contrary to Articles 81-87 of the ECT (or secondary law based on these provisions).<sup>(6)</sup> The European Court of Justice (ECJ) in its jurisprudence in the CIF case<sup>(7)</sup> has recently confirmed the duty of a national authority to disapply national legislation requiring or favouring infringements of Article 81 ECT, or reinforcing the effects of the anti-competitive conduct. Some national competition authorities have a particularly strong record of using that tool to open up heavily regulated markets. The Irish<sup>(8)</sup> and the Finnish Competition Authority<sup>(9)</sup> for example, played an important role in driving liberalisation of network industries in these countries. The Danish Competition Authority (DCA) is regularly screening markets to identify dysfunctional ('black') ones, applying a set of competition indicators. In the UK in all government offices have to assess the impact of legislative acts they propose on competition, by answering to nine questions (known as the 'competition filter').<sup>(10)</sup>

<sup>(3)</sup> Available at <http://www.oecd.org/dataoecd/24/6/34976533.pdf>

<sup>(4)</sup> OECD Ministers requested in 1995 that the OECD examine the significance, direction and means of reform in regulatory regimes in member countries. The 1995 Recommendations for Improving the Quality of Government Regulation were the first-ever international statement of regulatory principles common to member countries. Building on this fundamental text, and broadening it to embrace market openness, competition policy and micro-economic principles in a multidisciplinary framework, in 1997, the OECD produced a Report to Ministers on Regulatory Reform. The 1997 Report is available at <http://www.oecd.org/dataoecd/17/25/2391768.pdf>

<sup>(5)</sup> Available at [http://www.internationalcompetitionnetwork.org/capacitybuild\\_sg4\\_seoul.pdf](http://www.internationalcompetitionnetwork.org/capacitybuild_sg4_seoul.pdf)

<sup>(6)</sup> See case 267/86 *Van Eycke* [1988] ECR 4769, paragraph 16, and, most recently, Case C-198/01 *Conorzio Industrie Fiammiferi* [2003] ECR I-0000, paragraphs 45 and 46.

<sup>(7)</sup> See ECJ in Case C-198/01 *Conorzio Industrie Fiammiferi* [2003] ECR I-0000, paragraphs 45 and 46.

<sup>(8)</sup> For the Irish Competition Authority; see John Fingleton's speech on 'Enforcement and advocacy in regulated markets' at the Italian Competition Day in Rome on 9 December 2003.

<sup>(9)</sup> The advocacy role of the Finnish Competition Authority (FCA) was significant in making initiatives to deregulate the closed Finnish markets during 1988-1995, in particular in telecommunications. Before membership in the EU, the FCA primarily took structural initiatives to open up markets such as liberalising imports, abolishing licences and reforming technical standards; other initiatives focused on abolishing monopolies and restructuring state-owned enterprises. See for example the 2004 ICN Report on interrelations between antitrust and regulatory authorities, addressed to the third annual conference in Seoul. It is available at [http://www.internationalcompetitionnetwork.org/seoul/aers\\_sg3\\_seoul.pdf](http://www.internationalcompetitionnetwork.org/seoul/aers_sg3_seoul.pdf).

<sup>(10)</sup> Sources of information available for policy teams include the Cabinet Office guidance, available on its website at <http://www.cabinetoffice.gov.uk/> and the OFT guidance, available on the OFT website; available at [http://www.nao.org.uk/ria/ria\\_introduction.htm](http://www.nao.org.uk/ria/ria_introduction.htm). In the financial year 2004-2005 the OFT responded to more than 140 requests for advice. The majority of these were for new regulatory proposals but about 20% were repeat requests as proposals moved through the policy development process.

## IV. The EC approach to competition screening

### 1. General legal framework

One of the objectives mentioned in the Treaty on the European Community ('ECT') is 'an open market economy with free competition' (Article 4.1). Consequently, Article 3 (g) ECT gives the Community a clear mandate to ensure that competition in the internal market (the territories of the 25 EU Member States) is not distorted and to promote competitive markets. There is thus no doubt that competition policy aspects have to be considered when drafting new EU legislation.

### 2. Competition screening through Regulatory Impact Assessment (RIA)

At Community level all legislative and policy proposals set out in the Commission's Legislative and Work Programme (CLWP) <sup>(11)</sup> are subject to Regulatory Impact Assessment (RIA). Upon the initiative of the Directorate General for Competition, the revised Impact Assessment Guidelines for EC legislation endorsed by the Commission on 15 June 2005 <sup>(12)</sup> include for the first time a specific test used to assess competition impacts as part of the overall economic assessment. In considering whether public intervention at European level is appropriate, drafters of legislation have to examine whether the proposed regulation does not create more harm for consumers than benefits. For example, a consumer protection regulation which is meant to make up for market failures such as information asymmetries or lack of buyer power may interfere directly with the ways companies compete. Some of these rules (e.g. maximum prices or minimum quality standards) may have unintended side-effects as they reduce the variety of innovative goods and services and create entry barriers, excluding certain providers from the market. The question has to be asked whether the intended consumer protection level can also be achieved by alternative means other than regulation (e.g. voluntary information requirements for suppliers of certain goods or services).

<sup>(11)</sup> The 2005 Work Programme can be accessed at [http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005\\_0015en01.pdf](http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005_0015en01.pdf); Acts falling under the executive power of the Commission (e.g. Commission Block Exemption Regulations, enforcement decisions), Commission internal guidelines, best practices and Green Papers (since the latter are a basis for discussions rather than policy documents) are not subject to IA.

<sup>(12)</sup> SEC(2005)791; Available at [http://europa.eu.int/comm/secretariat\\_general/impact/docs/SEC2005\\_791\\_IA%20guidelines-main.pdf](http://europa.eu.int/comm/secretariat_general/impact/docs/SEC2005_791_IA%20guidelines-main.pdf)

Once the decision to regulate has been taken the drafters of the proposal have to assess the overall economic impacts including competition impacts. The particular questions, which they have to consider in this context are the following:

*'Does the (legislative) option affect EU competition policy and the functioning of the internal market? For example, will it lead to a reduction in consumer choice, higher prices due to less competition, the creation of barriers for new suppliers and service providers, the facilitation of anti-competitive behaviour or emergence of monopolies, market segmentation, etc.?' (see table I on page 29 of the IA Guidelines).*

In short, drafters of legislation are asked to consider what restrictions of competition may directly or indirectly result from the proposal (e.g. restrictions on entry, limiting the use of competition parameters, etc.) and whether there are less restrictive means available to achieve the same legislative objective. Annex IX to the Guidelines <sup>(13)</sup> in its chapter 9.2 describes different impacts on competition in the internal market (the EU 25), pointing drafters of legislation to rules which have the potential to cause the greatest distortions of competition. The emphasis is on sectors relevant for economic growth and competitiveness, that is, innovation intensive and high value added sectors as are network industries, such as financial services, or the energy sector. The following types of regulation are considered to be particularly relevant for competition screening (non-exhaustive list):

- Legislation on liberalisation, industrial policy and internal market measures
- Legislation introducing special commercial rights (e.g. IPRs) or exempting certain activities from the application of the competition regime
- Legislation on sectors pursuing environmental, industrial or regional policy goals having an effect on economic activities
- General regulation (e. g. corporate law) having a commercial impact, notably by limiting the number of undertakings in a certain sector.

Within these four types of regulations there are three main categories of rules which may potentially impact on the competitive process:

- i) Rules providing for a non-application of the competition rules;
- ii) Rules which directly interfere with companies' commercial conduct and

<sup>(13)</sup> See [http://europa.eu.int/comm/secretariat\\_general/impact/docs/SEC2005\\_791\\_IA%20guidelines-anx.pdf](http://europa.eu.int/comm/secretariat_general/impact/docs/SEC2005_791_IA%20guidelines-anx.pdf)



iii) Rules which indirectly impact on various competitive parameters.

The possible content of these three categories of rules, their potential negative impact on competition as well as examples for possible alternative options are further explained in a guidance paper published by the Directorate General for Competition in autumn 2005, and available on the Web-site of the Directorate-General. <sup>(14)</sup>

An example of the first category (non-application of the competition rules) is the implementation by the 25 Member States of the EU of three recently adopted directives on waste management, introducing an obligation for companies to recycle their waste observing specific conditions. The Commission recently published on its website a comprehensive guidance paper to advocate competition-enhancing implementation by Member States. <sup>(15)</sup> The guidance paper does not prescribe a particular form of implementation but simply explains the competition effects of the different options, advocating against solutions which would induce market sharing or price fixing, and in favour of allowing competition between several waste management systems. The example shows that it is possible to implement competition and environmental policies in a mutually reinforcing way.

Examples of the second category (direct interference with business conduct) are rules restricting the business conduct of service providers, such as television operators, including quantitative restrictions on TV advertising or content quotas. These rules pursue legitimate objectives such as the protection of minors or cultural diversity. However, if applied without distinction to all service providers they risk having a chilling effect on new business models such as pay-per-view or digital TV, reducing the ability for newcomers to compete with established players. A differentiated application of these rules could avoid competition restrictions while still assuring protection of viewers.

The third category (indirect interference with business conduct) refers to regulation, which unduly restricts access by competitors to important resources in concentrated markets (e.g. raw materials, land, IPRs or know-how on production methods) or favours incumbent suppliers at the expense of new entrants (e.g. by requiring the fulfilment of certain environmental performance targets in the energy field, which can only be met by incumbents). These rules may ultimately limit the

number of offerings and lead to higher prices. In order to avoid these conflicts, it is recommended to avoid regulation which de facto favours established providers. Especially in the liberalised sectors such as telecoms, postal services or public transport, regulation should provide that suppliers are selected on the basis of transparent, non-discriminatory and objective procedures.

## V. Conclusions

As can be seen from the above consideration, competition screening remains strongly on the agenda, not only at European level, but also at national and international level. There are strong indications that competition friendly legislation can indeed make a significant contribution to economic growth and competitiveness, and delivers benefits to consumers. <sup>(16)</sup> The OECD is currently working on a report evaluating different methods of including competition as part of regulatory impact analysis, the follow-up of which will be discussed in the summer of 2006.

In the light of recent experiences at EU and national level there are a number of elements, which can improve a competition authority's chances to successfully advocate competition-friendly regulation. First, it is important that the competition authority is given a clear mandate as competition advocate and its rights and duties in this respect should be laid down in competition law and — if appropriate — also in sector legislation. Second, if unnecessary regulatory restrictions have been identified, competition agencies have to be able to propose alternative solutions, which meet the purported legislative objectives.

Furthermore, given that competition agencies usually have limited resources, it is decisive that they set clear priorities when engaging in competition advocacy. This involves in a first step the identification of certain types of rules, which typically impact on competitive conduct or market structures (see for example the list provided in a guidance paper on competition screening of Directorate General for Competition). In a second step, the agency will select certain sectors, which it wants to monitor, e.g. because they display a high degree of concentration, or because they are in a critical stage of liberalisation.

<sup>(14)</sup> 'A Guide to Competition Screening'; available at [http://europa.eu.int/comm/competition/publications/advocacy/legis\\_test.pdf](http://europa.eu.int/comm/competition/publications/advocacy/legis_test.pdf)

<sup>(15)</sup> Available at <http://europa.eu.int/comm/competition/anti-trust/others/waste.pdf>

<sup>(16)</sup> A recent OECD report on the benefits of liberalising product markets concludes that aligning the stance of domestic regulations on that in the least restraining country could lead to an increase in GDP of 1 ¼ to 3% in the OECD area; see report of 2 December 2005, ECO/WKP(2005)50; 'The Benefits of Liberalising Product Markets and reducing barriers to International Trade and Investment in the OECD'.

A further decisive aspect, which improves acceptance of competition advocacy is ownership. The competition agency should aim to export knowledge on competition law and policy to the drafters of legislation, for example through specialised training sessions or staff exchanges (e.g. the French DGCCRF engages in this type of competition advocacy activities aimed at spreading specific skills across a range of governmental ministries and departments). More generally, competition agencies need to convince legislators that competition policy principles and other legislative objectives, such as consumer protection or environmental goals, are not only compatible but even mutually

enhancing. This is a more long-term goal, which it will take time to achieve, but it is worth pursuing. Legislators and regulators are often reluctant to accept comments from external sources but will be more prepared to consider competition aspects if presented by their own staff.

Turning these various elements of competition advocacy into practice is a challenging task. Therefore, it is very important that competition agencies continue to exchange views and share their experiences on competition advocacy in international organisations and networks such as the OECD or the ICN.

## Regulation of electronic communications — time for a review?

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The regulatory framework for the electronic communications sector has been applied for almost three years now and prescribes that its functioning shall be reviewed no later than 24 July 2006.

This article provides a brief overview of the underlying philosophy of the present and an outlook to the future of regulatory intervention in this sector. It first discusses the current regulatory framework. It then illustrates its functioning in practice through two recent cases under the so-called Article 7 consultation mechanism. Finally, some thoughts are given concerning both the process and the aim of the review of the current regulatory framework.

### 1. An overview of the current regulatory framework

There may be a need to intervene in the way certain markets are organised if consumers do not derive maximum benefit from market conditions in the absence of intervention. The fact that the electronic communications sector exhibits such market conditions was recognised at the time the current regulatory framework was drafted. It was established that even if the sector has been liberalised, competition problems may persist in the absence of intervention. This may be the result of continuing control over legacy infrastructure that is impossible or difficult to duplicate, coupled with significant network externalities and extensive economies of scale and scope. In the absence of any intervention, even an undertaking that is more efficient than the incumbent is unlikely to be able to enter markets and create competition to the benefit of the consumer.

It is also implicit in the current regulatory framework that intervention is not only necessary to open up markets that have been previously foreclosed and to allow competition, but also to promote competition in the initial stages of liberalization. <sup>(1)</sup>

Finally, even if electronic communications markets opened up to competition, some sort of inter-

vention may be necessary to ensure that markets remain open. In this case intervention is not any more about promoting effective competition but making sure it is sustainable.

The ultimate aim of sustainable competition may be achieved by both *ex ante* regulation, and *ex post* competition policy instruments. These two means of intervention constantly interact in many markets, but most typically in network industries, such as electronic communications. This was recognised when it was decided to build the current regulatory framework on the principle of competition law based regulatory intervention, where both the potential areas of regulatory intervention (i.e. relevant markets) and the grounds for such intervention (i.e. 'significant market power' — SMP) are defined in accordance with competition law.

#### 1.1. The potential areas of regulatory intervention: the Recommendation on relevant markets

In 2003, the Commission adopted the Recommendation on relevant markets <sup>(2)</sup>, defining a list of relevant product and service markets within the electronic communications sector, the characteristics of which may be such as to justify the imposition of *ex ante* regulation.

It is already clear from Recital 27 of the Framework Directive <sup>(3)</sup> that *ex ante* regulatory obligations should only be imposed where there is no effective competition, i.e. in markets where there are one or more undertakings with significant market power, and where national and Community competition law remedies are not sufficient to address the competition problem. It follows that the potential areas of regulatory intervention must necessarily be limited to certain markets fulfilling criteria that are stricter than and additional to the finding of

<sup>(1)</sup> See for instance the policy objectives and regulatory principles under Article 8 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, OJ L 108, 24.4.2002, p. 33 (the 'Framework Directive').

<sup>(2)</sup> 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 communications networks and services, (the 'Recommendation on relevant markets'), OJ L 114, 8.5.2003, p. 45.

<sup>(3)</sup> 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, OJ L 108, 24.4.2002, p. 33.

SMP. This does not impede competition law from continuing to be fully applicable in all electronic communication markets.

In addition to the ‘insufficiency of competition law’ condition already formulated in the Framework Directive, two further criteria were added in the Recommendation to define a 3-criteria-test constituting the first condition for imposing regulation in electronic communications markets (the second condition being the finding of SMP following market analysis, see point 1.2). The two additional criteria are i) high and non-transitory barriers to market entry and ii) a market structure that does not tend towards effective competition within the relevant time horizon. On the basis of these 3 criteria <sup>(4)</sup>, the Commission identified 18 markets susceptible to *ex ante* regulation.

Finally, in addition to being identified on the basis of the 3-criteria-test, all 18 markets set out in the Recommendation were defined by the Commission in accordance with the principles of competition law, in line with the requirements set out in Article 15 of the Framework Directive.

### 1.2. *The ground for intervention: finding SMP following market analysis*

The current regulatory framework is centered around the obligation of market analysis at the national level. National regulatory authorities (NRAs) must first, taking utmost account of the Recommendation on relevant markets and in accordance with the principles of competition law, define the relevant markets appropriate to national circumstances. <sup>(5)</sup>

It follows that NRAs must analyse the 18 markets set out in the Recommendation on relevant markets, unless they justify that, contrary to the assumption created by the Recommendation on relevant markets any of these markets or parts thereof do not fulfil the 3-criteria-test. Similarly, NRAs may also identify additional markets that are susceptible to *ex ante* regulation, provided they demonstrate that such markets also pass this test (in addition, of course, to being markets defined on the basis of competition law).

NRAs must then carry out an analysis of the relevant markets, on the basis of which they determine whether a relevant market is effectively competitive. Where a market (that passes the 3-criteria-test) is considered not to be effectively competitive as a result of an undertaking or several

undertakings having SMP on that market, NRAs must impose one or more obligations on this / these undertaking(s), respectively maintain or amend such obligations where they already exist. The notion of SMP is equivalent to that of dominance within the meaning of Article 82 of the EC Treaty. <sup>(6)</sup>

However, it is an additional feature of the current system that NRAs must conduct the market analysis by way of a forward looking, structural evaluation of the relevant market, based on existing market conditions. As a result, NRAs must determine whether the market is prospectively competitive, and thus whether any lack of effective competition is durable, by taking into account expected or foreseeable market developments over the course of a reasonable period of time. <sup>(7)</sup> A simple finding of SMP at the time of the review is an insufficient ground for intervention by regulatory means.

By way of summary, under the current rules on market analysis, the ground for (i.e. the second condition of) regulatory intervention is the definition of the market and the finding of SMP on that market based on competition law, in the context of a forward-looking assessment. In addition, competition policy instruments are not only used when defining the relevant markets and determining which undertaking is dominant in accordance with competition law, but also when imposing regulation. After all, the regulation imposed must aim at promoting competition by ensuring that there is no distortion or restriction of competition in the given market. <sup>(8)</sup>

### 1.3. *The notification procedure*

The fundamental aim of the current regulatory framework is to establish a harmonised approach to the regulation of electronic communications across the European Union, in particular with a view to avoiding that decisions at national level have an adverse effect on the single market or other Treaty objectives. <sup>(9)</sup>

Therefore, the draft measures envisaged by a given NRA in the light of the above presented market analyses must be notified to the Commission and other NRAs pursuant to Article 7 of the Framework Directive (the so-called ‘Article 7 consul-

<sup>(4)</sup> See Recitals 9 to 16 of the Recommendation on relevant markets.

<sup>(5)</sup> Article 15(3) of the Framework Directive.

<sup>(6)</sup> Article 14 and Recital 25 of the Framework Directive.

<sup>(7)</sup> Commission Guidelines 2002/C 165/03 on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (the ‘SMP Guidelines’), OJ C 165, 11.7.2002, point 27.

<sup>(8)</sup> Article 8(2)(b) of the Framework Directive.

<sup>(9)</sup> Article 1(1) of the Framework Directive.

tation mechanism'). The notification of the draft measures has a suspensive effect: NRAs may not adopt final measures before the Commission has pronounced itself or before the deadlines for the Commission to pronounce itself have expired.

Upon receipt of such a notification, the Commission verifies within one month the notified draft measures' compatibility with Community law, in particular EC competition law. After this period, the Commission may make comments on the notified draft measures or, if it has serious doubts concerning the NRA's market definition or its SMP analysis, open a second phase investigation for another two months. <sup>(10)</sup> At the end of a second phase investigation, the Commission can either withdraw its serious doubts or prohibit the NRA to adopt the notified draft measures (so-called 'veto decision').

Although the regulatory framework for electronic communications is based on competition law principles, the assessments under the Article 7 consultation mechanism are conducted by the services of DG COMP jointly with DG INFSO, which has a number of legislative competences in the field of electronic communications.

As of 27 January 2006, the Commission has investigated 325 cases in which only 7 second-phase investigations have been opened. After two of these second phase investigations, the Commission could withdraw its serious doubts (see below). In the other 5 cases, the Commission has adopted a veto decision. In further 15 cases, the NRA concerned decided to withdraw its notification in the first phase. <sup>(11)</sup>

#### 1.4. *Better regulation — The impact of the Article 7 consultation mechanism*

The assessment of these 325 cases delivers a sufficient basis to draw some preliminary conclusions as regards the functioning of the regulatory

framework for electronic communications, in particular the Article 7 consultation mechanism. <sup>(12)</sup> As regards the switch from the 'regulation by law' approach, which was inherent to the old framework, to the current competition law-based market analyses, it can on the one hand be concluded that the latter have enabled deregulation when markets have been proved to be effectively competitive and better targeted regulation in all other cases where the conditions of regulatory intervention were fulfilled. Furthermore, while this switch from the former to the current framework has put a certain administrative burden on the relevant authorities and the market players, this additional cost is not only justified by the interest of better targeting regulation. It is indeed also a good foundation for further action. Indeed, when regulation remains necessary at the present time, it provides the NRA with a basis to better monitor the evolution of the market and when necessary, reconsider the need for regulation. Conversely, when the analysis leads to the conclusion that no regulation is warranted, the market knowledge gathered is a good basis for monitoring the evolution of the market under competition law.

As regards the Article 7 consultation mechanism, it can be concluded that it has contributed to ensuring that the NRAs across the Member States largely approach regulation of markets in a transparent, appropriate and consistent way which is based on competition law. Such a regulatory consistency across the EU has laid the foundations for a genuine level-playing field in electronic communications. This will enable operators to make EU-wide investments and will ultimately increase consumer choice and price competition. In this context, it has however to be conceded that the status of competition in the Member States of the enlarged EU is still quite heterogeneous at the moment. To reach a EU-wide level-playing field, there is therefore still a long way to go.

## 2. **Defining the threshold for regulatory intervention in practice: the Dutch retail cable TV and the German wholesale broadband access cases**

### 2.1. *The complementary nature of regulation and competition law*

It was already shown above that, although ex ante regulation and competition law are complementary means within an overall competition policy

<sup>(10)</sup> The Commission does however not have the right to open a second phase investigation and adopt a veto decision with regard to draft remedies which are notified by an NRA. As has already been practised, the Commission has however the possibility to run a respective infringement proceeding according to Art.226 EC in such a case.

<sup>(11)</sup> For a brief description of the first three veto decisions, see L. Di Mauro, A.G. Inotai, 'Market analysis under the New Regulatory Framework for electronic communications: context and principles behind the Commission's first veto decision', (2004) 2 *Competition Policy Newsletter* 52 as well as D. Grewe, A.G. Inotai, Stefan Kramer, 'Two recent veto decisions under the New Regulatory Framework for electronic communications: The importance of competition law principles in market analysis', (2005) 1 *Competition Policy Newsletter* 49.

<sup>(12)</sup> A more detailed analysis can be found in the Commission Communication on Market Reviews under the EU Regulatory Framework — Consolidating the internal market for electronic communications, COM(2006) 28 final.

applied to the electronic communications sector, there are nevertheless strict rules determining which tool to take out from the toolbox and which particularities to consider. Two recent cases under the Article 7 procedure illustrate this.

## 2.2. *The Dutch retail cable TV case*

In September 2005, the Dutch NRA (OPTA) notified to the Commission the results of its market analysis concerning the retail cable radio and television (RTV) market, a market that is not listed in the Recommendation. <sup>(13)</sup> OPTA argued that the three retail cable RTV markets, corresponding to the coverage area of the three largest Dutch cable operators, were susceptible to *ex ante* regulation. It proposed imposing unbundling, transparency and price control obligations on the retail cable RTV transmission services of these three cable operators on the basis of finding SMP for each operator within its respective coverage area.

On 3 November 2005, the Commission sent a letter of serious doubts, thus opening a second phase investigation. The Commission indeed considered that OPTA had not provided sufficient evidence that the retail markets concerned fulfilled the three criteria test set out in the Recommendation. In particular, the Commission was not convinced that in such an innovation-driven market characterised by ongoing technological progress, alternative platforms (such as satellite, digital terrestrial and IPTV) would not jointly render entry barriers transitory within the timeframe of the review which was foreseen by OPTA (3 years).

The Commission was also concerned that OPTA's proposed measures were not proportionate to the objectives sought. It was of the view that regulation of retail prices for cable transmission may itself constitute a barrier to entry which may render more difficult the development of alternative infrastructures, and hence may hamper infrastructure based competition.

Therefore, the Commission had serious doubts as to whether OPTA's draft measures were compatible with Article 15(3) of the Framework Directive (obliging NRAs to define markets taking utmost account of the Recommendation) read in conjunction with the Recommendation and Article 8 of the Framework Directive. <sup>(14)</sup>

<sup>(13)</sup> See OPTA's notification of 29 September 2005 in case NL/2005/0247, available at: <http://forum.europa.eu.int/Public/irc/info/ecctf/home>.

<sup>(14)</sup> In particular, Article 8(1) of the Framework Directive, which provides that all reasonable measures that must be taken by NRAs to achieve the policy objectives set out in Article 8 shall be proportionate to those objectives.

In the second phase of the procedure, OPTA modified its draft measure limiting the regulatory period from three years to one year and committing itself not to intervene on the relevant retail tariffs. <sup>(15)</sup> It also presented additional arguments regarding the development of the market during the upcoming year. These modifications and the additional information provided by OPTA allowed the Commission to withdraw its serious doubts. It nevertheless invited OPTA to monitor to what extent the new technologies that are being deployed on alternative platforms will lower the barriers to entry on the retail cable RTV market.

The case is a good example of the fact that the finding of SMP on an electronic communications market is simply a necessary, but by no means a sufficient condition for *ex ante* regulation to be imposed (in this specific case, the Commission did not contest the finding of SMP). Furthermore, even if such *ex ante* regulation is warranted, it must, in order to be compatible with Article 8 of the Framework Directive, be limited to measures that are proportionate to the objectives of the framework, such as the promotion of competition, the development of the internal market and the promotion of the interests of citizens. Absent these various conditions, it is indeed for competition law alone to remedy any potential market failures.

## 2.3. *The German wholesale broadband access case*

The second case in which the Commission could withdraw its serious doubts at the end of a second phase investigation concerned the German NRA's (Bundesnetzagentur – BNetzA's) analysis of the wholesale broadband access market. <sup>(16)</sup> In this notification, BNetzA explicitly excluded wholesale broadband access which is based on VDSL <sup>(17)</sup> from the market analysis for the next 2 years. BNetzA mainly justified this exclusion by arguing that such services would not be available in Germany yet and that it would be unclear whether VDSL-based access would belong to the wholesale broadband access market as soon as such availability will be given.

Since the German incumbent operator Deutsche Telekom (DT) had announced its intention to provide VDSL services in the 50 biggest German

<sup>(15)</sup> Following an undertaking by the three cable operators not to increase their prices beyond the consumer price index for one year.

<sup>(16)</sup> See BNetzA's notification of 11 October 2005 in case DE/2005/0262, available at: <http://forum.europa.eu.int/Public/irc/info/ecctf/home>.

<sup>(17)</sup> VDSL means very high speed digital subscriber line access. Such access can be provided via hybrid local loops that are consisting both of a copper and of a fibre part.

cities by 2007 and since there were no indications that VDSL-based access would not belong to the wholesale broadband access market as set out in the Recommendation on relevant markets, the Commission issued serious doubts as to whether BNetzA's approach was in compliance with the current regulatory framework. This was in line with the requirement that market analysis be based on a technology-neutral, forward-looking approach.

During the second phase of the investigation, BNetzA amended its notification in order to address the Commission's serious doubts. In particular, the amended notification no longer argued that VDSL-based access would not be available during the 2 years-timeframe to be covered by the market analysis. It also abandoned the argument that VDSL-based access would not belong to the wholesale broadband access market (neither BNetzA nor DT were indeed able to provide any evidence supporting such exclusion). Following these amendments, the Commission issued a 'withdrawal of serious doubts' letter in which BNetzA's amended market analysis was no longer contested and in which BNetzA was required to quickly open up the German wholesale broadband access market, generally including VDSL-based access. Such opening is of particular importance in order to remedy the still relatively low level of competition in the German broadband markets — and the lack of broadband penetration in Germany.

The Commission however noted that, although it did not have at this stage any indication that VDSL-based access would constitute a new market that might not warrant sector-specific regulation, BNetzA still has the possibility to prove so at a later stage. Such a finding would then have to be notified to the Commission under the Article 7 consultation mechanism.

Although no final decision has therefore been taken on the question whether (all kinds of) VDSL-based access do belong to one and the same wholesale broadband access market in Germany defined in accordance with competition law, there are a number of lessons to draw from this case.

First, this case is a good illustration of the fact that analyses under the current regulatory framework need to follow a forward-looking (and technology neutral) approach. This may lead to differences with analyses carried out under antitrust law, which, while based on the same competition law principles, will in principle focus much more on the analysis of past and current conduct.

Second, this case raises the interesting question of how this forward-looking and technology neutral should approach new services that are closely linked and possibly substitutable to serv-

ices belonging to an already regulated markets. To what extent, at what stage, on the basis of which mechanism, should regulation apply to those new services? There is here a fine line to draw between 'mere upgrades' to existing services and genuinely new markets, with a view to determining the extent to which a reassessment of the market in the light of the three-criteria-test is required by the introduction of these new services. In this regard, the presence of links between the regulated market and these new products that allow to leverage market power may be of relevance.

While this case sheds some light on these issues, it does not provide a definitive answer to the above question, which is likely to be particularly topical in the upcoming review of the regulatory framework.

### 3. The review of the regulatory framework

#### 3.1. The process of review

At the end of 2005, the review process of the EU Regulatory Framework on electronic communications has started. This process aims at determining whether there is a need for modifications in light of changing technological and market conditions. As was the case with past experiences, it can be expected to give rise to a broad public debate in which various stakeholders (telecoms operators, governments and national regulators, European and national parliamentarians, etc.) will explain how they see the future development in, and regulatory framework, for the electronic communications sector.

The review process consists of two pillars. The first pillar is the review of the Commission Recommendation 2003/311/EC on relevant product and services markets which are susceptible to *ex ante* regulation (the 'Recommendation').

The second pillar is the review of major parts of the regulatory framework itself. This framework currently consists of six directives (Framework Directive 2002/21/EC, Authorisation Directive 2002/20/EC, Access Directive 2002/19/EC, Universal Service Directive 2002/22/EC, Data Protection Directive 2002/58/EC and Competition Directive 2002/77/58).

For both pillars of the review, a call for input was launched on in November 2005 to which interested parties could make submissions until the end of January 2006.<sup>(18)</sup> Whereas the new Recommen-

<sup>(18)</sup> A public hearing has also taken place on 24 January 2006.

dition shall already be published around the end of this year, the process of reviewing the directives involves a formal legislative process which will take much more time.

In this context, it is worthwhile mentioning that the Commission has recently published a Communication on its experience with regard to the application of the Article 7 consultation mechanism<sup>(19)</sup> and a Communication on the European electronic communications regulation and markets ('Implementation Report')<sup>(20)</sup> which will certainly provide valuable input to both debates.

Both pillars of the review are crucial in defining or re-defining the areas and the grounds for potential regulatory intervention in electronic communications markets.

### 3.2. *Re-defining the areas of potential ex ante regulation — the review of the Recommendation on relevant markets*

At this stage of the review process, no final statements as regards the new Recommendation on relevant markets can be made. It is however clear that, in contrast to the current Recommendation, the 'List of markets to be included in the initial Commission recommendation on relevant product and service markets referred to in Article 15' which can be found in Annex I of the Framework Directive, no longer needs to be used as a basis for identifying markets which are susceptible to sector-specific regulation in the future.

It will presumably also be discussed whether or not it is necessary to change the standard for identifying potential areas of regulatory intervention from the 3-criteria-test to something else, or whether a streamlining of the 3 criteria would be appropriate. In any case should the standard result from the deregulatory aim of the current framework that (as long as the framework as such is not amended), the threshold for ex ante regulatory intervention will have to remain higher than a simple finding of SMP in a given electronic communications market.

<sup>(19)</sup> Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on Market Reviews under the EU Regulatory Framework — Consolidating the internal market for electronic communications, COM(2006) 28 final.

<sup>(20)</sup> Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions — European electronic communications regulation and markets 2005 (11th report), COM(2006) 68.

Regarding more specifically the list of markets to be included in the next Recommendation on relevant markets, it is also clear that it will have to be discussed whether sector-specific regulation is still necessary in markets in which competition has strongly developed during the last years. As regards some markets (transit services in the fixed telephony network, access and call origination on public mobile telephone networks, voice call termination on individual mobile networks), discussions about the necessity to regulate have already been announced in the Explanatory Memorandum to the current Recommendation. In view of technological developments, another point of discussion will certainly relate to the boundaries of markets which might still be recommended as being susceptible to ex ante regulation.

In all these upcoming discussions, it should always be clear that both the general threshold of regulatory intervention and the individual markets should be defined with the aim of ensuring sustainable competition in retail markets.

### 3.3. *Re-defining the grounds for ex ante regulatory intervention: the review of the directives*

With regard to the aim of ensuring sustainable competition, it will have to be examined whether the ground for remedying competition problems by way of ex ante regulation should remain the finding of SMP corresponding to the notion of dominance under EC competition law.

Taking into account the rationale underpinning the current framework that there should be a transition from *ex ante* regulation to the sole application of competition law, it seems indispensable, in the interest of ensuring that the transition is as smooth as possible, that the underlying principles at the two ends of the intervention scale (regulation and competition law) are identical. This in fact requires the continued application of competition law principles when defining the grounds for intervention. This would also continue to result in more targeted, economically sound regulation and in a more harmonised approach throughout the EU.

On the other hand, it will have to be discussed whether in certain specific markets exhibiting the characteristics of narrow oligopolies, competition problems can not be remedied more effectively on grounds other than collective dominance as defined under EC competition law.

Beyond these presumably very concrete discussions, the review of the directives will have to



answer some more general questions which might relate to the future of the market review procedure and the related Article 7 consultation mechanism or the division of competences between NRAs and the Commission in the context of harmonising the approaches to regulatory intervention and consolidating the internal market for electronic communications.

During these upcoming discussions, one should however bear in mind that, with the current regulatory framework being less than 3 years in force and many NRAs not having performed completely the first round of market analyses, it may not yet be easy to draw the correct conclusions on the appropriateness of the fundamental principles underpinning the current regulatory framework.



## European Competition Day 2006

The European Competition Day 2006 will take place on June 19<sup>th</sup> at the Radisson SAS Hotel in Vienna. It will be organised together by Austria and Finland, the two EU-Presidencies of 2006 and will be titled *Competition Law and its Surroundings — Links and New Trends*.

The morning session (*'Do Mergers keep what they promise?'*) will discuss the example of a recent merger, the situation in transitional economies and if the EC Merger Regulation really entails a new approach.

The afternoon session (*'Links and Trends in Antitrust Policy'*) will focus on the impact of different areas of law on the combat of anticompetitive practices, on international experiences with the effects of antitrust policy and on the interaction between public and private enforcement and the role of leniency.

The European Competition Day will be opened by Commissioner Neelie Kroes and the Austrian Minister of Economics and Labour, Martin Bartenstein. Among the speakers there will be Philip Lowe, Emil Paulis and Professor Tomi Laamanen.

For further information and online registration: [www.competition06.com](http://www.competition06.com)

### Opening:

- Austrian Federal Minister Martin Bartenstein
- Director General Raimo Luoma (Finnish Ministry of Trade and Industry)
- Commissioner Neelie Kroes
- Member of EP
- Chair: Director General Michael Losch

### Morning session: 'Do mergers keep what they promise?'

- Tomi Laamanen: 'Mergers and business strategy'
- Austrian Entrepreneur: Example of a recent merger
- Zoltán Nagy (President of the Hungarian Competition Authority): 'Mergers and efficiencies — a case of transitional economy'
- Philip Lowe (European Commission): 'EC merger regulation — Is there really a new approach?'
- Discussion
- Chair: Director General Juhani Jokinen

### Afternoon session: 'Links and trends in antitrust policy'

- Hanno Wollmann: (Schoenherr & Partners) 'Counteracting anticompetitive practices — the impact of other laws'
- Rainer Geiger (OECD): 'Effects of antitrust policy — international experiences'
- Emil Paulis (European Commission): "Interaction between public and private enforcement and the role of leniency"
- Chair: Director General Walter Barfuß

### Discussion: 'Europe's quest for competitiveness — role of antitrust'

- Panel: Michael Losch, Juhani Jokinen, Philip Lowe, Emil Paulis
- Chair: Director General Losch

***The next European Competition day  
will be held under the Austrian Presidency  
of the Council of the European Union  
on the 19 June 2006 in Vienna.***

## The Commission proposes to repeal the Liner Conference Block Exemption

*Fabrizia BENINI and Carsten BERMIG,  
Directorate-General Competition, unit D-2*

On 14 December 2005 the Commission adopted a proposal for a Council Regulation repealing Council Regulation 4056/86 applying Articles 81 and 82 EC to maritime transport services and amending Regulation 1/2003 <sup>(1)</sup> to extent its scope to cabotage and tramp vessel services <sup>(2)</sup>.

Regulation 4056/86 <sup>(3)</sup> contains a block exemption for liner conferences, allowing providers of regular liner services to fix prices and to regulate capacity. This is the most exceptional exemption from competition rules in force today.

### 1. Historical context

This exemption has to be seen in its historical context. Since the 1870s, liner shipping has been organised in the form of cartels — liner conferences — that bring together all lines operating in a specific geographic zone. Liner conferences were recognised by the 1974 United Nations Convention on a Code of Conduct for Liner conferences.

In 1962, the Council adopted Regulation 17/62 setting out the first procedural framework for the Commission's application of EU Competition rules <sup>(4)</sup>. It took another 24 years before the Commission was endowed with powers to apply competition rules to the maritime transport sector. One of the reasons is that in the preceding decades, there had been some uncertainty concerning the application of EU competition rules to the transport sector and this until the Court of Justice ruled on the subject. In its 1974 *French Seamen* <sup>(5)</sup> judgement, the Court held that the transport sector was subject to the 'fundamental' and 'general' rules of the Treaty. In 1986, it clarified in *Nouvelles Frontières* <sup>(6)</sup> that this expression clearly encompassed the Treaty's competition rules. Against this background, when Regulation 4056/86 was adopted on 22 December 1986, it reflected the legislator's

reticence to apply competition rules fully to the sector. Moreover, it excluded cabotage and tramp vessel services from the implementing rules, de facto creating a safe harbour for these sectors. Significantly it formalised in EC law the acceptance of the international cartel for liner conferences.

Defenders of liner conferences have always claimed that the liner market is unique and thus required special treatment under competition law. An examination of the market shows this is no longer so today: in the twenty years that the Regulation has been in force the liner shipping market has changed considerably. Furthermore, the implementation of the block exemption has not been smooth as the interpretation of the exemption for rate-fixing has been in issue in several competition cases <sup>(7)</sup>. In its 1994 TAA <sup>(8)</sup> and FEFC <sup>(9)</sup> decisions, and again in the 1998 TACA decision, <sup>(10)</sup> the Commission objected, inter alia, to the collective fixing of tariffs for the inland leg of multimodal transport operations. In the TACA case, the Commission also objected to attempts by the conference to restrict the availability to shippers of individual and confidential service contracts. Finally, the Commission objected to capacity freezes in the TAA and EATA cases, decided with the obvious purpose of increasing freight rates by limiting supply. In its TAA and EATA <sup>(11)</sup> decisions the Commission found that these capacity freezes were not consonant with the aim of Article 3(d) of Regulation 4056/86, which was the improvement of the scheduled transport service(s) provided by the members of the conference. The Court upheld the Commission's decisions on the substance.

<sup>(1)</sup> OJ L 1, 4.1.2003, p. 1.

<sup>(2)</sup> COM (2005) 651 of 14.12.2005.

<sup>(3)</sup> OJ L 378, 31.12.1986, p. 4.

<sup>(4)</sup> Regulation 141/62 explicitly excluded transport from the scope of Regulation 17.

<sup>(5)</sup> Judgment in Case 167/73 *Commission v France* [1974] ECR 359.

<sup>(6)</sup> Joined Cases 209-213/84 *Ministère Public v Lucas Asjès* [1986] ECR 1425.

<sup>(7)</sup> *Competition in the maritime transport sector: a new era*, Competition Policy Newsletter, Vol. 1, February 2002, p. 10.

<sup>(8)</sup> Commission decision of 19 October 1994 in Case No IV/34.446 — *Trans-Atlantic Agreement* (OJ L 376, 31.12.1994, p. 1), hereafter the 'TAA decision'.

<sup>(9)</sup> Commission decision of 21 December 1994 in Case No IV/33.218 — *Far Eastern Freight Conference* (OJ L 378, 31.12.1994, p. 17).

<sup>(10)</sup> Commission decision of 16 September 1998 in Case No IV/35.134 — *Trans-Atlantic Conference Agreement* (OJ L 95, 9.4.1999, p. 1).

<sup>(11)</sup> Commission decision of 30 April 1999 in Case No IV/34.250 — *Europe-Asia Trades Agreement* (OJ L 193, 26.7.1999, p. 23).

## 2. The review process

Exemptions from competition rules are reviewed every few years to ensure that they continue to fulfil four cumulative conditions of Article 81.3. Regulation 4056/86 had never been reviewed. This until March 2003, when the Commission initiated an extensive review of Regulation 4056/86 to ascertain whether the block exemption delivered the benefits for which it was first established and to determine how best to apply competition rules to liner transport services in today's market conditions. In the three years leading to the adoption of the proposal to repeal the Regulation, the Commission put forward several papers for public consultation, held a public hearing and reported results to the Member States. Three independent studies were carried out. Industry contributed with substantive submissions both in favour and against the repeal of the block exemption.

All documents were published in the Commission's website: <http://europa.eu.int/comm/competition/antitrust/legislation/maritime/>

EU institutions and bodies also took an interest in the debate. On 1 December 2005, the European Parliament issued an own initiative report on the Commission's White Paper <sup>(12)</sup> of October 2004. The Economic and Social Committee and the Committee of the Regions adopted opinions <sup>(13)</sup>.

## 3. Liner Shipping Services

Liner shipping conferences are associations of ship-owners served by a secretariat. The block exemption contained in Regulation 4056/86 allows them to set common freight rates, to regulate capacity jointly and to coordinate timetables on the assumption that this was necessary for the provision of regular scheduled maritime services. Yet conferences do not provide services. Liner services are provided either by individual lines that may or may not be part of conferences or by groups of carriers organised in consortia and alliances.

Price fixing and capacity regulation are hard core restrictions of competition. This means that they are likely to produce a negative effect — they lead

to higher prices — without producing any countervailing value to consumers. As such, the Commission has stated that its general policy is to consider them likely to be in breach of EU competition rules <sup>(14)</sup>.

Liner shipping is an important part of the EU economy: it represents about 18% of all imports and 21% of all exports transported by land, sea or air. Considering the importance of the sector to the EU25 economy, this means that 18% of EU imports and 21% of exports are affected by carriers' ability to fix prices in the liner conference block exemption.

The liner shipping market has changed considerably since Regulation 4056/86 was adopted. The continuing trend towards containerisation has led to an emphasis on global route networks. This has contributed to the popularity of co-operation agreements between shipping lines in the form of consortia and alliances as a means for carriers to share the costs of providing regular services but without jointly fixing freight rates. The growth in importance of these operational arrangements has been accompanied by a decline in the significance of conferences.

European liner shipping operators are very successful in the world market. Four out of the top five carriers are European carriers and these four carriers control 33% of global liner capacity. Between 2000 and 2005, European carriers increased their global capacity share in liner shipping. During the same period, the share of Chinese, Japanese and other South East Asian carriers decreased. European carriers have a strong position on all international trade routes, not only on EU trades. For example, the Commission's analysis shows that EU carriers rank among the top 3 in almost all US trades.

## 4. Findings of the review

Recital 8 of Regulation 4056/86 is predicated on the assumption that liner conferences have a stabilising effect, assuring shippers of reliable services and that such results cannot be obtained without joint price fixing and capacity regulation.

The main objective of the review was to verify whether the legislator's assumption was still valid in today market conditions and in particular whether the four cumulative conditions of Article 81(3) were fulfilled.

<sup>(12)</sup> White Paper on the review of Regulation 4056/86 applying competition rules to maritime transport, COM(2004) 654 final, 13.10.2004.

<sup>(13)</sup> European Parliament resolution on the application of EC competition rules to maritime transport (2005/2033 (INI)) of 1 December 2005 (P6\_TA-PROV(2005)0466, A6-0314/2005), Economic and Social Committee TEN/208, CESE 1650/2004 of 16 December 2004. and Opinion of the Committee of the Regions of 13 April 2005, Cdr 485/2004.

<sup>(14)</sup> See Commission notice on Guidelines on the application of Article 81 (3) of the Treaty, OJ C 101, 27.4.2004, paragraph 46.

To fulfil the first condition of Article 81(3) of the Treaty, it must be established that concrete economic benefits flow from the price fixing and capacity regulation by conferences. To follow the legislators' assumption, a direct causal link would need to be established between price-fixing and supply regulation within conferences (leading to stability of freight rates), and reliable scheduled maritime transport services.

'Price stability' has been defined in the TAA decision as 'the maintenance of freight rates at a more or less constant level by liner conferences, in accordance with a set structure over a substantial period of time' <sup>(15)</sup>. It is questionable however if price stability as such would be regarded as sufficient for the fulfilment of the first condition of Article 81(3). Price stability only becomes relevant if it is read in conjunction with the concept of 'reliable services' meaning 'the maintenance over time of a scheduled service, providing shippers with the guarantee of a service suited to their needs'. Data put forward during the review process did not show that actual freight rates have been stable or that conferences have contributed to rate stability, i.e. with or without conferences there is price volatility. It was found that with conferences the source of price volatility comes from the structural instability of market participation and conference membership. This can be a fundamental and wasteful problem, since market entry and exit can be associated with transaction and investment costs. In contrast, without conferences price volatility will continue. This is due to price-maximising behaviour which is normal competitive conduct.

Carriers consider the reliability of service as the main benefit that derives from conferences. However, in today's market, conferences are not able to enforce the conference tariff and do not manage the capacity that is made available on the market. The majority of cargo is carried under confidential individual agreements between carriers and transport users ('contract cargo') rather than under the conference tariff. The proportion of contract cargo is very high ranging from 90% and above in the transatlantic trade to 75% in the Europe to Australian trade. The same occurs in the Europe to Far East trades. Regarding capacity regulation, this is a decision that is taken by individual lines or by consortia. Thus, it is difficult to claim that the provision of reliable services results directly from conference price fixing and capacity regulation. The alleged causal link between the restrictions and the claimed efficiencies is therefore too tenuous to meet the first condition of Article 81 (3).

<sup>(15)</sup> Recital 388.

The second condition of Article 81(3) of the Treaty requires that, if liner conferences were to achieve economic benefits, a fair share of these benefits should be passed on to consumers. In the case of a hard-core restriction of competition such as horizontal price fixing the negative effects are very serious and the benefits have to be very clear cut.

However, no clear positive effects have been identified in the review process. Transport users (shippers and freight forwarders) have systematically opposed the conference system which they consider does not deliver adequate, efficient and reliable services suited to their needs. They call for the abolition of conferences and consider the existing consortia block exemption to provide an adequate framework for co-operation among liner shipping carriers. It should be noted that although the conference tariff is no longer enforced it may act as a benchmark for the setting of individual contracts. This results in a reduction of shippers' negotiating power. Moreover the common setting of surcharges and ancillary charges and its application by non-conference members leads to, on average, 30% of the price of transport being fixed jointly. To the detriment of shippers there is no price competition between conference members and non-conference members for this part of the price. The second condition is therefore not fulfilled.

Under the third condition of Article 81(3) of the Treaty, the test is basically whether there are less restrictive alternatives than conference price fixing which would assure reliable liner services to the benefit of consumers.

Today, scheduled liner services are provided in several ways. Independent carriers operate outside conferences on all main trades to and from Europe. Co-operation arrangements between liner shipping lines not involving price fixing, such as consortia and alliances <sup>(16)</sup>, have increased and have important shares of the market in all major trades. Under certain conditions, consortia are block exempted from the prohibition set out in Article 81(1) of the Treaty by Commission Regulation (EC) No 823/200 of 19 April 2000 <sup>(17)</sup> on account of the rationalisation they bring to the activities of member companies and the economies of scale they allow in the operation of vessels

<sup>(16)</sup> Council Regulation (EEC) No 479/92, based on Article 87 [now 83] of the Treaty empowered the Commission to apply Article 81(3) of the Treaty to liner shipping companies grouped in consortia and providing a joint service (OJ L 55, 22.9.1992, p. 3).

<sup>(17)</sup> OJ L 100, 20.4.2000, p.24 as amended by Commission Regulation (EC) No 463/2004 of 12 March 2004, OJ L 77, 13.3.2004 and by Commission Regulation 611/2005, OJ L 101, 21.4.2005, p. 10.

and port facilities. Moreover, confidential individual service contracts between individual carriers and individual shippers account for the majority of cargo transported. Finally it should be noted that in some trades, conferences do not exist and this has not affected the regularity of the services. The restrictions permitted under Regulation 4056/86 (price fixing and capacity regulation) are therefore not indispensable for the provision of reliable shipping services. The third condition is therefore not fulfilled.

Finally, the fourth condition of Article 81(3) of the Treaty requires that competition should not be eliminated on a substantial part of the market. Conferences operate alongside consortia, alliances and independent operators. It would appear therefore that the fourth condition of Article 81(3) of the Treaty may be fulfilled. However, since the four conditions of Article 81(3) of the Treaty are cumulative and the first three conditions are not fulfilled for the reasons explained above, the question whether or not the fourth condition is fulfilled could be left open.

This said, carriers are likely to be members of a conference on a trade and outsiders in another. They may also be members of conferences and of consortia or alliances on the same market thus cumulating the benefits of the two block exemptions. In all cases, they exchange commercially sensitive information with their competitors that may allow them to adapt their conduct on the market. In addition for charges and surcharges there is clearly no price competition between conference and non-conference carriers. Given the increasing number of links between carriers, determining the extent to which a particular conference is subject to effective competition is a case by case assessment.

In conclusion, the four cumulative conditions of Article 81(3) of the Treaty that would justify an exemption are not fulfilled by conferences in present day market circumstances.

Besides fixing the tariff, conferences jointly fix certain surcharges and ancillary charges in particular currency and bunker adjustment factors (CAFs and BAFs) and terminal handling charges. As explained above, the same level of charges or adjustment factors is often applied by non-conference members. It is questionable whether joint fixing of terminal handling charges falls within the scope of the conference block exemption regulation. Moreover, fixing of charges and surcharges by lines that are not members of a conference is not foreseen by Regulation 4056/86. This means that in practice carriers are going beyond what is allowed in the very generous block exemption.

## 5. Impact of a repeal of the liner conference block exemption

### 5.1. *In Economic Terms*

Defenders of liner shipping conferences have often put forward the argument that perfect competition does not function since the industry has a number of features that are inconsistent with the requirements of perfect competition<sup>(18)</sup>. This means in certain situations the market does not have an equilibrium ('empty core'), which would endanger the provision of regular and reliable services and price instability. This economic approach is referred to as the 'theory of the core'. There is a fairly large body of theoretical literature supporting the view that the liner shipping market has an empty core and, therefore, liner shipping is characterised by an 'inherent instability'.

However, the theory of the core dates back to the 1960s and comes up with idealised market scenarios in order to show that the market is indeed suffering from an empty core. The basic problem with the core-theory approach is that it does not take due account of the working of competition and competition policy.<sup>(19)</sup>

Modern industrial organisation, notably non-cooperative game theory, which is characterised by a more restrictive view about the implementability of coalitions among market participants, appears to be a more appropriate framework for analysing the liner shipping market. A game theoretic model of the liner shipping market actually shows that conferences could lead to excess capacity or excess pricing and endanger service reliability. In any case, the model provides no evidence that competition between liner shipping carriers leads to 'inherent market instability'. Recent real-world experiences appear to confirm the theoretical model.<sup>(20)</sup> Furthermore, the cost structure of liner shipping does not differ substantially from that of other transport industries. In short, there is no empirical or theoretical economic evidence that the industry needs to be protected from competition.

<sup>(18)</sup> The line shipping market's features are notably regular scheduled services, economies of scale and density, capacity indivisibilities, high fixed avoidable costs, divisible and variable demand, inventories are not feasible and network effects.

<sup>(19)</sup> The core theory's assumption that each side of the market (carriers and shippers) can coalesce in any form, using enforceable contracts, is unrealistic and appears to violate competition law in any jurisdiction.

<sup>(20)</sup> On the West African trade conferences are likely to have de-stabilising effects on liner markets. On the other hand, the termination of a conference on the Europe-West Coast South America trade did not have any negative impacts on the stability of supply or regularity of services on this trade.



The Commission's impact assessment <sup>(21)</sup> analysed the economic, social and environmental impact of the repeal of the conference block exemption. The economic assessment comprised the potential impact of the repeal on transport prices and price stability, long-term economic growth and the Lisbon objectives, the reliability of liner transport services, service quality and innovation, competitiveness of the EU liner shipping industry in particular small EU carriers, trade and cross-border investment flows, market concentration and competition in the Internal Market, specific maritime regions and ports, small shippers and consumers as well as developing countries.

Summarising the main results of the impact assessment, the repeal of the conference block exemption is likely to result in lower transport costs. While the ocean transport prices will only moderately drop, the reductions in charges and surcharges are expected to be considerable. About 20% of EU external trade will thus directly profit from lower transport prices for liner shipping services to the benefit of shippers and the final consumer. The repeal is also likely to have a positive impact on developing countries since they typically export low-value commodities with a relatively high transport cost share.

The abolition of liner conferences would reduce structural overcapacity in the market while ensuring reliable liner services, i.e. a positive impact on service reliability can be expected. This applies to all trades — thin versus thick, North-South versus East-West and deep sea and short sea.

Market concentration in liner shipping will not be affected by the abolition of conferences. Concentration is a process independent of the repeal of the block exemption. Liner carriers are integrating horizontally and vertically as a reaction to customer demand for door-to-door services. Vertical integration provides greater reliability to the carriers to provide such services if they control all the key elements of the transportation chain.

The effects on the EU liner shipping industry itself are also expected to be positive. Experience from other recently liberalised transport sectors shows that service quality and innovation are likely to be improved. Since four out of the top five worldwide liner shipping carriers are European, a more competitive environment should allow EU liner shipping carriers to compete, even more successfully, and grow. Liberalisation gives 'smaller EU

carriers' <sup>(22)</sup> the opportunity to grow fast if they follow an innovative business model. The success of small carriers depends on their ability to adapt to a competitive environment and not on their actual size.

It should be noted that conference members come from all over the world. Liner conferences serving EU trades contain EU liner shipping carriers as well as carriers from third countries. EU carriers are also conference members on non-EU trades. As stated above EU carriers have a strong position on all world trades not only on EU trades. Therefore the competitiveness of EU carriers relative to non-EU carriers would not, in principle, be altered by the removal of the exemption.

The repeal of the block exemption will not bring about any social impacts or impacts on employment. Finally, the environmental impact is expected to be neutral since positive and negative impacts <sup>(23)</sup> are likely to offset each other.

## 5.2. *International considerations*

Liner conferences have traditionally been tolerated worldwide. This said they do not benefit from anti-trust immunity in all jurisdictions. However, in jurisdictions where such immunity or exemption exists, it has not so far been entirely removed, despite the 2002 OECD call to its member countries to do so.

If the EU were the first to repeal the liner conference system, the question arises of whether there is a risk of a conflict of international laws. The Commission considers that such a risk is unlikely. A conflict of laws arises only where one jurisdiction requires undertakings to do something that another jurisdiction prohibits. No jurisdiction imposes an obligation on liner shipping operators to operate in conferences or to fix prices jointly. If this happened it would go against the way operators have organised themselves in the market as there are several carriers that do not belong to conferences and operate as individual lines.

<sup>(22)</sup> It should be noted that there is no EU liner shipping carrier that would fall within the Commission recommendation 2003/361/EC of 6 May 2003 concerning the definition of small and medium sized enterprises (OJ L 124, 20 May 2003).

<sup>(23)</sup> Positive environmental impacts would stem from the abolition of joint fixing bunker charges (so-called bunker adjustment factors) which will put liner carriers under competitive pressure with respect to bunker costs. As a result carriers might invest in vessels that consume less bunker bringing about less individual greenhouse gas emissions. Negative environmental effects could emerge when the reductions of transport prices lead to accelerated growth in transport demand. In this case, even with reductions from individual vessels, emissions from the sector could be expected to increase.

<sup>(21)</sup> SEC (2005) 1641.

Given the nature of the industry, attention has been paid to the international dimension of liner shipping. Throughout the review process bilateral contacts with the major trading partners (e.g. US, Canada, Japan), as well as with developing countries, have taken place. The result of these contacts is encouraging. Several countries also realise that liner shipping conference cartels are not indispensable for the provision of reliable shipping services.

## 6. Need for a new framework to replace the conference system?

Industry is divided on the need for a substantive alternative to Regulation 4056/86. The European Liner Affairs Association (ELAA) has proposed that the conference block exemption should be replaced with an exchange of information system. Transport users do not consider this to be necessary. They regard the consortia block exemption as allowing for all the co-operation necessary for the provision of reliable services by carriers.

The proposed ELAA system would potentially cover the whole liner shipping market and thus be broader in scope than the exchange of information within the present conference system. To be acceptable, any new system must respect the competition rules. Some elements of the ELAA proposal appear to be in line with these requirements. However, others are problematic notably because they do not differ in effect from what conferences do today. Accepting the proposal as initially presented would remove all the pro-competitive effects of the abolition of the conference system.

This said, the Commission remains committed to continuing the dialogue with the ELAA with a view to assisting it in developing an alternative system compliant with EU competition rules. It has acknowledged that exchanges of information leading to greater market transparency may contribute to the improvement in the way liner services are provided, in the interest of carriers, transport users and the public in general. Discussions will be focusing on the details of the various parts of the ELAA proposal.

Given that competition rules have never applied fully to the liner sector, the Commission will issue appropriate guidelines on competition in the maritime sector so as to help smooth the transition to a fully competitive regime. The purpose of these guidelines is to explain, *inter alia*, how the competition rules apply to the liner sector in general, including timely and regular exchange and publication of information on capacity and utilisation.

They are due to be promulgated by end 2007. As an interim step in the preparation of guidelines, DG COMP will publish an 'issues paper' on liner shipping in September 2006.

## 7. The extension of the general competition implementing rules to cover cabotage and tramp vessel services

The Commission is proposing to amend Regulation 1/2003 so as to include in its scope cabotage and tramp vessel services.

Maritime transport services are key to the development of the EU economy. Tramp vessel services account for the major part of the volume of these services. Tramp vessel services are unscheduled transport services of bulk and break-bulk cargo. Cabotage is defined as maritime transport services between ports of one and the same Member State.

Regulation 4056/86 does not explain why cabotage is excluded from its scope. The only indirect reference is to be found in recital 6 which states that the Regulation's objective is to avoid excessive regulation of the sector, implying that in a majority of cases cabotage services would not affect intra-Community trade. However, this does not justify why these services should from the outset be excluded from the scope of Regulation 1/2003. Similarly, The fourth recital of Regulation 4056/86 suggests that the exclusion is due to these services operating on a free and competitive market. This however is presumed to be the case for all de-regulated services, without it being deemed necessary to exclude such services from the implementing regulations.

The proposal to bring these services under the common competition implementing rules does not involve a substantive change for the industry as the substantive competition rules, set out in Articles 81 and 82 of the Treaty, already apply. It rather establishes equality of treatment between these sectors of the economy and all others.

The maritime sector guidelines due for end 2007 will also deal with the application of the EU competition rules to tramp services. To that end, the Commission services are engaged in discussions with tramp operators so as better to understand the issues at stake. Whilst formal guidance could be issued only after Regulation 1/2003 is modified, if necessary, informal guidance can be provided beforehand.

## Parallel import of motor vehicles: the Peugeot case

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The *Peugeot* decision, adopted by the Commission on 5 October 2005, imposed a fine of 49.4 million euros for breach of Article 81 EC on the motor vehicle manufacturer Automobiles Peugeot SA ('Peugeot'), and its subsidiary Peugeot Nederland NV, which is tasked with importing vehicles of the Peugeot brand into the Netherlands from other Member States, in particular France.

The decision is directed at an infringement implemented in the context of selective and exclusive distribution agreements regulating the relations between Peugeot and its Dutch dealers. The addressees of the decision have committed one infringement composed of two measures, which had for object and effect to restrict competition. The first measure, applied from 1997 to 2003, consisted in a system of bonuses paid to dealers and discriminating against export sales; this system of bonuses, viewed from the angle of its objective *modus operandi*, went beyond what was necessary to induce Dutch dealers to devote their best sales efforts to their contract territory. The second measure impugned by the decision, which was applied from 1997 to 2001, consisted in Automobiles Peugeot SA bringing pressure to bear on dealers active in export sales — a direct measure which strengthened the impact of the discriminatory bonus.

In respect to both measures, it has been possible to show the existence of an agreement, of a restriction by object — but also a concrete effect on the market.

### The discriminatory bonus

As concerns the first measure, it is worth recalling that in the Netherlands, dealer remuneration was made up of a fixed portion (the margin on invoices <sup>(1)</sup>) and a portion linked to the dealer's

results (the bonus <sup>(2)</sup>), which the dealer needed in order to earn a profit from his business. This bonus could be obtained by the Dutch dealer only if the cars sold by him were registered in the Netherlands. The system put in place by Peugeot had two distinct phases regulating the mechanism for granting a bonus: the right to the bonus was established on the basis of a progressive scale of annual sales targets established at the start of the exercise: these targets related to sales to be made in the dealer's territory. Later, when the volumes corresponding to the sales targets were reached, bonus payments were also calculated on the basis of the number of vehicles sold in the territory. In other words, registration in the Netherlands was required by Peugeot for the purpose of (1) achieving any sales target leading to the acquisition of entitlement to the bonus and the determination of the level of discount per car, and (2) identifying each vehicle sold by Peugeot eligible for such remuneration (the payment of the bonus).

The annual circulars sent to all dealers from 1 January 1997 until 30 September 2003 concerning implementation of the new bonus scheme provided that only private cars registered in the Dutch market would count for the payment of the bonus. In its reply to the statement of objections, Peugeot argued that its network remuneration policy was pro-competitive and had the 'sole, manifest objective' of motivating dealers by offering them the necessary economic incentives, in the form of bonuses, to concentrate their best sales efforts on their own area and thereby enable Peugeot to increase its market share in the Netherlands.

In the light of this agreement, the Commission decision does not call into question the possibility for the manufacturer to tailor its commercial policy according to the requirements of different

<sup>(1)</sup> The dealer's margin is the difference between the net recommended list price of a given model and the price at which the dealer buys the car from his supplier. This amount serves to cover the dealer's distribution costs and overheads as well as the discounts which he has to grant most of the time to final consumers.

<sup>(2)</sup> The bonus consists of a flat-rate payment made to the dealer by his supplier at regular intervals for each vehicle sold in accordance with the terms applicable. Payment of the bonus is subject to the dealer's meeting certain quality and quantity targets.

national markets with a view to achieving better penetration rates in those markets. It does not dispute the manufacturer's freedom to agree with its dealers sales targets set in terms of sales to be achieved in the contract territory or its freedom to adopt appropriate incentivisation schemes, in the form of performance bonuses in particular, in order to urge its dealers to increase their sales volumes in the territory allocated to them. This possibility, which stimulates inter-brand competition was furthermore expressly provided for by exemption Regulation 1475/95 <sup>(3)</sup>.

However, any dealer of the Peugeot Dutch network who had fully achieved his territorial sales targets and had therefore acquired entitlement to the bonus was nevertheless denied the benefit of the bonus thus acquired when it came to payment of that entitlement with respect to cars sold to non-resident consumers. Such a system, viewed from the standpoint of its objective *modus operandi*, therefore went beyond what was necessary to encourage Dutch dealers to devote their best sales efforts to their contract territory. It was an infringement of one of the black clauses banned by Regulation 1475/95, Article 6(1)(8) of which provides that the exemption does not apply where 'the supplier, without any objective reason, grants dealers remunerations calculated on the basis of the place of destination of the motor vehicles resold or the place of residence of the purchaser'.

In its reply to the statement of objections, Automobiles Peugeot SA also questioned the effectiveness of such a measure, maintaining that the amount of the bonus was too small for its non-payment to act as a disincentive for dealers to export.. The evidence held on file bears out the objections about the measures' significant impact by showing that the bonus was important to dealers throughout the

period and that its loss on export sales significantly affected dealer interest in selling to non-resident consumers <sup>(4)</sup>.

### Pressure put on dealers

It is worth highlighting at this point that the strategy employed by Automobiles Peugeot SA was known to the members of the distribution network, who feared the long-term effects of exports on their profits and who indicated, in the context of certain meetings of their national and regional associations, that they agreed with the measures taken by it. Where exports took place, the importer intervened through direct threats and delivery restrictions with a view to maintaining the discipline thereby established. Notably, from 1997 onwards and until a more recent period in 2001, Peugeot exerted direct pressure by occasionally acting to limit the export sales of certain dealers. It brought such pressure to bear among other things through its Account Managers Dealernet (AMDs), who were employed by its Car Sales Department. In addition, specific versions of certain Peugeot models were ear-marked for the national market, and therefore excluded from exports.

The pressure put on Dutch dealers was intended to hinder cross-border trade in cars between the Netherlands and other Member States with a view to walling off the Dutch market from the other markets in the European Union. Such a strategy strengthened therefore the impact of the discriminatory remuneration system described above.

### Measures having a significant and measurable effect

As regards the discriminatory bonus, it is possible in the present case to determine the concrete

<sup>(3)</sup> Article 4(1): The exemption shall apply notwithstanding any obligation whereby the dealer undertakes to: ... (3) endeavour to sell, within the contract territory and during a specified period, a minimum quantity of contract goods, determined by the parties by common agreement or, in the event of disagreement between the parties as to the minimum number of contractual goods to be sold annually, by an expert third party, account being taken in particular of sales previously achieved in the territory and of forecast sales for the territory and at national level.

<sup>(4)</sup> It should be noted that the defence put forward by Peugeot is somewhat paradoxical. On the one hand, Peugeot argues that the level of the bonus maintained in place between 1997 and 2003 was too low to have had any effect on dealers' behaviour. On the other hand, it stresses that the system at issue, and in particular the level of the discounts granted to dealers who had achieved their sales targets, was essential to providing appropriate financial incentives to ensure that dealers devoted their best sales efforts to their respective contract territories.

impact that the measures in question have actually had on parallel imports. Exports declined after 1997, the year in which the remuneration system was implemented, then fell sharply after 1999. In its reply to the statement of objections, Automobiles Peugeot SA attributes this to factors other than the remuneration system at issue, namely the 'essential role' played by diminishing price differentials. However, several factors contradict this analysis. First, there was no significant variation in the price differential at Community level during the period concerned. And second, internal Peugeot documentation quantifies precisely the negative impact of the measure for the non-resident final consumer, stating that, if the bonus was paid in respect of vehicles sold for export, this would have generated additional sales to non-resident final consumers amounting to more than 50% of the current level of exports.

In addition, as regards pressure put on dealers, 24 consumers lodged a complaint before the Commission for the damage caused by delivery delays linked to the Peugeot threats against dealers. One of the complainants informed the Commission that twelve orders had been cancelled as a result of similar behaviour obstructing parallel trade from the Netherlands

## Fines

The Commission considered that, taking into account both its gravity and duration, the infringement committed by Automobiles Peugeot SA and its subsidiary Peugeot Nederland NV was a very serious infringement of Article 81. This was true both as regards the bonus policy applied from January 1997 to September 2003 and the other supporting measures taken by Peugeot. The Commission and the Court of Justice have already ruled on remuneration systems that discriminate according to the vehicle's destination <sup>(5)</sup>. The evaluation of the gravity of this infringement in this case was strictly based on the provisions of the Guidelines for calculating fines, confirmed by other previous decisions of the Commission in the motor vehicle sector (Volkswagen I, Opel).

The present case is therefore fully in line with the Commission's decision-making practice, as confirmed by the Court of Justice, which has as its guiding line the protection of parallel trade of motor vehicles in view of the importance that this trade has taken on over the years for the consumer in a context of price differentials between Member States.

<sup>(5)</sup> Commission Decision of 28.1.1998 in Case IV/35.733 — *Volkswagen* (OJ L 124, 25.4.1998, p. 60), paragraph 129; Commission Decision of 20.9.2000 in Case COMP/36.653 — *Opel* (OJ L 59, 28.2.2001, p. 1), paragraph 117.

## Competition issues in waste management systems

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### 1. Introduction

On 22 September 2005, DG Competition published the 'DG Competition Paper concerning issues of competition in waste management systems' (the Paper) on its internet website. <sup>(1)</sup> The Paper sets forth key competition issues, in particular as regards the collection and treatment of three types of waste under the corresponding EC Directives, namely: (i) packaging waste (Packaging Directive <sup>(2)</sup>), (ii) end-of-life vehicles (ELVs) or 'car wrecks' (ELV Directive <sup>(3)</sup>) and (iii) waste electrical and electronic equipment (WEEE) (WEEE Directive <sup>(4)</sup>). The Paper was prepared by DG Competition in co-operation with the national competition authorities (NCAs). The objective was to exchange information and to prepare transparent and coherent policy guidance in the waste management sector in order to enhance consistency of approaches within the European network of competition authorities.

### 2. Background

The markets for recycled materials will become key resource markets of the future and the waste management sector is rapidly increasing in economic importance. For example, Germany has seen a significant amount of takeover activity in the field of waste management recently as undertakings are aiming to position themselves in the lucrative waste management markets. <sup>(5)</sup> In Germany alone, the waste management sector handles almost 400 million tonnes of waste every year,

employs over 240,000 employees and generates an annual turnover of approximately € 50 billion. <sup>(6)</sup> The application of competition policy is therefore of considerable importance in this field. In applying competition policy to the waste management sector, the overall objective is to achieve competition and environment policies that are implemented in a mutually reinforcing way in order to best contribute to ensuring open and competitive markets as part of the partnership for growth and jobs under the Lisbon strategy.

### 3. Procedure

The process applied in the preparation of the Paper was a rather novel one. In 2003, the Commission decided to enter into a comprehensive dialogue process with the NCAs in the field of waste management. As a first step, a questionnaire was sent to the NCAs requesting information, e.g., about waste-specific competition law provisions under national legislation and NCAs' case law and experience in the field of waste management. A discussion paper was subsequently drafted on the basis of existing Commission decisions <sup>(7)</sup> and on the basis of the replies received from the NCAs. In 2005, a meeting took place with the Commission and the NCAs to discuss the draft paper, which was finalised and published in September 2005. Stakeholders were not consulted during the process. The Paper is not legally binding and does not constitute 'Commission Guidelines'.

The co-operation with the NCAs allowed the Commission to obtain an overview of the waste management sector and to identify potential competition concerns with a limited use of resources, in particular without the considerable manpower required for sector inquiries under Article 17 of

<sup>(1)</sup> The Paper is available at <http://europa.eu.int/comm/competition/antitrust/others/>

<sup>(2)</sup> Directive 94/62/EC of the European Parliament and Council of 20 December 1994 on packaging and packaging waste, OJ L 365, 1994, p. 10. This Directive was amended by the Directive 2004/12/EC of the European Parliament and Council of 11 February 2004, OJ L 47, 2004, p. 26 (hereinafter the Revised Packaging Directive).

<sup>(3)</sup> Directive 2000/53/EC of the European Parliament and of the Council of 18 September 2000 on end-of-life vehicles, OJ L 269, 2000, p. 34.

<sup>(4)</sup> Directive 2002/96/EC of the European Parliament and of the Council of 27 January 2003 on waste electrical and electronic equipment (WEEE), OJ L 37, 2003, p. 24.

<sup>(5)</sup> See, for example, the takeover of Duales System Deutschland (DSD), a collective system active in the packaging waste sector, by the private equity investor KKR in the beginning of 2005 and the attempted takeover of Cleanaway by SULO at the end of 2005.

<sup>(6)</sup> See the website of the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety at [http://www.bmu.de/english/waste\\_management/downloads/doc/35563.php](http://www.bmu.de/english/waste_management/downloads/doc/35563.php)

<sup>(7)</sup> Commission decision of 16 October 2003, ARA, ARGEV, ARO, OJ L 75, 2004, p. 59 (Article 81 EC) — appeal pending; Commission decision of 17 September 2001, DSD, OJ L 319, 2001, p. 1 (Article 81 EC) — appeal pending; Commission decision of 15 June, 2001, *Eco Emballages*, OJ L 233, 2001, p. 37 (Article 81 EC); and Commission decision of 20 April 2001, DSD, OJ L 166, 2001, p. 1 (Article 82 EC) — appeal pending.

EC Regulation 1/2003. <sup>(8)</sup> This approach may be applied in an identical or similar form in other industry sectors in the future.

#### 4. The relevant markets

The waste markets are relatively new markets. The packaging waste markets have developed gradually since the mid-1990s. As regards ELVs and WEEE, the markets in most countries are either in the process of being created or will be created in the future. As a result, it is difficult to precisely delineate the relevant product and geographic markets in the ELV and WEEE sector.

##### a. The relevant product markets

In the Paper, the Commission has identified three principal product markets for each of the three types of waste concerned. Similar market definitions may also apply to other types of waste (e.g., waste batteries). Each of the three markets may be further subdivided into several sub-markets.

The first market is that for the *organisation of systems or solutions* to fulfil the obligations under the respective waste Directives. Collective systems and individual solutions organise the collection and recovery of waste. Collective systems offer their services to the companies obliged to recycle their waste under the national laws implementing the respective Directive, usually producers and importers (obliged companies). Instead of taking part in a collective system, obliged companies may also opt for an individual solution and organise the collection and recovery of waste for their own products.

The second market is that for the *collection and sorting* (including dismantling and shredding in the case of ELVs and certain WEEEs) of waste. In this market, the systems/solutions obtain the collection and sorting services from private and public companies. The collection and sorting markets may also constitute separate markets.

The third market is that for *recovery services and secondary material*. Recovery companies offer their services to the systems/solutions, which in turn organise the delivery of the collected and sorted waste to the recovery companies. Recovery companies sell the secondary material for re-use, e.g., to producers.

<sup>(8)</sup> Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 1, 2003, p. 1.

##### b. The relevant geographic markets

As regards the *organisation of systems or solutions*, the supply and demand conditions including the legal framework continue to differ considerably from country to country. Thus, the geographic market is likely to be national.

The geographic market for *collection and sorting services* is likely to be local or regional as collection and sorting companies normally operate at local or regional level but may also be national (e.g., the collection of car wrecks in a small or medium sized Member State may be carried out nation-wide).

The geographic market for *recovery services and secondary material* may be national but may also be EU-wide since this market is becoming increasingly internationalised. The geographic scope will, *inter alia*, depend on the material in question as transport costs (and thus cross-border traffic) may vary for each secondary material such as, e.g., plastics, glass or paper.

#### 5. The competition concerns

##### A. General

The Paper identifies three principal competition policy objectives in the field of waste management systems:

- first, the prevention of anti-competitive practices such as, e.g., market sharing, price fixing and the exchange of sensitive information;
- second, the assurance of a framework which allows choices between several waste management systems for the companies obliged under national legislation to recycle their waste;
- third, the avoidance of exclusive arrangements of all kinds without solid and convincing economic justification.

The Paper discusses possible competition concerns for each of the three types of waste separately. It is noteworthy that the Commission, as well as most of the NCAs, have considerably more experience in the field of packaging waste as compared to the relatively new areas of car wrecks and electronic waste. The Paper analyses the relationships between the relevant economic actors in the waste management sector, i.e., the systems/solutions, the obliged companies and the collection/sorting/recovery companies. This article limits itself to presenting a general overview of the possible competition concerns without distinguishing between the three types of waste.

### B. Relationship between obliged companies

In nearly all Member States, obliged companies co-operate in order to establish waste management systems. This co-operation may give rise to certain competition concerns. According to the Commission's Horizontal Guidelines (para. 182), <sup>(9)</sup> collection/recycling agreements may relate to and have effects on two markets, i.e., (i) the market on which the parties are active as producers or distributors (spill-over effects) and (ii) the markets of collection (or sorting) services potentially covering the good in question (in particular effects of bundling of demand).

**Spill-over effects.** If obliged companies are competing producers or importers, their co-operation at the waste management level may potentially lead to (i) the development of a common design of the product, (ii) commonality of costs as regards the products through uniform recycling costs and (iii) the exchange of sensitive information. The risk of developing common designs will largely depend on the level of homogeneity of the product in question. The risk of commonality of costs will depend in particular on the importance of the recycling costs in relation to the total costs. For example, the recycling costs of certain types of light bulbs may account for a very significant percentage of the total costs of light bulbs, and co-operation between producers in the field of waste management could therefore lead to considerable price alignment. The risk as regards the exchange of sensitive information will mainly depend on whether the obliged producers participating in a collective system are direct competitors or not (the risk would appear limited if, e.g., producers of shampoo and cereals co-operate in the packaging waste area whereas co-operation among all shampoo producers would give rise to more serious concerns).

**Effects of bundling of demand.** The co-operation of obliged companies may bundle the demand for collection, sorting and recovery services for waste. The importance of these 'effects of bundling' depends on the market share (market power) of the system. Generally, the market power of a collective system increases the more obliged companies with important market shares participate in it. However, it is important to note that the market share of a system on the purchasing markets for collection, sorting and recovery services does not necessarily correspond to the aggregated market shares of the members of the system as producers or distributors. For example, televisions and

computer monitors may constitute different product markets, whereas their collection may be part of the same collection services market.

The adverse effects of bundling need to be balanced with possible network effects and economies of scale. For example, due to the high infrastructure costs required for the collection of household packaging waste at individual homes, systems may only be economically viable if they are able to cover a sufficient amount of waste. For this reason, a certain degree of bundling of demand would seem to be the inevitable consequence to allow for the creation of viable systems in the area of household packaging waste. For other types of waste such as, e.g., industrial packaging waste or car wrecks these considerations would seem to be much less relevant. In order to mitigate the adverse effects of bundling, it is essential to ensure that the bundling of demand does not lead to unjustified restrictions of competition on the downstream markets (competition between collection, sorting and recovery companies) and upstream markets (competition between systems). Possible measures to limit anti-competitive effects may include restrictions of the scope of the system (e.g., a system with a high market share in the area of household packaging waste may be prevented from expanding into industrial packaging waste), limitations on the duration of agreements with the collection, sorting and recovery companies and an obligation to carry out tender procedures.

#### **Possible indicative 30% market share threshold.**

The Paper emphasizes the difficulty to determine indicative market share thresholds below which a co-operation among obliged companies may be generally accepted. To the extent that the principal effects of a co-operation relate to the *vertical* relationship between systems and collection/sorting/recovery companies, it could be argued that guidance may be drawn from the Commission's policy regarding vertical restraints (see Article 3 of the Block Exemption Regulation for vertical agreements (BEVR)). <sup>(10)</sup> On the basis of Article 3 BEVR, a co-operation of producers/importers representing a market share of less than 30% in the market for the manufacture and distribution of the product would be presumed not to raise anti-competitive concerns. However, the 30% threshold would appear most appropriate for car wreck systems as the share of the co-operating car producers/importers as regards car sales is likely to reflect their share of demand in the purchasing market

<sup>(9)</sup> Commission Notice — Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, OJ C 3, 2001, p. 2.

<sup>(10)</sup> Regulation 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336, 1999, p. 21.



for the collection and sorting services. This congruency of market shares applies to a much lesser extent to packaging waste and electronic waste systems. In any case, even for car wrecks the 30% threshold is by no means to be regarded as absolute and is merely put forward as an approximate benchmark. The exceeding of the 30% threshold would not lead to an automatic prohibition of a system but would merely indicate that closer scrutiny may be warranted.

### C. Relationship between systems/solutions and obliged companies

**Membership criteria.** Dominant collective systems must apply objective, transparent and non-discriminatory conditions as regards membership criteria and with regard to fees levied by the system.

**Fees of the systems.** The fees of a collective system should reflect the costs of the collection and recovery in order to provide an incentive to improve efficiency. Also, contractual arrangements of a dominant system which do not respect the principle 'no service, no fee' are abusive. For example, the German system DSD obliged its customers to use the trademark 'Green Dot' held by DSD on their packaging and required them to pay the fee for all packaging placed on the market bearing the 'Green Dot'. The fee applied irrespective of whether the collection and recovery service was provided by DSD or not. As a result, where an obliged company wanted to use DSD's services only for some of its packaging (because it wanted to use a competitor for the rest), it either had to pay the full fee amount to DSD or it had to introduce two different packaging lines (with and without the 'Green Dot'). As this excluded competitors from the market, the Commission adopted a prohibition decision based on Article 82 EC in 2001.<sup>(11)</sup> Furthermore, the fee structure of a dominant system may be found to be abusive if it includes rebates designed to attract the entire or a very substantial waste amount of the obliged companies.

**All or nothing rules.** Systems may require that the participants transfer all of their obligations to the system, i.e., participating members may either contract for all of their waste or for nothing. The effect of such an 'all or nothing rule' is to deny alternative systems the possibility to compete for these 'tied-in' waste amounts. The rule infringes Article 81(1) EC to the extent that it appreciably

restricts competition and appreciably affects trade between Member States. The effects are appreciable in the case of systems with high market shares or in the case of systems with relatively small market shares if there are cumulative effects of parallel networks of similar agreements. The all or nothing rule may also infringe Article 82 EC where a system is dominant. The Commission accepted the all or nothing rule under Article 81(3) EC in the past under exceptional circumstances, namely to encourage vital investment in a country's collection and recycling infrastructure.<sup>(12)</sup> However, the rule cannot be exempted where further substantial investment in waste collection infrastructure is no longer necessary to fulfil the obligations under the relevant waste legislation and/or where the rule may no longer be regarded as an effective means of securing new investment.

### D. Relationship between systems/solutions and collection/sorting/recovery companies

**Exclusivity in favour of collection/sorting/recovery companies.** Many collective systems contract exclusively with one collection/sorting company for a given collection district. Exclusive agreements may also be entered into with recovery companies. According to Article 3(1) BEVR,<sup>(13)</sup> exclusive agreements are exempted if the market share of the supplier (i.e., the collection/sorting/recovery company) does not exceed 30%. However, companies in a local or regional collection district may often exceed the 30% threshold of Article 3(1) BEVR. If the BEVR does not provide an exemption, a case-specific analysis is necessary taking into account the market conditions, the market position of the collective system and the collection/sorting/recovery company and the duration of the collection agreement. For example, the market for the collection and sorting of household packaging waste is characterised by very specific supply-side conditions (strong network economies, disposal traditions of consumers, container instalment constraints). For this reason, efficiency gains, but also considerations of reliability and continuity may favour contracting with only one collector.

**Exclusivity in favour of systems.** It follows from the DSD and ARA decisions that collection,

<sup>(11)</sup> See Commission decision of 20 April 2001, DSD, OJ L 166, 2001, p. 1; also see, *Commission acts against Duales System Deutschland AG for the abuse of a dominant position*, by Michael Gremminger and Gerald Miersch, Competition Policy Newsletter 2/2001, p. 27.

<sup>(12)</sup> A number of UK packaging waste systems in 1998 and 2000 received comfort letters on the grounds that the operation of the all or nothing rule was necessary to encourage vital investment in the UK's collection and recycling infrastructure for packaging waste.

<sup>(13)</sup> Regulation 2790/99 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336, 1999, p. 21.

sorting and recovery companies should not be obliged to contract exclusively with one system. Both DSD and ARA undertook not to impose exclusivity clauses on their collection and sorting companies.

*Shared use of infrastructure.* For certain types of waste, the duplication of existing collection infrastructures may not be economically viable. For example, the collection of household packaging waste requires thousands, if not millions, of collection facilities at individual households. Therefore, unrestricted access to — and the unlimited sharing of — such collection facilities of a dominant system may be essential for competition on the down-stream market of organising systems/solutions. The collection companies operating these facilities must not be prevented from offering the same facilities to competitors of the dominant system.

## 6. Conclusion

The Paper does not provide an exhaustive list of competition concerns that may arise in the waste management sector. Nor is the Paper legally binding on the Commission or the NCAs, as mentioned earlier. The aim of the Paper is to provide some informal guidance to the economic actors concerned and to the various authorities and courts applying EC competition law. As a result of the modernisation of antitrust rules empowering NCAs (and national courts) to apply Articles 81 and 82 EC in their entirety and due to the largely national scope of waste management systems, antitrust cases in the waste management sector are more likely to be dealt with by NCAs than by the Commission in the future. However, the Commission will, together with the NCAs, continue to closely monitor the developments in this important sector and intervene where appropriate.

## Developments in cartel case-law: Commission decisions and Court judgments of 2005

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2005 was a notable year for anti-cartel enforcement and for development of cartel case-law. In March, Commissioner Neelie Kroes set out her agenda in anti-cartel work, giving it an even higher priority, <sup>(1)</sup> and then followed-up with the creation of the new Cartels Directorate. <sup>(2)</sup> In the year, the Commission issued five significant decisions that covered 37 undertakings and imposed fines totalling over € 683 million; which is an increase of € 293 million from 2004. Moreover, it issued eight Statements of Objections.

The Commission is therefore prosecuting EU-wide cartels of important economic impact in line with its policy to deter cartels with substantial fines. Furthermore, the Commission's leniency program continues being very successful, which confirms that the incentive for companies to come forward has remained strong. The Commission continues to receive through this channel valuable applications that merit follow-up, while also benefiting from information from other sources, such as whistle-blowers.

The Commission's enforcement activity against cartels, in particular its action on major cases with impact on the European consumers, emphasises the message to the business community that cartels are the most pernicious infringement of EC competition rules.

2005 was also marked by several important judgments by the Community Courts. <sup>(3)</sup> In all during 2005 the Courts reviewed eight cartel decisions,

as compared to four in 2004. Among others, the Court confirmed on several issues the validity of the Guidelines on Fines and of their interpretation by the Commission; validated the non-application of *ne bis in idem* in international (transatlantic) cartel cases; and, in line with previous jurisprudence, backed the tough stance of the Commission in relation to obstruction of investigations.

### Commission Decisions in 2005

**Monochloroacetic Acid (MCAA).** <sup>(4)</sup> On 19 January 2005, the Commission fined three MCAA producers almost € 217 million <sup>(5)</sup> for a cartel that allocated volume quotas and customers, agreed price increases, exchanged information on sales volumes and prices to monitor the cartel and agreed on a compensation mechanism to ensure its implementation. The cartel had lasted for at least 15 years (1984-1999).

**Industrial Thread.** <sup>(6)</sup> On 14 September 2005, the Commission fined industrial thread producers a total of € 43.5 million <sup>(7)</sup> for agreeing on price increases and/or target prices, exchanging sensitive information on prices and for avoiding undercutting the incumbent supplier's prices with a view to allocating customers. This all in relation to two cartels targeting industrial customers — *one* in the Benelux and the Nordic countries (1990-2001) and *another* in the UK (1990-1996), and a *third* European wide cartel targeting automotive customers (1998-2000).

<sup>(1)</sup> See the Commissioner's Speech 05/157 at the International Bar Association / European Commission Conference 'Anti-trust reform in Europe: a year in practice'.

<sup>(2)</sup> See article by Anna Saarela and Paul Malric-Smith in the Competition Policy Newsletter (CPN), Number 2, Summer 2005, p. 43.

<sup>(3)</sup> I.e. the European Court of Justice (ECJ) and the Court of First Instance (CFI).

<sup>(4)</sup> Case COMP/37.773 MCAA. For more information see a detailed article on the decision in the CPN, Number 1, Spring 2005, p. 71-72.

<sup>(5)</sup> Akzo was fined € 84.38 million, Hoechst € 74.03 million and Atofina, now Arkema, € 58.5 million. Clariant cooperated with the Commission under the 1996 Leniency Notice. As for calculation of fines, apart from being divided into three groups according to the undertakings' relative importance in the market, Atofina and Akzo saw their *fine upwardly adjusted* with regard to their large size and overall resources.

<sup>(6)</sup> Case COMP/38.337 Thread. It is noted that due to limitation the Commission did not impose fines for the UK cartel.

<sup>(7)</sup> Coats was fined a total € 15.7 million, Amann und Söhne € 13.09 million, Cousin/Amann € 4.89 million, Gütermann € 4.021 million and a number of other undertakings were fined, as well.

**Raw Tobacco Italy.** <sup>(8)</sup> On 20 October 2005, the Commission fined leading tobacco processors in Italy € 56 million, <sup>(9)</sup> for colluding on their overall purchasing strategy, agreeing on purchase prices and allocating their suppliers over a period of 1995–2002. They also rigged their bids in public auctions for the sale of tobacco in 1995–1998. This was the *first decision* where the Commission applied the *2002 Leniency Notice*. <sup>(10)</sup> Deltafina, granted conditional immunity at the beginning of the procedure, saw its *final immunity withheld* due to a serious breach of the cooperation obligations. <sup>(11)</sup>

**Industrial Bags.** <sup>(12)</sup> On 30 November 2005, the Commission fined 16 firms a total amount of € 290.7 million. Having lasted for some 20 years (1982–2002), the cartel was organised at two levels: (i) global, within the framework of the professional association Valveplast and (ii) regional and functional sub-groups, which also held meetings regularly. <sup>(13)</sup> It is to be noted that aggravating circumstances brought about an increase of the fines for Bischof + Klein: *destruction of a document during the inspection*, justifying an increase in the basic amount of the fine of 10%, and UPM-Kymmene for a repeated infringement of the same type.

**Rubber Chemicals.** <sup>(14)</sup> On 21 December 2005, the Commission fined four undertakings € 76 mil-

lion for having agreed to exchange information about prices and/or raise prices, over a period 1996–2001 (and 1999–2000 as General Quimica was concerned). <sup>(15)</sup> Flexsys was the immunity applicant. After the inspections, Crompton (now Chemtura), Bayer and General Quimica applied for a reduction of fines.

## Judgments by CFI and ECJ in 2005

**Specialty Graphite.** <sup>(16)</sup> On 15 June 2005, the CFI supported the essence of the Commission decision's findings and reasoning. It confirmed that when placing parties in categories and assigning each category a specific '*starting amount*' for the fine ('*grouping*'), the Commission may use worldwide product turnover and market shares as a reference provided the cartel is worldwide in character. <sup>(17)</sup> As regards a mistake in the presentation of facts, the CFI decided to remedy it with a correction of one party's starting amount. The CFI confirmed that, under the principle of territoriality, there is no conflict of *ne bis in idem* in the exercise by the Commission and by the US authorities of their power to impose fines on undertakings. <sup>(18)</sup>

**Pre-insulated Pipes.** <sup>(19)</sup> On 28 June 2005, the ECJ confirmed in substance the Commission's 1998 decision when it dismissed all appeals and fully upheld the CFI judgments of March 2002. It was the first time that the *ECJ confirmed the legality of the Guidelines on Fines* and esp. the application of the method of calculating the amount of fines; also stating that the Guidelines were 'reasonably foreseeable' for undertakings. The ECJ underlined the

<sup>(8)</sup> Case COMP/38.281 *Raw Tobacco Italy*. The non-confidential version of the decision is published at: <http://europa.eu.int/comm/competition/antitrust/cases/decisions/38281/en.pdf>.

<sup>(9)</sup> Deltafina was fined € 30 million, Transcatab € 14 million, Mindo (Dimon) € 10 million and Romana Tabacchi € 2.05 million. The decision was also addressed to Universal Corporation (US parent company of Deltafina and the biggest tobacco merchant worldwide) and Alliance One International Inc. (the company resulting from the merger of the parent companies of Transcatab and Dimon and the second biggest tobacco merchant worldwide). Finally, symbolic fines of € 1 000 were applied on the processors' and producers' associations. In October 2004, the Commission also fined processors and producers associations in Spain — Case COMP/38.238 *Raw Tobacco Spain*.

<sup>(10)</sup> The fines' reductions for Mindo/Dimon 50% and Transcatab 30% amounted to the maximum available in the band for reduction of fines under the 2002 Notice.

<sup>(11)</sup> Having informed the competitors of its leniency application, it revealed (before surprise inspections) that an investigation existed against them. Based on the specific circumstances of the case however Deltafina's actual contribution to the establishment of the processors' infringement justified a fine reduction of 50%.

<sup>(12)</sup> Case COMP/38.354 *Industrial Bags*. For more information see a detailed article on the decision in this number of the CPN.

<sup>(13)</sup> British Polythene Industries (BPI) provided information to start investigation under the 1996 Notice.

<sup>(14)</sup> Case COMP/38.443 *Rubber Chemicals*. For more information see a detailed article on the decision in this number of the CPN.

<sup>(15)</sup> Bayer was fined € 58.88 million, Crompton (now Chemtura) € 13.6 million and General Quimica (with Repsol YPF) € 3.38 million.

<sup>(16)</sup> Joined Cases T-71/03, T-74/03, T-87/03 and T-91/03 *Tokai, Intech EDM and SGL Carbon v Commission* [not yet reported].

<sup>(17)</sup> It does not have to consider the turnover of competitors that did not participate in the cartel, in case of a lack of reliable data. Moreover, on the current doctrine as to the notion of 'undertaking', the CFI accepted that the Commission can generally assume a wholly-owned subsidiary to be essentially following the instructions given to it by its parent company. It also noted that when invoking this notion outside standard cases, the Commission must explain in detail as to how far the term can be applied.

<sup>(18)</sup> No such conflict exists, even if penalties have already been imposed in the US and/or the Commission has calculated fines according to worldwide market shares and worldwide turnover. The CFI lowered one party's increase in fine from 50% to 35%, when it found the cartel members' conduct not so readily distinguishable that it justified such an increase for one party but no increase for the others.

<sup>(19)</sup> Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P. *Dansk Rørindustri and others v Commission* [2005] ECR I-5425. For more information see a detailed article in CPN, Number 3, Autumn 2005, pp. 78–79.

*Commission's wide discretion in the field of competition policy*, in particular as regards the determination of the amount of fines. <sup>(20)</sup> Another point clarified by the ECJ was that the benefits of leniency should only be available to undertakings that 'genuinely cooperate' with the Commission. Finally, the ECJ rejected several complaints relating to a breach of the right to be heard and the obligation to state reasons.

**Alloy Surcharge (Stainless Steel).** <sup>(21)</sup> On 14 July 2005, the ECJ rejected the appeals against the CFI judgment of December 2001, which had largely upheld the Commission's 1998 decision. The ECJ confirmed that the Commission cannot presume a *parent company that has acquired a subsidiary of another party* and expressly assumes liability for the acts of that subsidiary to have waived its right to exercise its rights of defence relating to the subsidiary's earlier conduct, before the transfer of its business. The ECJ also reiterated that an *express admission of the infringement*, on top of merely admitting the nature of the facts, may give rise to an additional reduction of fine under the 1996 Leniency Notice.

**SAS Maersk.** <sup>(22)</sup> On 18 July 2005, the CFI upheld the Commission decision 2001/716/EC of 18 of July 2001 <sup>(23)</sup> against a market sharing agreement between these two companies. <sup>(24)</sup>

**Luxembourg Brewers.** <sup>(25)</sup> On 27 July 2005, the CFI confirmed in its entirety the Commission decision. The CFI also confirmed the established case law according to which no effects need to be demonstrated where the infringement has the *restriction of competition as its object* and according to which the gravity of the infringement as very serious is determined by its very nature.

**Belgian Brewers.** <sup>(26)</sup> On 25 October 2005 and 6 December 2005, the CFI confirmed the Commission's 2001 decision by rejecting the arguments that Danone and Haacht had raised against it. The CFI slightly reduced Danone's fine due to one of the aggravating circumstances not having a causal link with the extension of the cartel. It *inter alia* confirmed that there is no obligation to define a *relevant market* for infringements by object and that a *reduction for cooperation* is not due for replies not going beyond what the undertaking is obliged to reply in a request for information. <sup>(27)</sup> Undertakings should be aware that recidivism is one of the possible aggravating circumstances, that it can be taken into account in a final decision, without this requiring a specific mention in the Statement of Objections, and that it may be based on previous findings, including those without a fine, and without a time limitation. <sup>(28)</sup>

**Vitamins.** <sup>(29)</sup> On 6 October 2005, the CFI annulled the Commission's 2001 decision as far as Sumitomo Chemical and Sumika Fine Chemicals were concerned, whose infringement was time-barred and therefore no fine was imposed on them. The CFI stated that the Commission is entitled to adopt a decision declaring conduct which had already been terminated by the undertaking concerned to be an infringement (also in case of prescription), *provided that the institution shows a legitimate interest in doing so.*

<sup>(20)</sup> Therefore the Commission may at any time adjust the level of fines to the needs of proper application of EC competition rules. And undertakings 'cannot acquire a *legitimate expectation that it will not exceed the level of fines previously imposed*' or that a particular method of calculating them will be used. Moreover, the ECJ stated that in setting out in the Guidelines the method which it proposed to apply when calculating fines, the Commission remained within its legal framework and did not exceed the discretion conferred on it by the legislature.

<sup>(21)</sup> Joined Cases C-65/02 P and C-73/02 P *Thyssen Krupp Stainless and Thyssen Krupp Acciai speciali Terni v Commission* and Case C-57/02 P *Acerinox v Commission* [both not yet reported].

<sup>(22)</sup> Case T-241/01 [not yet reported].

<sup>(23)</sup> Relating to proceedings pursuant to Article 81 of the EC Treaty and Article 53 of the Agreement on the European Economic Area (Case COMP.D.2 37.444 — SAS/Maersk Air and Case COMP.D.2 37.386 — Sun-Air versus SAS and Maersk Air) OJ 2001 L 265, p. 15.

<sup>(24)</sup> The CFI held that the Commission had justifiably considered the infringement as 'very serious,' considering its very nature (an essential criterion), geographic scope and the noticeable effect on the market. As to duration, the Commission rightly considered the date of reaching the agreement as the starting date of the infringement, even if it was not implemented until later. The CFI also decided that, for the purpose of attenuating circumstances, the company's willingness to cooperate is irrelevant, inasmuch as it is only the actual degree of cooperation that matters.

<sup>(25)</sup> Joined case T-49/02, T-50/02, T-51/02 *Brasserie nationale v Commission* [not yet reported].

<sup>(26)</sup> Case T-38/02 *Groupe Danone v. Commission* and case T-48/02 *Haacht v. Commission* [not yet reported].

<sup>(27)</sup> Such as providing factual answers to questions put by the Commission in a request for information that relate to dates of and the identity of the participants in a number of meetings and the subject-matter thereof.

<sup>(28)</sup> There is no obligation to individualise the deterrence factor of a fine (unlike the practice in most cases, in this case there was one assessment of the relative gravity of each undertaking's participation, without a separate market share grouping and deterrence multiplier for each undertaking).

<sup>(29)</sup> Joined cases T-22/02 and T-23/02 *Sumitomo Chemical Co. Ltd and Sumika Fine Chemicals Co. Ltd v Commission* [not yet reported].

*Zinc Phosphate.* <sup>(30)</sup> In four judgments handed down on 29 November 2005, the CFI fully confirmed the Commission's decision and dismissed all applications for annulment or reduction of

finer. The CFI considered that, in view of the gravity and duration of the infringement, *the fines were justified and were calculated in an appropriate manner.* <sup>(31)</sup>

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<sup>(30)</sup> Cases T-33/02 *Britannia Alloys & Chemicals Limited*, T-52/02 *Société Nouvelle des Couleurs Zinciques S.A.*, T-62/02 *Union Pigments AS* and T-64/02 *Hans Heubach GmbH & Co KG* [not yet reported].

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<sup>(31)</sup> The companies concerned were SME size and the fines amounted to a significant percentage of their global turnover. The CFI validated the cartel's span of more than four years and the 'differential treatment' applied to the companies. In the *Britannia* case, the CFI stated that the Commission was not obliged, in setting the upper limit of 10% of the turnover, to refer to the turnover achieved in the business year preceding the decision and that in this particular case, it was correct in relying on the most recent turnover corresponding to a 'complete' year of economic activity, i.e. business year ending in 1996 and not in 2001.

## La Commission inflige une amende de 290 millions d'euros à seize entreprises du secteur des sacs industriels, pour participation à un cartel

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Le 30 novembre 2005, la Commission européenne a adopté une décision infligeant des amendes d'un montant total de 290,71 millions d'euros à 16 producteurs de sacs industriels en matière plastique pour leur participation à une entente ayant couvert les marchés allemand, espagnol, français et du Benelux pendant plus de 20 ans. Cette entente consistait à fixer entre concurrents les prix minimums et les quotas de vente par zone géographique, à répartir les commandes des gros clients, à organiser des soumissions concertées à certains appels d'offre et à mettre en œuvre des mécanismes d'échange d'informations sur leurs parts de marché.

British Polythene Industries (BPI), ayant été la première à fournir des éléments de preuve de l'infraction à la Commission, a bénéficié de l'immunité d'amende totale en application du programme de clémence de la Commission. Cinq autres entreprises ont bénéficié de réductions d'amendes allant de 10 à 30% pour avoir coopéré à l'enquête de la Commission.

### Résumé de l'infraction

Les sacs industriels en matière plastique, communément désignés par le terme sacs industriels, sont destinés à l'emballage des produits de base, et plus généralement des matières premières, des engrais, des polymères, des matériaux pour la construction, des produits agricoles et horticoles, des aliments pour animaux. Ils peuvent être classés en quatre catégories: les sacs gueule ouverte («open mouth bags»), les sacs à valve («valve bags»), les gaines FFS («Form, Fill and Seal») et les blockbags. Depuis les années 1970, la tendance est à la substitution progressive des sacs gueule ouverte et des sacs à valve par les gaines FFS, dont le processus de remplissage automatisé permet un traitement de grands volumes plus rapide.

En novembre 2001, la société British Polythene Industries Plc («BPI») a informé la Commission de l'existence de l'entente et fourni des informations qui ont permis l'organisation d'inspections en juin 2002 dans les locaux des entreprises suspectées. L'enquête a établi l'implication et la responsabilité, outre de BPI et de sa filiale Combipac, des sociétés suivantes: Plásticos Españoles SA (et Armando Álvarez SA), Bernay Film Plastique, Bischof+Klein

GmbH & Co. KG, Bischof+Klein France SAS, Bonar Technical Fabrics NV, Low & Bonar PLC, Cofira-Sac SA, Nordenia International AG, Nordfolien GmbH, Fardem Packaging BV, FLS Plast A/S et FLSmidth & Co A/S, Kendrion NV, RKW AG Rheinische Kunststoffwerke, JM Gesellschaft für industrielle Beteiligungen mbH & Co. KGaA, Sachsa Verpackung GmbH, Groupe Gascogne, Stempher BV et K. V. Stempher CV, Trioplast Wittenheim SA, Trioplast Industrier AB et UPM-Kymmene Oyj. Pour certaines de ces entreprises la participation à l'entente remonte à 1982 et a duré jusqu'en 2002.

L'entente s'organisait à deux niveaux:

- Le niveau global de l'entente sous couvert d'une association professionnelle officielle, l'association européenne des fabricants de sacs à valve en matière plastique, Valve-Plast, qui réunissait les dirigeants des membres de l'entente en moyenne 3 à 4 fois par an. Un sous-groupe fonctionnel dédié exclusivement au blockbags a été constitué en 1994.
- Le niveau des sous-groupes régionaux, avec cinq sous-groupes (France, Allemagne, Benelux, Belgique et Pays-Bas). La catégorie des sacs gueule ouverte était notamment traitée dans ces sous-groupes régionaux.

Les pratiques mises en œuvre par les entreprises couvraient:

- la fixation des prix et de modèles communs de calcul de prix;
- l'attribution de quotas;
- la répartition de clients et de commandes;
- l'établissement de listes des clients principaux et la désignation de responsables en vue de la coordination des offres à ces clients;
- des discussions multilatérales et bilatérales sur des clients spécifiques et des soumissions concertées à certains appels d'offres;
- l'échange régulier d'informations sensibles sur les parts de marché.

Le marché concerné par l'entente a été estimé d'après les informations fournies par les entreprises entre 250 et 300 millions d'euro en 2001 et à environ 220

millions d'euro en 1996, dernière année complète au cours de laquelle toutes les entreprises impliquées étaient encore présentes sur le marché des sacs industriels. Les membres du cartel représentaient environ 75% du chiffre d'affaires total réalisé sur ce marché en 1996.

### Fixation de l'amende et application de la communication sur la clémence

Pour déterminer le montant de l'amende, la Commission a pris en compte la gravité et la durée de l'infraction.

Au regard de la nature de l'infraction et de la taille de la zone géographique affectée par le cartel, la Commission a considéré que les entreprises impliquées avaient commis une infraction très grave à l'article 81 du traité.

Afin de tenir compte de leur capacité économique effective à provoquer un dommage important à la concurrence, un traitement différencié a été appliqué aux entreprises. Cette différenciation était d'autant plus nécessaire qu'il existait des différences notables, en termes d'importance sur le marché, entre les entreprises ayant participé à l'infraction. Les entreprises ont été divisées en six catégories selon leur poids relatif en 1996 sur le marché concerné.

Pour l'entreprise Stempher, sa participation apparaissant limitée au sous-groupe s'occupant des Pays-Bas (et ponctuellement du marché belge) et aucun élément de preuve du dossier ne permettant d'établir son implication ni sa connaissance du schéma global de l'entente illicite, un facteur de réduction de 25% a été appliqué dans le calcul du montant de l'amende qui lui a été infligée.

Au regard de la taille et de la puissance économique d'UPM-Kymmene, un facteur multiplicateur de deux a été appliqué au montant de l'amende infligée à cette entreprise.

La plupart des entreprises impliquées dans l'entente ont commis une infraction de longue durée de plus de 5 ans (et jusqu'à 20 ans pour certaines) et se sont vues appliquées une majoration en conséquence.

S'agissant d'UPM-Kymmene, la Commission a considéré comme circonstance aggravante le fait qu'elle ait répété le même type d'infraction que celui de l'affaire «Carton»<sup>(1)</sup> dans laquelle elle avait été impliquée. Une augmentation de 50% a été ainsi appliquée au montant de base de l'amende.

La Commission a également considéré comme circonstance aggravante pour Bischof + Klein le fait qu'un de ses salariés ait, au cours de l'inspection, fait obstruction au bon déroulement de l'enquête en détruisant un document sélectionné par les agents de la Commission, indépendamment des effets que ce comportement a pu avoir sur la suite de la procédure. En conséquence, la Commission a considéré approprié en l'espèce d'appliquer sur le montant de base de l'amende (lequel intègre la majoration liée à la durée de l'infraction) une augmentation de 10%.

La Commission a appliqué au montant de l'amende de plusieurs entreprises la limite de 10% du chiffre d'affaires prévue à l'article 15, paragraphe 2 du Règlement n° 17 et à l'article 23, paragraphe 2, du règlement n° 1/2003.

BPI a été la première entreprise à prendre contact avec la Commission pour l'informer de l'existence de l'entente et pour lui fournir des informations qui lui ont permis d'organiser les inspections. BPI ayant maintenu une coopération permanente tout au long de l'enquête, elle s'est vue accordée par la Commission une réduction de 100% de l'amende en application de la section B de la Communication sur la clémence de 1996<sup>(2)</sup>.

Trioplast a fourni des informations ayant contribué à confirmer l'existence de l'infraction et justifiant que lui soit accordée une réduction d'amende de 30%. Bischof + Klein et Cofira-Sac ont également fourni à la Commission des informations ayant contribué à confirmer l'existence de l'infraction et par ailleurs n'ont pas contesté la matérialité des faits tels qu'ils ressortaient de la communication des griefs. Elles ont en conséquence chacune bénéficié d'une réduction d'amende de 25%. Bonar Technical Fabrics, Low & Bonar et Nordfolien ont bénéficié d'une réduction d'amende de 10% pour non contestation des faits.

(1) Décision 90/601/CE de la Commission du 13 juillet 1994 (JO L 243 du 19.9.1994, p. 1).

(2) JO C 207 du 18.7.1996, p. 4.



Au final, les amendes infligées aux entreprises sont résumées dans le tableau qui suit:

	Nom	Réductions d'amende % (€ millions)	Amende (€ millions)
1.	Bernay Film Plastique	0%	0,94
2.	Bischof + Klein GmbH & Co KG et Bischof + Klein France SA	25%	29,15 3,96
3.	Bonar Technical Fabrics NV et Low & Bonar PLC	10%	12,24 (*)
4.	British Polythene Industries PLC et Combipac BV	100% (52,95)	0 (*)
5.	Cofira-Sac SA	25%	0,35
6.	Fardem Packaging BV	0%	34 (*)
7.	Kendrion NV		
8.	Koninklijke Verpakkingsindustrie Stempheer CV et Stempheer BV	0%	2,37(*)
9.	Nordenia International AG	0%	39,10 (*)
10.	Nordfolien GmbH	10%	
11.	Plásticos Españoles SA et Armando Álvarez SA	0%	42 (*)
12.	RKW AG Rheinische Kunststoffwerke et JM Gesellschaft für industrielle Beteiligungen mbH & Co KGaA	0%	39 (*)
13.	Sachsa Verpackung GmbH et Groupe Gascogne	0%	13,20 (*)
14.	Trioplast Wittenheim SA et Trioplast Industrier AB	30%	17,85 (*)
15.	FLSmidth & Co A/S et FLS Plast A/S	0%	
16.	UPM-Kymmene Oyj	0%	56,55
<b>Total</b>			<b>290,71</b>

(\*) les entités juridiques correspondantes peuvent être tenues conjointement et solidairement responsables d'une partie ou de la totalité de l'amende imposée

## Commission fines nine companies a total of € 43.5 million for participating in industrial thread cartels

*Elodie CLERC, Directorate-General Competition, unit E-1*

On 14 September 2005, the European Commission fined thread producers a total of € 43.5 million for operating cartels in the market for industrial thread.

Industrial thread is used in a variety of industries to sew or embroider various products such as clothes, home furnishings, automotive seats and seatbelts, leather goods, mattresses, footwear, ropes, etc. The industrial thread market amounted to around € 6 billion in 2000 worldwide.

The Decision arises out of inspections carried out by the Commission on 7 and 8 November 2001 pursuant to Article 14(3) of Regulation No 17 at the premises of several Community producers of textile/haberdashery products <sup>(1)</sup>. On 26 November 2001, Coats filed an application under the 1996 Commission Notice on the non-imposition or reduction in fines in cartel cases. In April 2003, Oxley Threads also applied for a reduction in fines. By means of the inspections and the subsequent investigation, the Commission discovered evidence that undertakings had taken part in the following three cartel agreements and concerted practices:

- a cartel on the market in thread for industrial customers in Benelux and the Nordic countries from January 1990 until September 2001;
- a cartel on the market in thread for industrial customers in the United Kingdom from October 1990 until September 1996;
- a cartel on the market in thread for automotive customers in the European Economic Area from May/June 1998 until 15 May 2000.

The relevant geographic market for industrial thread has been considered as regional <sup>(2)</sup>. The

<sup>(1)</sup> See Commission Decision of 26.10.2004, case 38.338 PO/Needles.

<sup>(2)</sup> The regional character of the market is explained by several factors: (i) the ability to service an order within 1-2 days is a key customer's requirement, (ii) the market largely consists of small contractors placing frequent but relatively small orders, (iii) the high number of customers and orders combined with the need for local advice can only be managed efficiently by a regional sales organisation, (iv) demand and product specifications for industrial thread vary greatly from one EEA country to another, (v) the large range of prices for industrial thread within the EEA.

region can cover several Contracting Parties to the EEA (e.g. Benelux or Nordic countries) or just one (e.g. the UK). Due to higher specification standards (e.g. thread for seat belt) which request uniformity in the EEA, the thread market for automotive customers must be differentiated from the rest of the industrial thread market and has been considered as EEA wide.

The three cartels have been considered as three separated infringements. Indeed, firstly, participants in the agreements were not the same. Even though some participants took part in two or three of the cartels, most undertakings took part in only one cartel, as they were not active on the markets involved in the other cartels. Secondly, there is no evidence of any overall coordination between the three collusive arrangements. Lastly, the markets involved in the three cartels are different.

### Summary of the infringements

#### *Cartel concerning industrial thread sold in Benelux and in the Nordic countries*

The agreement and concerted practices between Ackermann Nähgarne GmbH & Co, Amann und Söhne GmbH & Co KG, Barbour Threads Ltd, Belgian Sewing Thread N.V., Bieze Storck B.V., Coats Viyella plc, Gütermann AG and Zwicky & Co AG had as their primary objective the maintenance of high prices on the market for industrial thread sold in Benelux and in the Nordic countries. These agreements consisted in exchanges of price lists and discussion of these price lists; agreement on price list increases as well as on the dates of these increases; agreement on maximum rebates; agreement on prices to individual customers in order to avoid undercutting the incumbent supplier's prices and with a view to sharing customers; complaints to suppliers who had undercut and threats of retaliation; and agreement to contact suppliers who were not part of the agreement to persuade them to join. The meetings were very well organised and held at least once a year. They were split into two halves: a session during which the Nordic markets were discussed and a session during which the Benelux markets were discussed. In addition to the meetings, competitors used to contact each other to exchange information and to agree on prices they would apply to specific customers.

### *Cartel concerning industrial thread sold in the United Kingdom*

In United Kingdom, Barbour Threads Ltd, Coats UK Ltd, Donisthorpe & Company Ltd, Perivale Gütermann Ltd and Oxley Threads Ltd agreed to maintain high prices on the market for industrial thread and/or exchange information on prices to individual customers in order to avoid undercutting incumbent suppliers' prices. To pursue that objective, the main producers used to meet at least from 1990 until 1996 to agree on percentages increases of list and net price, the timing of those increases and the sequence of announcements which would be made by the suppliers. These meetings used to take place after the meetings of the UK Thread Manufacturers Association (UKTMA). There were also bilateral contacts about prices to individual customers.

### *Cartel concerning thread for automotive customers*

The main EEA suppliers of automotive thread, Amann und Söhne GmbH & Co KG, Cousin Filterie SA, Coats Viyella plc, Barbour Threads Ltd, Oxley Threads Ltd, fixed target prices for core products sold to European automotive customers and exchanged information on prices to individual customers and agreed on minimum target prices for those customers. They also agreed to avoid undercutting to the advantage of the incumbent supplier. The cartel was not strictly organised. The small number of players made it possible to have small irregular meetings supplemented by frequent bilateral contacts.

The arrangements of the three cartels have been clearly implemented throughout the infringement period. There are evidence that at least some of the agreed price increases have been implemented and monitored through regular meetings and bilateral contacts. While some other prices may have remained the same or decreased during the period, they would likely have fallen in a more significant

way if the competitors had not agreed on list price increases, since the worldwide tendency was a fall of the prices in the thread sector.

### **Calculation of the fines**

In fixing the amount of the fines, the Commission took into account the gravity and duration of the infringement, as well as the existence of aggravating and/or mitigating circumstances.

The infringements committed by the addressees have been considered as "very serious" as they have the object of fixing prices, thereby restricting competition and affecting trade between Member States. Such practices are by their very nature the worst kind of violations of Article 81. However, the Commission took into account the relatively limited size of the markets when setting the starting amount of the fines.

The Commission notice on non-imposition of fines in cartel cases of 1996 was applicable in this case and in particular section D since all the undertakings came forward only after the Commission's inspections. Reductions of the fines were granted to all in accordance with the value of their individual cooperation.

For the cartel of industrial thread in the Benelux and Nordic countries, the Commission imposed the following fines: Coats Ltd € 15.05 million, Amann und Söhne GmbH €13.09 million, Gütermann AG € 4.021 million, Barbour Thread Ltd € 2.145 million, Belgian sewing thread N.V. € 0.979 million, Bieze Stork B.V. € 0.514 million, Zwicky € 0.174 million.

For the cartel of automotive thread in the EEA, the Commission imposed the following fines: Cousin/Amann € 4.888 million, Coats € 0.65 million, Oxley € 1.271 million, Barbour € 0.715 million.

No fine was imposed for the cartel of industrial thread in the UK as the Commission has no proof that the undertakings participated in a continuous cartel within the five years preceding the Commission's inspections in November 2001.

## Commission fines 3 undertakings a total of € 76 million for participating in rubber chemicals cartel

*Erja ASKOLA, Directorate-General Competition, unit F-3*

*In the fifth decision against hard core cartels adopted in 2005, the Commission imposed fines totalling EUR 76 million on a number of rubber chemicals producers, including Chemtura (USA), Bayer (Germany) and General Química (Spain), while granting Flexsys (Belgium) full immunity for having disclosed the existence of the cartel to the Commission.*

### The infringement

On 21 December 2005, the Commission adopted a decision finding a number of leading world-wide producers of certain rubber chemicals, namely Flexsys, Chemtura (former Crompton) and Bayer, guilty of infringing Article 81 EC by fixing prices and exchanging confidential information in the EEA and elsewhere at least in the period 1996-2001. General Química participated in these arrangements at least in 2000. Its parent company Repsol Química SA and Repsol YPF SA, owning 100 % of the former, were held liable for the conduct of their wholly owned subsidiary. The Decision concerns antioxidants, antiozonants and primary accelerators which are synthetic or organic chemicals that improve the production and the characteristics of rubber in various applications, mainly in tyres for cars and other vehicles. In 2001, which was the last full year of the infringement, the EEA market value was estimated at about € 200 million.

The cartel scenario was a classic one. As described by one of the participants: *'There was a contact among competitors from at least the mid 1990's, before, during and after every price increase for rubber chemicals or at least an attempt to have such contact.'* During these contacts, the competitors reached agreements on price increases at least in 1996, 1998, 1999, 2000 and 2001. A participant recalled one of these price increases *"as the most orchestrated and collusive 'agreement' he ever made"*. Coordination of the price increases normally followed a general pattern, involving contacts among the competitors during a preparatory phase preceding the announcement to customers, thereafter during the negotiations with customers, and lastly after the contracts had been made to monitor compliance and success on the market. During the contacts preceding the coordinated action, the parties sought support for a suggested price increase and agreed upon its amount, the products and territory covered, as well as the

leader and the timing of the announcements. During the implementation phase, the focus was on the customers' reactions to the announced price increases and exchanges on the positions regarding price negotiations with the customers. The follow-up contacts included typically the exchange of detailed information on contracted volumes and prices with specific customers.

In this case, the Commission discovered an abundant body of written evidence concerning the infringement, including *inter alia* some explicit type-written reports of cartel meetings, hand-written notes concerning telephone conversations and other contacts between the competitors.

### Calculation of the fines

In assessing the gravity of the infringement, the Commission took account of its nature, its actual impact on the market, where this could be measured, and the size of the relevant geographic market. All the undertakings concerned were found to have committed a very serious infringement, considering that it consisted primarily of secret collusion between cartel members to fix prices in the EEA and elsewhere, supported by the exchange of confidential information.

Within the category of very serious infringements, the scale of likely fines makes it possible to apply differential treatment to undertakings in order to take account of the effective economic capacity of the offenders to cause significant damage to competition, as well as to set the fine at a level which ensures that it has sufficient deterrent effect. Based on the fact that both the geographic scope of the cartel and the rubber chemicals business in general were essentially world-wide, the global market shares in 2001, the last full year of the infringement, were used as reference values in determining the relative weight of the undertakings.

The undertakings were divided into four groups according to their relative importance in the global rubber chemicals market, Flexsys being the largest player, followed by Bayer, Chemtura and General Química. Further upward adjustment was made in the case of Bayer and General Química's mother company Repsol, in order to take account of their large size and overall resources. Except for General Química, the participants committed infringements of long duration, i.e. exceeding five years.

Whilst the Commission did not find any aggravating circumstances in this case, it considered that the passive and minor role of General Química in the infringement warranted application of an attenuating circumstance. The corresponding fine was therefore reduced by 50%.

### **Application of the 2002 Leniency Notice**

Flexsys disclosed the existence of the cartel to the Commission and was therefore granted full immunity from fines. Chemtura contested, however, Flexsys' immunity, claiming *inter alia* that Flexsys had failed to fulfil the conditions of its immunity by coercing other parties and by continuing the infringement after its application for immunity. After a close investigation of Chemtura's allegations, the Commission found that there was no decisive material evidence to support these allegations.

All the undertakings subject to the Decision applied for leniency after the Commission's successful inspections to their premises. The Commission considered that each of them was able to bring significant added value to the evidence and rewarded the applicants with appropriate reductions ranging from 10 to 50%.

In this case, the Commission issued a strong warning against leniency applicants who attempt to weaken its ability to prove the whole duration of the infringement, where, taken together, there is a consistent body of indicia and evidence showing the existence of the cartel. The Commission considers that such an attitude puts the extent and continuity of cooperation of leniency applicants into serious doubt, which pushes the amount of reduction of the fine unavoidably towards the lower end of the reduction band.



## Merger Control: Main Developments between 1 September and 31 December 2005

Mary LOUGHRAN and John GATTI,  
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### Recent cases — Introductory remarks

During the reference period a total of 99 notifications were made to the Commission. This figure represents almost no change compared to the previous four month period but an increase of more than 35% as compared to the corresponding 2004 period. The Commission adopted 110 final decisions during the trimester, an increase of 10% as compared to the previous period and of over 45% as compared to the same period in 2004. Of this total 105 transactions were cleared unconditionally under Article 6(1)(b) and 4 were cleared with conditions and obligations pursuant to Article 6(2). Of the unconditional clearances 50 were cleared in accordance with the simplified procedure. The Commission also adopted one decision after a second phase investigation. This transaction, E.ON/MOL, was cleared subject to conditions and obligations (Article 8(2)) and is discussed in detail elsewhere in this newsletter. Lastly, five Phase II investigations were opened (Article 6(1)(c)).

The Commission received a total of 24 requests for referrals during this period. Two of these were made by Member States under Article 9 requesting that the Commission refers the case to the national authority. Two were requests, again made by Member States, for the Commission to accept a referral under Article 22. Finally, there were 13 reasoned submissions made by notifying parties. Of these, 6 concerned a request for a case with a Community dimension to be referred, under Article 4(4) to the Member State or States concerned and 7 were made under Article 4(5) requesting that cases without a Community dimension, but notifiable in at least three Member States, be referred to the Commission.

### A – Summaries of decisions taken under Article 6 (2)

#### Amer/Salomon

On 12 October the Commission approved, subject to conditions, the proposed acquisition by Amer Group of the Salomon business segment of Germany's Adidas-Salomon AG. Amer had entered into an agreement to acquire the entire issued share capital and assets of the Salomon business of Adidas Salomon. Both Amer and Salomon manu-

facture and sell winter sports goods such as alpine and cross-country skis and accessories (such as bindings and boots). The Amer Group is active in these markets through its wholly-owned subsidiary Atomic Austria GmbH. The transaction was subject to mandatory merger filings under the national merger control laws of six Member States, Austria, Germany, Italy, Poland, Spain and the United Kingdom. All Member States agreed with the parties' application to refer the case to the Commission.

The Commission's investigation showed that the proposed acquisition of Salomon by Amer could significantly reduce competition in the markets for cross-country skis, in particular in Austria, Germany and France. Salomon and Fischer GmbH, the leading manufacturer of cross-country skis in the world, entered into a cooperation agreement in 1997. As a result of the notified transaction, this link between Salomon and Fischer in the segment of cross-country skis would have been extended to Amer/Atomic, Fischer's main competitor in cross-country skis in Austria, Germany and France. This gave rise to the risk of market coordination between the leading players in these markets.

To address the Commission's concerns, the parties undertook to make a significant reduction of the scope of the cooperation agreement between Fischer and Salomon. In particular, the elements of the agreement which facilitate the coordination of the commercial strategies of the parties and other clauses limiting the independent market conduct of Fischer were removed.

#### TUI/C P Ships

On 24 August the TUI company notified its intention to acquire the Canadian shipping company CP Ships. TUI owns the Hapag-Lloyd shipping company. Both CP Ships and Hapag-Lloyd are active in container liner shipping. After the merger they will become the world's fourth largest operator and a leading competitor on some shipping routes.

The Commission's market investigation focused on the trade routes to and from Europe to determine whether the parties' market shares and the links created by their participation in various conferences and consortia with their competitors would

result in anti-competitive effects whereby markets could be shared and prices increased to the detriment of shippers and final consumers.

Under the European Union's competition rules applicable to shipping, liner conferences (groupings of shipping companies engaged in regular scheduled services) benefit from an antitrust immunity which was granted nearly 20 years ago. Shipping lines grouped in consortia also benefit from an antitrust exemption. After a two-year investigation, in October 2004 the European Commission issued a White Paper concluding that the exemption for liner conferences should be abolished because it no longer results in efficient and reliable services that meet shippers' requirements.

In the shipping trade routes between Europe and North America, Hapag-Lloyd is a member of two conferences. As a result of the merger and continued membership of these conferences, a link would be created between the leading players on the routes. The Commission considered that the combined market shares of the conference members gave rise to competition concerns and the Commission therefore made its approval conditional on the withdrawal of Hapag-Lloyd from these two conferences.

### Jefferson Smurfit /Kappa

In September the Irish-based international packaging group, Jefferson Smurfit ('JSG') notified its plan to acquire the Dutch company Kappa Holding B.V. ('Kappa').

JSG is an international packaging company with operations in Western Europe and Latin America, active in the manufacturing and sale of corrugated case materials, sheets, and boxes and the recovery of recycled wastepaper. Kappa is active in the manufacturing and sale of corrugated case materials, corrugated and solid board sheets, corrugated and solid board, graphic and specialty board and the recovery of recycled wastepaper.

The market investigation carried out by the Commission showed that the proposed transaction would i) remove JSG as the closest competitor of Kappa in the market for corrugated boxes in Denmark; ii) reduce the number of players in the market for corrugated boxes in Sweden and significantly strengthen the parties' position in this market; iii) reduce the number of players in the market for solid board sheets in some regions and might have foreclosure effects on the downstream market for the production and sale of solid board boxes especially in some regions (for instance, in Spain); iv) significantly strengthen the parties' position in the market for solid board boxes in some regions (like Sweden and France); v) remove JSG, the

main competitor to Kappa in the EEA market for graphic board and significantly strengthen the parties' position in this market; and vi) remove the main competitor for the market of solid board partitions. Thus the operation as initially notified to the Commission raised serious competition concerns in the markets for corrugated boxes, solid board sheets, solid board boxes, graphic board and solid board partitions.

In order to remove these concerns the parties offered to divest significant businesses and production facilities. It was considered that these commitments, when fully implemented, would considerably reduce the parties' market shares and would either significantly reduce or completely remove the overlap in the problem markets and geographic areas concerned.

### Lufthansa/Eurowings

On 22 December 2005 the Commission gave its approval to the proposed acquisition by Deutsche Lufthansa AG of Eurowings Luftverkehr AG and its subsidiary, the low cost airline Germanwings.

Lufthansa is the principal airline in Germany. It is a member of the airline alliance 'Star Alliance'. Lufthansa recently acquired the airline Swiss International Airlines Ltd. Eurowings currently offers scheduled low cost air services and related services through its wholly owned subsidiary Germanwings. It operates from Cologne/Bonn, Stuttgart and Berlin-Schönefeld airports and, since the beginning of the 2005/2006 Winter season, from Hamburg.

Lufthansa already had a 49% shareholding in Eurowings but could not determine the strategic commercial behaviour of Eurowings and Germanwings. The notified transaction involved the acquisition by Lufthansa of the majority of the voting rights in, and sole control of, the two companies.

Lufthansa, as a network carrier, and Germanwings, as a low cost airline, operate with different business strategies. Nevertheless, they are perceived as competitors by time-sensitive and non-time sensitive passengers alike. The Commission's investigation showed that the proposed acquisition of Eurowings by Lufthansa would eliminate competition on three intra-European routes, i.e. Cologne/Bonn-Vienna, Stuttgart-Vienna and Stuttgart-Dresden. In reaching this conclusion the Commission also took into account the impact of Lufthansa's close co-operation with Austrian Airlines, which is also a member of the Star Alliance.

To address the Commission's concerns, the parties agreed to surrender certain slots at the airports of Vienna and Stuttgart. This was considered to make



it possible for competing airlines to emerge on the affected routes. The parties also gave a number of additional commitments, including allowing competitors flying the affected routes to participate in Lufthansa's Frequent Flyer Programme with the aim of making entry more attractive.

## *B – Summaries of decisions taken under Article 9*

### **Tesco/Carrefour <sup>(1)</sup>**

The proposed acquisition, which was notified on 4 November, involved the acquisition of sole control of the Czech and Slovak business of the undertaking Carrefour (France) by Tesco (UK).

Tesco, based in the UK, is active in food and non-food retailing and has over 2,300 stores worldwide covering a wide variety of shop formats. The company owns and operates 31 stores in Slovakia and 27 stores in the Czech Republic. The French company Carrefour is also active in food and non-food retailing with more than 11,000 stores worldwide. It operates 11 large-format stores in the Czech Republic and 4 large-format stores in Slovakia.

The Commission's investigation indicated that in relation to the Czech Republic as well as Slovakia the product market could be defined in line with previous decision-making practice as the retail sale of daily consumer goods in supermarkets, hypermarkets and possibly discounters. Geographically, the market was confined to local areas around the relevant stores within 20 to 30 minutes' driving time.

On 30 November 2005 the Commission received a request for referral of the case from the competent authority of the Slovak Republic. In its request the authority claimed that the transaction would affect competition in the market for the retail sale of daily consumer goods in supermarkets and hypermarkets in three local markets in the cities of Bratislava, Košice and Žilina. In addition the Slovak competition authority considered that these markets do not constitute a substantial part of the common market.

In the Slovak Republic there were indications that the transaction would strengthen Tesco's position as the leading retailing company at the national level. Furthermore in the cities of Bratislava, Košice and Žilina the merged entity would have had high market shares and the number of available alternative stores would have been reduced. Therefore the Commission concluded that the transaction affected competition in these three local markets.

<sup>(1)</sup> COMP/M. 3905.

Each of these local markets constitutes less than 0.1% of the total grocery sales in the common market and cannot be regarded as a substantial part of the common market. In line with the EU Merger Regulation, the Commission thus referred the assessment of the Slovak part of the transaction to the Antimonopoly Office of the Slovak Republic.

As regards the Czech Republic the Commission's investigations indicated that the merged entity would be the fourth largest retailing group on a national basis. Even within individual local markets the parties would still face competition from a number of other strong retailers such as Lidl&Schwarz, Ahold or Rewe.

The Commission therefore concluded that the transaction affected competition in three local markets which could be regarded as distinct markets within Slovakia and which did not form a substantial part of the common market. Those aspects of the transaction were referred for examination by the Slovak competition authority under national competition law. At the same time the Commission approved the transaction with regard to the Czech Republic as it would not significantly impede effective competition in the Czech retailing sector. This was the first time that a transaction had been referred to a competition authority in a new Member State.

### **FIMAG / Züblin <sup>(2)</sup>**

The proposed acquisition, which was notified on 26 August, involved the acquisition of control of the German construction company Züblin by FIMAG, the holding company of the Austrian Strabag construction group. The Strabag Group ('Strabag') is an Austrian-based construction group which operates in all areas of the industry, especially in building construction and civil engineering. It also produces and distributes building materials. Züblin is a German construction company and also operates in building construction and civil engineering as well as in construction related services. Through its subsidiary ROBA Baustoff GmbH ('Roba'), it is active in the production and distribution of building materials. By acquiring the share package of the insolvent Walter Bau FIMAG would gain control of Züblin.

Strabag and Züblin are among the largest construction companies in Germany. However the parties' combined shares of the construction and civil engineering markets would remain well under 15% even if these markets would be further divided. Equally while Strabag is the largest con-

<sup>(2)</sup> COMP/M.3864.

struction company in Austria, the parties' shares in the Austrian market did not reach a level which would give rise to competition concerns.

A request for partial referral of the case was made by the German authorities under Art. 9(2) (b) of the EC Merger Regulation on 20 September. The Bundeskartellamt considered that the notified operation would affect competition in the regional markets for asphalt mix in Berlin, Chemnitz, Leipzig/Halle, Rostock and Munich, each of which presented all the characteristics of a distinct market and did not constitute a substantial part of the common market. For the Bundeskartellamt there was a risk that because of the structural relationship between Strabag and the Wehrhahn group as joint shareholders of Deutag, Strabag's takeover of

Roba, one of the last remaining independent competitors for producing asphalt mix, would further restrict competition on the relevant regional markets.

The Commission concluded that the envisaged operation would not significantly impede effective competition in the European Economic Area (EEA) or any substantial part of it, as the parties' combined market shares on the relevant markets in Germany would be limited and there would be only a slight increase of market share on the relevant markets in Austria. At the same time, the Commission referred to the Bundeskartellamt the assessment of the impact of the operation on the regional asphalt markets in Berlin, Chemnitz, Leipzig/Halle, Rostock and Munich.

## A combination of gas release programmes and ownership unbundling as remedy to a problematic energy merger: E.ON / MOL

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### 1. Introduction

Following an in-depth investigation, on 21 December 2005, the Commission approved under the EU Merger Regulation the acquisition of MOL WMT and MOL Storage, two subsidiaries of MOL, the incumbent oil and gas company in Hungary, by E.ON Ruhrgas ('E.ON'), a large integrated German energy supplier, subject to conditions and obligations.

The two subsidiaries of MOL part of the transaction are active in the wholesale, marketing and trading of gas (WMT), and the storage of gas (Storage). MOL would keep minority shareholdings (25%) in both companies. MOL would also have a put option for two years to sell its gas transmission subsidiary to E.ON.

MOL already had, prior to the transaction, an almost exclusive control over the access to gas resources and gas infrastructures in Hungary. MOL owned the gas transmission network, all Hungarian gas storage facilities and had a quasi-monopoly position on the gas wholesale markets. This 'gatekeeper' position would be, owing to the deal, taken over by E.ON.

The essential change brought about by the transaction was that E.ON, unlike MOL, has strong market positions in the retail supply of gas and electricity in Hungary, as it controls two out of six gas regional distribution companies (RDCs) and 3 out of six electricity RDCs. Therefore, except for the transmission and gas production businesses of MOL, the transaction would create a fully vertically integrated entity along the gas and electricity supply chains in Hungary.

The Commission's market investigation established that, owing to the new entity's nearly exclusive control over gas resources available in Hungary and its vertical integration in the gas and electricity markets, the transaction would lead to a serious risk of foreclosure of competitors on the downstream gas and electricity markets. As mentioned, contrary to MOL, E.ON is active downstream of the gas wholesale market, in the retail and distribution of gas and electricity, as well as in the generation of electricity. This would lead to a change of incen-

tives of the new entity vis-à-vis its downstream competitors. The new entity would thus have both the ability and the incentive to discriminate against its competitors in the downstream markets both in the gas and in the electricity sectors. Such behavior would undermine the ability of rivals to compete and would lead to price increases to the detriment of consumers. Such anti-competitive effects would occur even if the merged entity would not necessarily acquire a dominant position in retail gas or electricity markets in the near future.

In order to remove the competition concerns identified by the Commission, E.ON submitted a comprehensive and far-reaching package of commitments. The Commission concluded that the undertakings met the concerns expressed by third parties as regards the need to ensure sufficient liquidity on the Hungarian wholesale gas market at price and conditions allowing third parties to compete effectively with the new entity on the downstream gas and electricity markets in Hungary.

From a remedy policy viewpoint, this case is interesting because the package of remedies includes, *inter alia*, a gas release programme, whereby E.ON will sell 1 billion cubic meters ('bcm') through 8 yearly auctions. It is the first time that a gas release programme features in a remedy package in the framework of the Commission's merger control activities. Moreover, E.ON will divest half of its 10-year gas supply contract with MOL Exploration and Production (E&P), covering Hungarian domestic production, through a contract release. These two measures will release 16 bcm until 2015, up to 2 bcm per year, equivalent to 14% of Hungarian consumption. This will be the most significant gas 'release' ever implemented in Europe, both in terms of volumes and duration. As such, it gives all current and future market participants the possibility to conclude gas supply contracts on a level-playing field.

This article will first sketch out the main relevant features of the Hungarian regulatory environment in both the gas and the electricity sectors; it will subsequently describe the main theory of harm of the competitive assessment carried out by the

Commission; and it will finally focus on the remedies package, in particular on the gas release programme.

## 2. Hungary's regulatory framework

### 2.1. Gas

The Hungarian natural gas sector is characterised by a hybrid model, with the coexistence of a regulated segment of the market (or 'public utility market'), resulting from the old gas regime in Hungary, and a liberalized segment of the market (or 'open segment of the market'). Since 1 July 2004, all non-residential customers have become eligible customers free to choose their supplier under Hungarian law. Residential customers will become eligible on 1 July 2007 at the latest. In the regulated segment of the market, the public utility wholesaler (MOL WMT) is under an obligation by law to cover the full natural gas demand for public utility purposes of the RDCs, whereas the RDCs are under an obligation to source their natural gas needs for their public utility customers exclusively from the public utility wholesaler (at regulated prices). The RDCs have in turn the exclusive right and obligation to supply (at regulated prices) the customers in the regulated segment who are situated in their territory. Eligible customers have the choice between remaining supplied within a public utility contract by their historic gas supplier (their RDC or the public utility wholesaler, MOL WMT if the customer was supplied directly by MOL WMT) or terminating their public utility contract and purchasing their gas requirements from a trader or importing natural gas themselves. Switching has remained marginal (around 5%), due to the low prices in the regulated segment. It is expected that this hybrid model will disappear after July 2007, in line with the second Gas directive <sup>(1)</sup>.

### 2.2. Electricity

The Hungarian electricity sector is also characterised by a hybrid model, including a regulated segment and an open segment. On 1 July 2004, all non-residential customers became eligible customers. Residential customers will become eligible on 1 July 2007, in line with the second Electricity directive <sup>(2)</sup>. As in the gas sector, eligible custom-

ers have the right, but not the obligation to switch suppliers, and may thus stay with their respective regional supplier in the context of a public utility contract. There are however more customers that have switched to the open segment of the market in the electricity sector than in the gas sector. In June 2005, the open segment represented 32% of total Hungarian electricity consumption.

## 3. The theory of harm: foreclosure of access to gas, due to the vertical integration of the new entity and changed incentives

The essential change brought about by the transaction was that E.ON, unlike MOL, is active in the gas and electricity downstream markets. The merger would thus result in the creation of a vertically integrated company, active both in gas wholesaling and retailing and in electricity generation/wholesale and retailing. Immediately after the transaction, the new entity would likely have the ability and incentive to foreclose its actual and potential competitors on the gas and electricity downstream markets, as its competitors would necessarily have to rely on the new entity to procure their wholesale gas.

### 3.1. The ability to foreclose: the new entity would be the 'gatekeeper' for all competitive gas resources in Hungary

Due to its previous position as legal monopolist, MOL WMT holds a dominant position in the wholesale supply of gas to RDCs and to traders in Hungary. While MOL WMT retains its former monopoly rights on the regulated segment of the market, the Commission's investigation revealed the existence of significant barriers to entry on the open segment of the Hungarian gas market. The main barrier faced by new entrants in Hungary was the difficulty of access to competitive sources of gas, and the lack of liquidity of the Hungarian gas wholesale market.

In particular, MOL WMT controlled and will keep controlling access to domestic gas resources and to competitive imports.

Hungarian domestic gas production is not negligible and amounted to approximately 3 bcm in 2004, accounting for about 20% of the total national gas consumption. Although MOL E&P was not part of the transaction, MOL E&P and MOL WMT have entered into a 10-year supply agreement for the domestic gas produced by MOL E&P. The Commission found that, pursuant to the agree-

<sup>(1)</sup> Directive 2003/55/EC of the European Parliament and the Council of 26 June 2003 concerning common rules for the internal market in natural gas, OJ L 176, 15.7.2003, p. 57.

<sup>(2)</sup> Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity, OJ L 176, 15.7.2003, p. 37.

ment, no (or only marginal) volumes of domestic gas would be available for third parties as most of forecasted production would be 'booked' by WMT.

Imports account for 80% of total gas consumption in Hungary and are expected to increase, as domestic production is declining. There are two entry points from which to import gas, the Eastern entry point (Beregovo, at the Ukrainian border) and the Western entry point (HAG, at the Austrian border). The Beregovo entry point is highly congested, while some capacity is available at the Western entry point. However, the Commission found that gas imported through the Western entry point is physically Russian gas and is approximately 30% more expensive than the gas imported through the Eastern entry point.

The investigation showed that all gas imported into Hungary — and the only competitive source of gas — is either Russian gas (i.e., sourced from Gazprom) or gas from a CIS country (in particular Turkmenistan) transiting through Russia and Ukraine (i.e., via transit pipelines under the control of Gazprom). Alternative gas sources are not expected to be available in Hungary before 2012 when the Nabucco pipeline (bringing gas from the Middle East and Caspian area) may become operational.

The market investigation indicated that it was difficult for new entrants to get access to Russian gas in parallel to MOL WMT's existing contracts. It appeared that there would be no incentive on the part of the Russian supplier Gazprom to sell 'more' gas for exports to Hungary.

Gazprom's gas supplies cover most of Hungary's needs. The Commission was of the opinion that it would not be possible to purchase gas from Gazprom to compete with MOL WMT. First, Gazprom would have no incentive to supply another gas trader at cheaper prices as the quantities would simply displace the quantities it already sells for the Hungarian market. Secondly, any gas Gazprom would sell at a price higher than the one charged to MOL WMT would not be competitive in Hungary.

For these reasons, already prior to the transaction, MOL WMT was dominant on the various Hungarian gas wholesale markets (gas supply to RDCs, gas supply to traders, gas supply to power plants). This dominant position as 'gatekeeper' of access to gas resources would now accrue to E.ON through the transaction.

### 3.2. *The incentives to foreclose:*

#### *E.ON presence in the gas and electricity downstream markets*

##### 3.2.1. *Gas markets*

The Commission found that the new entity would likely have the incentive to use its gatekeeper position to foreclose access to wholesale gas to its competitors (RDCs and traders) on the markets for gas supply to small industrial and commercial customers and to residential customers. Most crucially, prior to the transaction MOL (the 'original' gatekeeper) lacked any incentive to exploit its position in a similar way.

Following the merger, the new entity would have the ability and the incentive to pursue this foreclosure strategy and raise its rivals' costs in various ways. In the regulated segment of the market, where prices are regulated, the new entity could engage in non-price discrimination (such as delays in supply, reduction in quality of service, lack of flexibility, unwillingness to renegotiate, etc.). In the open segment of the market, it could directly increase the wholesale price of gas to traders and/or engage in non-price discrimination.

E.ON, through its RDCs, holds a market share of around 15-25% on the market for gas supply to small industrial and commercial customers and a similar market share for gas supply to residential customers. The Commission's analysis indicated that the new entity's incentive to raise the costs of rivals and its optimal foreclosure strategy was likely to evolve with the regulatory environment.

Immediately after the transaction, as long as both retail prices to small industrial and commercial customers, residential customers and wholesale gas prices are regulated, the new entity would have an incentive to raise the costs to rival RDCs through non-price discrimination. Simultaneously, it would be likely to increase the price of wholesale gas to independent traders to capture customers that switch to the open segment of the market.

In July 2007, when regulated prices are expected to be abandoned, all eligible customers would have to switch to the open segment of the market. It is then likely that the new entity would have an incentive to foreclose all its downstream rivals on the market for the supply of gas to end users either by increasing the cost of gas or by reducing the quality of supply, or combining these strategies.

As a result, competitors of the new entity would be likely to be marginalised, thereby allowing the new entity to gain increased market power on the downstream market for the supply of gas to small industrial and commercial customers. This input

foreclosure would also be likely to discourage new entries in this market as potential entrants would not expect to be in a position to contract gas supplies with the new entity under terms and conditions similar to those applicable to E.ON's affiliates. The Commission thus considered that the merger would significantly impede competition on the market for gas supply to small industrial and commercial customers and to residential customers.

Specifically as regards the impact on residential customers, since they will become eligible in July 2007, i.e. only 18 months after the adoption of the decision, the Commission considered that the main anticompetitive effects resulting from the merger would occur as from that date.

Finally, the Commission found that the new entity would acquire a dominant position in the supply of gas to large industrial customers through the addition of MOL WMT's and E.ON's significant customer portfolios (for E.ON, through its controlled RDCs). The new entity would therefore immediately gain access to a significant customer base (a combined market share of around 40-50%) as opposed to EMFESZ, its current only competitor (with a market share below 10%), and to potential entrants.

The Commission also found that the new entity would have control and influence over gas infrastructure (storage and transmission) and that this would lead to further impediments to competition.

MOL Storage was the only company able to offer gas storage services in Hungary. Access to storage is crucial for any gas supplier to be active on the gas wholesale and retail markets, essentially in order to manage the seasonal fluctuations in the demand of its customers. The Commission found that as a result of the merger, the new entity would have the ability and incentive to reinforce its gas input foreclosure strategy by adopting discriminatory behaviour in granting access to storage, even in a scenario of fully regulated prices for storage services.

MOL Transmission, which owns and manages the high pressure grid in Hungary, would remain under the control of MOL. However, the 25% minority shareholding that MOL would retain in MOL WMT would give MOL Transmission an incentive to reinforce the gas input foreclosure strategy to the detriment of E.ON's competitors downstream through discriminatory behaviour in granting access to the transmission network.

### 3.2.2. *Electricity markets*

The Commission's market investigation also identified competition concerns on various electricity

markets, resulting from the vertical integration of MOL WMT's activities in the upstream market of gas supply to large power plants with E.ON's activities in the downstream markets of electricity generation/wholesale and electricity retail.

Whereas MOL was not active in the electricity markets, E.ON has made significant investment in the electricity sector in Hungary since 1995 and was planning (already prior to the merger) to expand its presence considerably. The group is currently active at the generation level with a small size gas-fired power plant in Debrecen (95 MW), and at the wholesale and retail supply level with ownership of three out of the six electricity RDCs (holding a market share of 40-50%) and the electricity trading company E.ON EK. In addition, E.ON controls various companies involved in electricity retail supply in neighbouring countries.

As to electricity generation/wholesale, it is estimated that significant new electricity generation capacity (5,000 MW or 60% of current installed capacity) will be needed in Hungary by 2020 to replace old power plants (3,500 MW) and to satisfy the increase in demand. Accordingly, Hungarian electricity generation capacity should increase from 8,000 MW to approximately 10,500 MW.

The Commission's market investigation on existing new power plants projects in Hungary established that gas will be the predominant fuel for new power plants. The Hungarian energy regulator considered that gas-fired power plants could reach approximately 60% of new generation capacity.

Prior to the transaction, MOL WMT already had a dominant position in the market for the supply of gas to large power plants. Following the transaction, the new entity would thus have the ability to determine its competitors' power plants gas supply conditions (prices, rules for nomination, take-or-pay penalties, interruptibility, etc.) and to discriminate against rival power generators in several ways. The Commission's investigation showed that, immediately after the transaction, E.ON would be more likely than not to pursue two strategies to strengthen its position in both electricity generation/wholesale supply and electricity retail supply in Hungary.

As regards new power plants, E.ON would be likely to increase the cost of gas to potential entrants, with the aim to deter these rivals from building new gas-fired power plants and to favour its own new power plants projects. This strategy would be attractive for E.ON in view of its strong interest in expanding significantly its power generation capacity in Hungary. E.ON would also be in a position to discriminate against new gas-fired power plants that would not supply its downstream electricity

retail affiliates. This strategy would be economically rational as it would provide E.ON with a certain degree of control over the electricity generation/wholesale market and additional competitive advantage on the electricity retail market.

As regards existing power plants, the new entity would be likely to implement the same foreclosure strategies with the objective of limiting their ability to compete on the open segment of the generation/wholesale market and to eventually induce them to exit the market. Several market players expressed the concern that E.ON would then seek to acquire their assets.

In the future liberalized regulatory framework, greater power generation capacity will be available on the open segment of the market and no longer 'booked' under long term Power Purchase Agreements (PPAs). In that future framework, and owing to E.ON's future larger share in power generation, the foreclosure strategies described above would be even more effective and therefore more damaging. They would reduce the ability of rival gas-fired power plants to compete, and limit the scope for the development of the competitive electricity wholesale market.

E.ON's strategy would lead to a slower and less competitive development of new generation capacity in Hungary starting immediately after the transaction (compared to a situation where new power plants would be built by distinct market players) and ultimately to higher electricity wholesale prices. It would thus impede effective competition on the market for generation/wholesale supply of electricity to traders.

As regards electricity retail, E.ON was the leading player in the retail supply of electricity in Hungary. It was the only group with strong positions in both the regulated segment (with 3 out of 6 RDCs) and the open segment (E.ON EK is one of the three largest electricity traders in Hungary), with a market share around 40-50%.

E.ON's strategy on the electricity generation/wholesale market would significantly impede competition on all the markets for the retail supply of electricity. This impact would first result of the non competitive development in new generation capacity and higher wholesale prices. Second, the new entity's likely strategy to link the gas supply and electricity sales of gas-fired power plants would reduce the ability of rival electricity retailers to source competitive electricity and would increase the new entity's already strong market power in electricity retail. Finally, the Commission's market investigation indicated that dual offers (gas and electricity) were likely to play an important role in Hungary. According to the Commission, E.ON

would have the ability and incentive immediately after the transaction to prevent any other company active in electricity retail from developing dual offers by foreclosing access to gas resources to those competitors willing to pursue this marketing strategy. In combination, these practices would significantly impede competition on the markets for the supply of electricity to small industrial and commercial customers, as well as to residential customers.

### 3.2.3. *Application of the new substantive test*

It should also be noted that the gas foreclosure concerns described above would lead to higher retail prices in both gas and electricity markets even if the merged entity does not in fact acquire a dominant position in each of such markets in the relatively near future. Thus, arguably the new substantive test adopted in May 2004 is better suited to take these anti-competitive effects into account than the old test.

Following the reformulation of the substantive test, it is no longer a requirement that a dominant position be created or strengthened in order to challenge a merger, as this could lead to under-enforcement or an enforcement gap. The basic intuition behind this argument can be expressed as follows: if the merging parties sell very close substitutes, they impose on each other a significant competitive constraint. Pre-merger if a firm raises prices, customers may simply switch to its rival. However, post-merger, customers may have no other close substitutes to turn to and the merged entity could raise prices significantly, irrespective of whether it becomes the market leader.

Furthermore non-merging rivals will also react to the merger and raise their prices, resulting in a new equilibrium. In other words, when firms compete in prices, the final equilibrium effect will exceed the direct effect of eliminating the merging parties as competitive constraint to each other. A merger test — such as the dominance test — that focuses almost exclusively on the market power of the merged firm may thus not capture the full equilibrium effect. It is important to realize that these equilibrium effects do not arise from any collusion between firms, or from any trade-off of future/current profits. It is simply a change in the competitive equilibrium.

Similarly in vertical mergers, when an upstream firm merges with a downstream firm, that upstream firm has lower incentives to engage in price-cutting competition with other upstream firms in order to serve non-integrated downstream firms. As a result, the rival upstream firms can charge higher prices for their inputs, other things being

equal. This raises the costs of the non-integrated downstream sector. This increase in costs is then reflected in higher final good prices, so that the integrated downstream firm can in turn raise its prices and make higher profits. The end result is that final goods prices rise, total producer surplus becomes larger and consumers are worse off. A monopoly that integrates downstream may have the ability and incentive to raise its downstream rivals' costs. This can lead to significant price increases downstream even if the merged entity falls short of acquiring downstream dominance in the short term. This applies to several of the anti-competitive effects resulting from the E.ON/MOL merger and for which the remedies described below were necessary.

#### 4. The remedies: a complex and innovative package

In order to remove the competition identified by the Commission on the gas and electricity markets, E.ON offered remedies aimed at increasing liquidity of gas on the Hungarian wholesale gas market at price and conditions will allow third parties to compete effectively with the new entity on the downstream gas and electricity markets in Hungary.

The remedies package is based on a combination of both structural and behavioural measures, having in essence a two-fold objective: completing the ownership unbundling (brought about only partially by the transaction) by severing the structural links due to the remaining minority shareholdings of MOL into WMT and Storage; and releasing sufficient quantity of gas for third parties to be able to source their gas needs independently of the new entity and at competitive conditions.

##### 4.1. Unbundling

First, pursuant to the commitments, MOL will divest its remaining shareholdings of 25% in MOL Storage and MOL WMT within six months following the date of closing. In addition, MOL will not acquire direct or indirect minority stakes in MOL WMT and MOL Storage for a period of 10 years as long as E.ON is a majority shareholder of these companies.

The divestiture of MOL's 25% shareholdings in MOL Storage and MOL WMT pursuant to the commitments removed the concerns stemming from the structural links between MOL and E.ON. The ownership unbundling is now complete between MOL controlling gas production and transmission (MOL E&P and MOL Transmission) and E.ON controlling gas wholesale and storage (WMT and Storage).

Secondly, pursuant to the commitments, MOL will not exercise the put option for the 25% interest in MOL Transmission, while retaining the put option for the 75% stake, which would bring about a change in control and therefore would trigger the scrutiny of the competent competition authorities. In addition, MOL will not sell to E.ON or any of its affiliates, for a period of 10 years as long as E.ON is a majority shareholder of MOL WMT and MOL Storage, a share interest in MOL Transmission that would not result in the acquisition of sole or joint control over MOL Transmission by E.ON.

This remedy will provide the competent competition authorities with the opportunity to review the creation of any structural link between the new entity and MOL Transmission (notably if the put option is exercised) in the framework of the market conditions prevailing at such time.

##### 4.2. Gas release and contract release

E.ON undertook to implement a gas release programme in Hungary by way of business-to-business internet auctions. The gas release programme foresees 8 annual auctions of 1 bcm of gas (between 2006 and 2013) and will have a duration of 9 years until July 2015.

In addition, E.ON undertook to assign to a third party half of the contract between MOL WMT and MOL E&P for the supply of domestic gas. Once the contract assignment becomes effective, the third party will take over all the rights and obligations of MOL WMT under the supply agreement for 50% thereof. The assignment will become effective at the beginning of the gas year 2007 (July 2007) and will be valid for the whole duration of the supply contract, until July 2015. The part of the supply contract to be assigned represents approximately 7.6-10 bcm of gas in total, with the volumes to be released in the first year amounting to 1.2 bcm.

##### 4.3. Gas release programmes in Europe: the criteria for success

In view of the novel character (at least in merger control) of the remedies offered by the parties, and of the limited experience of the Commission with gas release programmes at large, the Commission reviewed existing similar programmes in various European countries and carried out a market test with Hungarian and international gas and electricity operators to be in a position to assess properly whether the gas release and the contract release remedies submitted by the parties were suitable to remove the competition concerns identified during the procedure.



#### 4.3.1. General features

Gas release programme and contract release programme aim at making gas available to wholesalers and end users at the wholesale level. In this type of programme, the gas incumbent company undertakes to offer certain quantities of gas for sale to its competitors/customers.

In a gas release programme, the gas incumbent offers for sale certain quantities of gas from its overall gas sourcing portfolio. Purchasers enter into supply contracts with the gas incumbent for these quantities. In a contract release programme, the gas incumbent transfers (assigns) part of its gas supply contracts with gas producers. Purchasers enter into a supply contract directly with the gas producers (without the intermediary of the incumbent) and the transferred gas supply contract(s) of the incumbent is terminated, or the gas quantities in the transferred supply contracts are reduced accordingly. Both types of programme are designed to improve the liquidity of gas markets and enable competing traders and customers to acquire gas for their own use or for resale. The essential difference between contract and gas release is that the incumbent's supply portfolio remains the same in a volume release programme, while it is partly transferred to competitors/customers in a contract release programme. Contract releases are also 'once-off' measures, whereas gas releases are programme running over several years.

The sale of the gas or the transfer of the gas supply contract may be achieved in two ways: (i) auctions, or (ii) bilateral contracts. The gas quantities may be sold through public auctions where companies with the highest bid are selected. In case of bilateral negotiations, the incumbent negotiates with interested companies and gas sales/contract transfers are concluded based on mutual agreement. The undertakings proposed by the parties in the present case comprise both a gas release through auctions and a contract release through bilateral negotiations.

#### 4.3.2. Specific features

Gas release programme have been and are being implemented in several European countries; experience is more limited for contract release programme. Gas release programme are either part of a broader action plan required under national law and/or designed by the national energy regulators to open the gas wholesale markets to competition (UK, Spain, Italy) or are implemented as undertakings in merger or antitrust procedures (France, Germany, Austria).

The Commission contacted the energy regulators in each of the countries where a gas release

programme has been implemented with a view to understanding whether the programme has actually fulfilled its objectives and to establishing which elements are crucial for a gas release programme to be effective.

The Commission also drew useful guidance and suggestions from the paper 'Implementation of Gas Release Programme for European Gas Market Development' published by the European Federation of Energy Traders' <sup>(3)</sup> (EFET) to which the parties had widely referred ('the EFET paper').

#### 4.3.3. Volumes

The quantities of gas to be released depend on the objectives of the gas release programme and of the regulatory framework. More specifically, in a merger case, the volumes should be sufficient to remove the competition concerns and are thus linked to the number and the size of markets in which competition concerns arise. The released volumes need to be sufficient to exclude that the incumbent supplier can foresee that all or most of the released volumes will be acquired by certain customer categories. Only if the volumes released are sufficient to allow eligible customers in all affected markets to benefit from the programme (as direct purchasers or indirectly as customers of traders buying gas through the gas release programme) can a gas release programme offset the incumbent's ability and incentives to engage in anticompetitive behaviour and thus remove the negative impact on competition.

A gas release programme should in addition foresee that gas quantities that were offered for sale but did not find a buyer a given year should be added to the quantities to be released the following years.

#### 4.3.4. Duration of the programme

A gas release programme generally aims at increasing the liquidity on gas wholesale markets and facilitating new entries. In the context of a merger case, a gas release programme may seek to reduce or eliminate the merging parties' ability and incentives to engage in behaviour that would significantly impede effective competition. To achieve these objectives, the gas release programme should remain in place for a sufficiently long time as to ensure that the market structure and the competitive conditions have the potential to change significantly, and that the level of competition achieved through the programme can be regarded as sustainable.

<sup>(3)</sup> <http://www.efet.org>

#### 4.3.5. *Price and costs*

The price at which gas is available through the gas release programme should enable wholesalers to compete with the supplier of gas under the gas release on the gas wholesale and retail markets. The auction mechanism is a convenient way to allocate efficiently the gas quantities to be released. As the final price results from competitive bids, it is the price that bidders are willing to pay for the gas made available under the programme, given prevailing market conditions.

The Weighted Average Cost of Gas (WACOG) is recognised in the EFET paper as one of the benchmarks for the definition of price mechanisms in auctions for gas release programme. As regards additional costs, all costs incurred by participants to the auctions and by successful bidders should be clearly defined. As a principle, the costs of the auctions should be borne by the incumbent, unless there are specific reasons not to do so.

#### 4.3.6. *Gas supply duration and lot size*

The duration of the gas supply contract and the size of the lots in a gas release programme should be designed so as to meet the needs of the various categories of bidders in the relevant markets.

#### 4.3.7. *Flexibility*

The daily, monthly, quarterly and yearly flexibility provisions for the gas supplied through the gas release programme are essential. Wholesalers and industrial customers should have the ability to structure the gas quantities they purchase according to their own or their customers' consumption profiles. Depending on the conditions of access to storage, the requirements for the flexibility of the gas supplied through a gas release programme differ.

The annual flexibility (swing and TOP levels) should reflect the incumbent's average annual flexibility. As quarterly flexibility needs may be provided by the storage of gas, the flexibility provided by the seller in the gas release programme depends on access to storage.

Finally as regards daily flexibility, it is clear that wholesalers, especially small ones, and end users have higher flexibility requirements than large importers (such as the seller generally). Therefore, it is clear that a base-load gas supply or even a daily flexibility similar to the seller's gas portfolio's average daily flexibility may be insufficient.

Experiences in European countries, particularly in Germany, show that the attractiveness of a gas

release programme for small wholesalers and industrial customers strongly depends on the flexibility provisions of the gas supply.

#### 4.3.8. *Gas delivery points*

The gas should be delivered at a delivery point from which wholesalers can easily transport and store the gas. A gas hub or cross-border entry points are therefore generally appropriate delivery points. A certain degree of flexibility for the choice of the delivery point (as is often the case for the seller) increases the attractiveness of the programme.

The delivery point location is in particular relevant when gas transmission network are split among various owners, when the level of free capacity is low in the transmission or storage system and when entry-exit tariffs (and not post stamp tariffs) are applicable. Availability of gas at more than one delivery point reduces the risk that the transmission regime constrains competition in any market area and ensures that purchasers face similar physical and operational risks as the seller.

In a merger case, the delivery point of a gas release programme should be selected so as to enable wholesalers and end users to source gas from the gas release programme for resale or for their own use in the geographical market where competition concerns have been identified.

#### 4.3.9. *Security of supply*

The gas supply conditions should include standard provisions on security of supply issues (maintenance, force majeure, off-spec, interruptibility, etc.) following the common practices in the relevant markets. The rights and obligations of the purchasers and the seller should be balanced.

#### 4.3.10. *Auction design and guarantees*

The 'ascending clock auction' has been used in several countries as an appropriate procedure to allocate the gas quantities. The organization of the auction should also ensure that the seller does not gain information on its competitors.

The amount of the deposits and guarantees should not be disproportionate and should not constitute a disincentive for potential bidders. Payment terms should reflect standard market practices and in particular should not be less favourable than those of the seller's upstream supply contracts.

#### 4.3.11. *Access to transmission*

Access to sufficient gas transmission capacities is necessary to ensure that wholesalers and end users purchasing gas through the gas release programme can transport gas to the place where the pro-

gramme is intended to solve competition concerns. Thus, access to transmission capacities is essential and a gas release programme is not expected to be successful if little free capacity is available in the gas transmission network. If transmission capacity is booked by the company that organizes the gas release programme, it should be released to the transmission system operator to the extent of the gas quantities released.

Responses from market operators indicated that difficulties to obtain sufficient capacity to transport the acquired gas were one of the main issues explaining the lack of success of the first auctions in the German gas release programme of E.ON/Ruhrgas.

#### 4.3.12. Access to storage

If the flexibility conditions foreseen in the gas release programme are not sufficient to meet the flexibility needs of wholesalers and end users, access to sufficient gas storage capacities is necessary to ensure that wholesalers and end users purchasing gas through the gas release programme can structure the acquired gas according to their own or their customers' needs. Thus, access to storage capacities is essential and a gas release programme is not expected to be successful if marginal free capacity is available in the gas storage system. If storage capacity is booked by the company that organizes the gas release programme, it should be released to the storage system operator to the extent of the gas quantities released.

#### 4.3.13. Access to customers

A gas release programme has little chance to be successful if the majority of customers are bound to their gas suppliers under long-term supply contracts. In these conditions, a gas release programme is not expected to introduce much competition on the gas markets as customers are not able to switch suppliers. Therefore, it is essential that customers purchasing gas in the gas release programme or indirectly from a trader purchasing gas in the gas release programme have the opportunity to terminate their existing gas supply contracts or to reduce their obligation to purchase gas. In case of reduction, it is also important that the incumbent be not allowed to worsen supply terms for the remaining quantities.

#### 4.3.14. Monitoring and review provision

Experience has shown that it was important for an effective gas release programme to be able to review the conditions of implementation to address the difficulties encountered with the practical implementation of the programme. Given the

high complexity and the specificities of the various market conditions, it is essential to provide for a close monitoring by the competent national authorities and for sufficient flexibility to modify the auction and gas supply rules so as to take duly into account the needs of third parties.

While gas release programme imposed by energy regulators may be easily reviewed and improved on an on-going basis, this is more difficult for gas release programme constituting undertakings in merger cases. Therefore the degree of freedom of the parties to set the terms and conditions of the programme should be restricted to ensure the effectiveness of the remedy and most practical/technical rules for the implementation of the programme should not be part of the undertakings attached to a decision, but rather defined at a later stage under the supervision of the relevant regulatory and competition authorities.

#### 4.4. The final assessment of the gas release and the contract release

On the basis of the specific market investigation, whose results were sketched out above, and of its knowledge and assessment of the Hungarian gas and electricity markets, the Commission reached the conclusion that the gas release programme and the contract release as offered by the parties, incorporating the amendments and improvements proposed by third party respondents to the market test, were sufficient to remove all the competition concerns resulting from the transaction. In particular, the combination of the gas release programme and the contract release would ensure that all market participants (whether gas customers or traders) would have the ability to source their gas needs under competitive and non-discriminatory conditions and, for at least a significant part, independently from the merged entity.

In particular, the Commission considered that the volumes offered in the gas release programme (in conjunction with the volumes made available by the contract release for MOL E&P's production) are suitable to create sufficient liquidity of gas on the gas and electricity markets so as to ensure that effective competition can develop and remain sustainable.

At least until 2013/2014, substantial quantities of gas (around 2 bcm) will be released and the programme will last until 2014/2015. The quantities released by the parties account for up to 14% of the total Hungarian demand and represent 21% of total third parties' gas sales. This means that third parties will have the ability to purchase a significant share of their gas from the gas release and/or the contract release.

The commitments do not foresee any restriction on the quality of participants to the gas release programme and the gas released may thus be purchased by commercial and industrial customers and power generators to meet their own needs or by gas traders. It was therefore not possible to estimate which quantities of gas released will be used in each of the relevant market where the Commission identified competition concerns.

However, the total quantities of gas released over the gas years 2007/2008 to 2013/2014 represent approximately 60% of the size of the market for the supply of gas to power plants and 55% of the size of the market for the supply of gas to large industrial customers. The Commission therefore estimated that the released gas quantities will significantly increase liquidity and hence limit the ability of the new entity to engage in anticompetitive behaviour.

The total quantities of gas to be released through both remedies are significant in terms of international benchmark. In this regard, the volumes of gas are significantly higher (in percentage value) than in the similar programme implemented in other European countries. For example, the gas release programme organized by Econgaz in Austria amounts to 2.9% of the total Austrian gas market, the programme by E.ON Ruhrgas in Germany corresponds to 2.5% and ENI's programme in Italy represents 3.1% of total demand.

#### 4.4.1. Gas release programme

The Commission concluded that the gas release programme offered by the parties is designed, as regards its main features (volumes, duration, price mechanism) and in its more technical features (size of lots, duration of contracts, flexibility rules) largely in line with the criteria 'for success' described above. The detailed rules for the effective implementation of the auction and the gas supply contracts will be elaborated by the parties under the scrutiny of the Hungarian Energy Office (HEO), and submitted to the Commission for its approval.

The duration of the gas release programme will ensure that sufficient liquidity will be available for a sufficiently long time so as to ensure that the market structure and competitive conditions have changed. First, as mentioned, the Nabucco pipeline (carrying gas from the Middle East and the Caspian area) is expected to become operational around 2012 and will then provide alternative gas resources. Secondly, it has to be highlighted that all of the new entity's current supply agreements, including those with Gazprom, will have terminated by 2015. The new entity's gas supply

contracts with Gazprom and the privileged access to gas resources (which confer to new entity the ability to foreclose access to gas to its downstream competitors and to significantly impede effective competition on the gas supply markets) will be open for competition at this date.

Furthermore, the price mechanism foreseen for the programme will ensure that successful bidders will obtain gas at the same competitive conditions as the parties, and possibly cheaper, owing to the fact that the starting bidding price foresees a 5% discount off the WACOG. The Commission considered that this pricing mechanism is attractive for third parties and will provide good incentives to participate actively in the programme's auctions.

As regards the implementation of the gas release programme, it is important to ensure that all participants are admitted at transparent and non-discriminatory terms and that the sale is made at competitive conditions.

To this end, the size of the lots was adjusted to meet the specificities of the Hungarian markets: three lots sizes are offered to better meet the needs of the various categories of market players. The period between the auction and the delivery period is considered as sufficient for successful bidders to find new customers if they intend to resell the gas they have acquired.

Access to customers is also granted under the remedies as the parties will amend the existing contracts of their existing customers intending to purchase gas from the gas release programme, either directly or through a wholesaler.

#### 4.4.2. Contract release

The Commission also considered that the assignee of the contract release will constitute a sizeable and sustainable competitive force in the Hungarian gas markets. The assignee will purchase significant quantities of gas from MOL E&P starting in July 2007 (expected date of the further liberalization of the Hungarian gas markets) until 2013/2014, independently from the new entity. It will also have to ability to combine the contract release with the purchase of gas quantities through the gas release programme until 2013/2014. The assignee of the contract release will therefore have sufficient long term gas resources to develop its position on the Hungarian gas markets and introduce liquidity on these markets.

The fact that the terms and conditions of the contract will be similar for the new entity and the assignee ensures that the latter will have the ability to compete with the new entity. In particular, MOL

will grant equal treatment to WMT and the third party in exercising its put options concerning production quantities.

Access to customers is also granted under the proposed remedies as the parties undertake to entitle to amend the existing contracts of their existing customers from the Third Party assignee of the contract release.

The Commission believes that the Hungarian regulatory framework (in particular 'capacity-follows-the-customer' principle) should ensure, for that sufficient transmission and distribution capacities are made available to the successful bidders of the gas release programme and to the assignee of the contract release to transport the acquired gas within Hungary.

Additionally, the commitments of the parties to grant access to storage for the successful bidders of the gas release programme and the assignee of the contract release at regulated prices are sufficient to grant an effective and non-discriminatory access to the storage capacities for the relevant gas quantities. The Commission believes that this commitment will enable traders and customers to structure the acquired gas according to their own or their customers' needs.

Finally, the effective monitoring by the HEO, with the assistance of the Commission's Trustee, will help the Commission ensure that the parties will fully comply with their commitments for their entire duration.

## 5. Conclusion

The Commission finally reached the conclusion that the commitments submitted by E.ON were sufficient to address the competition concerns raised by the concentration and therefore declared the transaction compatible with the common market and the functioning of the EEA Agreement pursuant to Article 8 (2) of the Merger Regulation.

With this case the Commission has, for the first time in merger control, accepted gas release and contract release as measures aimed at remedying competition concerns in the energy sector.

The experience and knowledge acquired with this case will undoubtedly prove useful in future merger cases and beyond. The preliminary results of the ongoing energy sector inquiry have provided indications that these markets are still not working as they should. While the Commission supports European integration and restructuring of the energy sector, it must ensure that any competition concerns are remedied, and that consumers are protected. The remedies of this case are also consistent with the preliminary findings of the ongoing energy sector inquiry which emphasize the need for structural solutions such as ownership unbundling and for sufficient liquidity to secure pro-competitive conditions for energy markets' development.

## Consolidation in container liner shipping — Merger control aspects

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In 2005, three acquisitions of container liner shipping companies were notified to the European Commission. The consolidation wave started with the public bid of the Danish company A.P. Moller Maersk (Maersk) for the Dutch-British shipping company Royal P&O Nedlloyd (PONL). Prior to the acquisition, Maersk was the leading global player, and by incorporating PONL, the fourth largest carrier in the world, it secured that position. Some months later, the German tourism and logistics company TUI with its shipping subsidiary Hapag-Lloyd presented a public offer for the Canadian shipping company CP Ships. The bid resulted in the creation of the fifth largest player in the world in terms of capacity. Finally, the French shipping company CMA CGM acquired the French company Delmas, which although relatively small globally, has important activities in the Mediterranean and Africa. Following the transaction, CMA CGM became the third largest global player. The European Commission approved all three transactions <sup>(1)</sup>. However the acquisitions of PONL and CP Ships were subject to conditions.

Prior to these acquisitions the container liner shipping industry was considered to be non-concentrated at the individual carrier level. Even after the acquisition of PONL, Maersk's worldwide capacity share remains below 20%. However, for the merger analysis the position of the parties on the relevant market is crucial. As will be shown below, containerised liner shipping does not constitute a worldwide market but has to be assessed on the basis of single trades, defined by the range of ports which are served at both ends of the service. Further, the co-operation of liner shipping companies in conferences, consortia and alliances has to be taken into account when analysing the competitive constraints on each trade.

### Market definitions

The product market is that for the maritime transport of goods chiefly by container. Containerised liner shipping involves the provision of regular, scheduled services for the carriage of cargo by

container on one or more trades. It can be distinguished from non-liner shipping, i.e. tramp and specialised transport, on account of the regularity and frequency of the service. In addition, unlike bulk shipping it uses containerised vessels.

A possible narrower product market is that for transport of refrigerated goods, which could be limited to reefer (refrigerated) containers only or could include transport in conventional reefer (refrigerated) vessels. From a demand side perspective, certain goods such as fruit, meat and dairy products must be shipped under refrigerated conditions. For this reason, non-reefer containers are not a substitute for reefer containers. As to the supply side, in principle each container ship can carry non-reefer containers as well as reefer containers. Reefer containers have their own cooling unit which depends on electric energy to be provided by the ship. However, on imbalanced trades with high volumes of reefer containers in one direction and relatively low volume in the other direction, the reefer capacity on the ships can be exhausted on the trade direction with high reefer volumes. Installation of additional plugs and power generation capacities on ships which are already operating on the trade entails time delays and additional investments. The redeployment of ships with higher reefer capacity also comes with time delays and additional costs. On these trades, supply side substitution is therefore more difficult.

As to the possible substitution between transport in reefer containers and transport in bulk reefer vessels, the market investigation produced some evidence that substitution is mainly one-way from bulk reefer to reefer containers, whereas substitution from reefer containers to transport in bulk reefer vessels seems to be relatively limited <sup>(2)</sup>. The possibility of substitution depends on a number of factors, such as the product shipped, the volume shipped, the logistic chain, cooling techniques available and sanitary requirements. These factors may differ from trade to trade.

The geographical dimension of containerised liner shipping services consists of single trades. Each trade has specific characteristics depending on the

<sup>(1)</sup> M.3829 — Maersk/PONL — decision of 29 July 2005; M.3863 — TUI/CP Ships — decision of 12 October 2005; M.3973 — CMA CGM/Delmas — decision of 1 December 2005.

<sup>(2)</sup> See also judgment of the CFI of 30 September 2003 in Joined Cases T-191/98, T-212/98 and T-214/98, TACA, paragraph 790 ff.

volumes shipped, the types of cargo transported, the ports served and the length of the journey from the point of origin to the point of destination. These elements determine the types of ships deployed on a trade. Moreover, considering that in liner shipping supply has to be provided by a sufficient number of similar vessels to generate a scheduled service, these characteristics influence the level of barriers to entry that may be present on the trade. Relevant trades are those from Northern Europe to other non European areas <sup>(3)</sup> and back and from the Mediterranean to other non European areas and back.

The market conditions on the two directions of a trade can be different, in particular in the case of trade imbalances or different characteristics of the products being shipped <sup>(4)</sup>. In these instances, a distinction between the two directions of a trade is justified. As regards substitution between Northern European and Mediterranean ports, the possibility of inland transport and transshipment between Northern Europe and the Mediterranean does not seem to lead to substitution to a considerable extent. On this point it was however not necessary to conclude on a precise definition of the geographic dimension of each trade because the competition analysis did not significantly differ under either alternative market definitions.

### Principles of assessment

To assess non-coordinated effects of the transaction, the market power of the merged entity on a trade is relevant. As in other sectors, in container liner shipping market shares provide useful first indications of the market structure and competitive importance of both the merging parties and the competitors. Market share data is processed on the basis of volume actually carried <sup>(5)</sup> on the trade. In the case of trade imbalances, each trade direction must be analysed. On trades with high reefer shares, the competitive situation in the transport of reefer containers requires a separate assessment. With the exception of the Europe-South Africa trade in the *Maersk/PONL* case, such non-coordinated effects did not give rise to competition concerns in the notified transactions.

The assessment of coordinated effects was of particular importance because shipping companies

are members of a number of liner conferences, consortia and alliances. Conferences, consortia and alliances are arrangements between shipping lines that play an important role in the organisation of the liner shipping industry. They restrict competition between their members. In both the *Maersk/PONL* and the *TUI/CP Ships* case, coordinated effects led to competition concerns on several trades.

Liner shipping conferences are groups of vessel-operating carriers which engage in price fixing and capacity regulation. These activities are exempted from the prohibition contained in Article 81 by Council Regulation 4056/86 <sup>(6)</sup>. Conferences are required to set common or uniform freight rates and may make a common policy on the discounts or rebates, which may be offered to shippers in the geographical area covered by the conference. In addition, conferences fix surcharges <sup>(7)</sup> and ancillary charges <sup>(8)</sup> per trade, country, port or direction as relevant. Furthermore, conferences discuss capacity utilisation, volumes lifted by each member line, evaluate members' market shares and carry out market forecasting through the elaboration of a business plan.

There is at present some internal price competition within conferences because individual rate fixing between carriers and shippers is allowed. In these cases the conference tariff is not applied but used as a benchmark to fix the price of individual or multi-carrier contracts. The percentage of the parties' cargo that is carried under individual service contracts is an indication of the extent to which internal competition takes place. However it cannot be assumed that the other members of the conference also carry roughly the same percentage of cargo in individual services contracts as the parties to the transaction. As regards the other components of the price, surcharges and ancillary charges are still imposed by all conference members on cargo that transits under individual service contracts. This results in part of the price being fixed jointly. The percentage of surcharges in relation to the price of the sea leg of the journey varies from trade to trade with an average of about 20-30%. There is no competition between the members of a conference on this important part of the price.

<sup>(3)</sup> Such as North America, Far East, Indian Subcontinent, Middle East, East Africa, South Africa, West Africa, Caribbean/Central America, East Coast South America, West Coast South America and Australia/New Zealand.

<sup>(4)</sup> E.g. mainly technical products in one direction and food in the other.

<sup>(5)</sup> Expressed in TEU (Twenty foot Equivalent Unit), the size of a standard container.

<sup>(6)</sup> On 14 December 2005 the Commission adopted a proposal for a Council Regulation repealing Regulation 4056/86. The proposal has to be adopted by the Council by qualified majority after the EP has expressed its views before the liner conference block exemption can be repealed.

<sup>(7)</sup> E.g. bunker adjustment factor, currency adjustment factor, congestion surcharge and war risk surcharge.

<sup>(8)</sup> I.e. those charges triggered by or associated with the operation of moving containers.

Consortia and alliances are operational agreements between carriers on a trade-by-trade or global basis for the provision of a joint service. Unlike conferences, consortia do not price fix but carry out extensive co-operation. This co-operation ranges from vessel sharing, exchange of space or slots in vessels, equipment interchange, joint operation or use of port terminals and related services, temporary capacity adjustments to the participation in a revenue or a cargo pool, joint marketing and the issuing of a joint bill of lading. These activities are exempted from the prohibition contained in Article 81 of the Treaty by Commission Regulation 823/2000 as amended by Regulation 611/2005. The block exemption is based on the assumption that in order to fulfil Article 81(3), consortia are subject to internal or external competition<sup>(9)</sup>. The extent to which competition amongst member lines takes place depends on the characteristics of the consortium. Exchange of commercially sensitive information takes place within consortia at least to the extent necessary for the provision of the joint service. This may include for example information on individual members lifting, actual and future, terms and conditions negotiated with third parties for the provision of port terminal services or customer information. The bundling of several consortia each operating in a different trade is known as an alliance.

The combined market position of the members of conferences and consortia on a trade can be substantial. Carriers are often members of a conference and of one or more consortia on the same trade. This enables them to cumulate the benefits of the Conference Block Exemption Regulation (price fixing) and of the Consortia Block Exemption Regulation (operational arrangements for the provision of a joint service). In line with previous merger decisions, the parties' membership in conferences and consortia is taken into account in the assessment of the consequences of the operation on the affected markets<sup>(10)</sup>. Therefore, market shares of the merged entity and those of relevant conferences and consortia are considered. The market share of a conference or a consortium is the aggregated market share of their members, calculated on the basis of the members' volume which is carried under the conference or consortium agreement. However, in order to assess the risk of coordination between the members of a conference or

a consortium and to evaluate the strength of the carriers interlinked due to their conference or consortium membership, it is appropriate to take into account the total volume transported by the conference or consortium members in the relevant trade.

Depending on the parties' membership, the transaction may have different effects on conferences and consortia. The following scenarios may occur:

- In cases where the parties to a merger are in the same conference or consortium and the merged entity maintains its membership, the concentration would not change the total market share of the conference or consortium. Depending on the structure of the conference or consortium, however, this could lead to a strengthening of the internal cohesion and eventually lead to the merged entity controlling the conference.
- In some instances the purchaser (A) is in a conference or consortium, but not the target (B), even though it is active on the same trade. If A maintains its membership, B can be expected to be integrated into the conference or consortium, and the market share of the conference or consortium will rise. If only B is in a conference or consortium, the merger would create a link between A and the conference and/or the consortium. This link would enable A to take part in the exchange of information within the conference and/or the consortium. A could use the commercially sensitive information exchanged therein to adapt its conduct on the market over time, thus increasing the risk of market sharing or lessening of competition between itself and the other members of the conference or the consortium. Even without integrating itself into the conference or the consortium, A would no longer be an independent competitor because it controls a member of the conference or the consortium.

## Application to cases

### *Maersk/PONL*

On account of the global presence of both merging parties, the transaction led to affected markets on nearly all trades to and from Europe and strengthened the position of Maersk as the number one global carrier. The extensive investigation revealed competition concerns stemming both from coordinated effects and, in the case of one trade, from non-coordinated effects, which raised serious doubts as to the compatibility of the concentra-

<sup>(9)</sup> After the adoption of Regulation 1/2003, consortia with a market share above 35% (and 30% if consortia operate within a conference) are under the obligation to self-assess whether their practices fulfil the four cumulative conditions of Article 81(3).

<sup>(10)</sup> See M.831 — PO/Royal Nedlloyd; M.1651 — Maersk/Sealand.



tion with the common market. However, following commitments submitted by the parties, the Commission approved the transaction with conditions in phase I of the proceedings.

As regards coordinated effects, on a number of trades, this merger created links between Maersk and the conferences and consortia to which only PONL was a member. In seven of these trades<sup>(11)</sup>, the combined market share of these connected shipping lines was so significant that it gave rise to competition concerns. In most of these markets, Maersk was the most important individual competitor of the shipping lines grouped in conferences and consortia to which PONL was a member. Following the merger, competition between Maersk and these conferences and consortia would be significantly weakened. Furthermore, the market position of other shipping lines operating independently from these conferences and consortia was not strong enough to provide a sufficient competitive constraint. In order to remove the competition concerns identified by the Commission, Maersk proposed to withdraw PONL from these conferences and consortia thus severing the link that connected its activities to that of its competitors.

Another area of concern was the trade between Europe and South Africa, especially the transport of refrigerated goods in reefer containers where the parties' combined market share was higher than 50%. The EU to South Africa trade is long and thin, in other words the distance to be covered is significant whilst the volume of cargo transported is not. Growth potential is also limited. More than 80% of the cargo transported northbound requires refrigerated transportation in reefer containers or in bulk reefers. The market investigation showed that for some shippers bulk reefer vessels are not a substitute for reefer containers on account of the types of fruits transported. Shippers were concerned about the impact of the merger on the availability of transport in reefer containers from carriers other than Maersk. Moreover the parties were able to identify those shippers dependent on reefer containers and eventually to price discriminate against them. There were few competitive constraints because the only independent competitor was not deploying significant reefer capacity on the trade. In view of the strong position of the parties for the transport of reefer containers, the

Commission concluded that the transaction raised serious doubts as to its compatibility with the common market. To meet the Commission's concerns, Maersk offered to divest PONL's business dealing with the transport of cargo from South Africa to Europe.

On 19 January 2006 the Commission approved the acquisition of PONL's business on the trade between the EU and South Africa by Mitsui O.S.K. Lines (MOL).

### *TUI/CP Ships*

The activities of Hapag-Lloyd and CP Ships are geographically largely complementary with the exception of the North Europe–North America and Mediterranean–North America trades. In these two trades the merger resulted in a creation of the most important individual shipping company. The market investigation confirmed serious doubts as to the compatibility of the transaction due to the coordinated effects in these two trades and could thus be approved in phase I of the proceedings only subject to commitments submitted by the parties which eliminated these concerns.

In the shipping trade lanes between Europe and North America, Hapag-Lloyd was a member of two conferences — TACA conference on the North Europe trade and USSEC on the Mediterranean trade. As CP Ships was not a member of these conferences, the merger would create a link between the leading players on the shipping trade lanes belonging to these two conferences and CP Ships. The combined market shares of these interlinked carriers were substantial, on both trades significantly exceeding 50%. Before the merger, CP Ships was the most important individual competitor not linked to these conferences and able to provide a competitive constraint. Following the transaction there would be only limited external competition faced by the carriers interlinked due to their membership in TACA and USSEC respectively. In order to remove the competition concerns identified by the Commission, TUI proposed to withdraw Hapag-Lloyd from these two conferences.

### *CMA CGM/Delmas*

The transaction by which CMA CGM acquired Delmas and indirectly also joint control over the shipping company Sudcargo led to overlaps in container liner shipping on the Europe-East Africa trade and the South Europe–Maghreb trade. Furthermore, the parties were both active in Ro-Ro shipping services on the South Europe–Maghreb trade. Ro-Ro shipping services are defined as the regular transport of wheeled cargo (trucks, cars) with their load and can be distinguished from the transport of containerised or bulk cargo as well as

<sup>(11)</sup> Namely North Europe–North America, North Europe/Mediterranean–Middle East, North Europe/Mediterranean–East Africa, North Europe/Mediterranean–Caribbean/Central America, North Europe/Mediterranean–East Coast South America, North Europe/Mediterranean–West Coast South America, North Europe/Mediterranean–Australia/New Zealand.

from the transport of new or second-hand vehicles which are for sale <sup>(12)</sup>. Ro-Ro shipping services are also liner services with conferences and consortia and thus the same principles apply for the merger assessment of these services as for container liner services.

The Commission found that although the transaction would result in an increase of the market

share of the parties on some trade routes between Africa and Europe in the market for container shipping services and Ro-Ro services, this would not be sufficient to impede effective competition. Further, the transaction would not have the result of appreciably strengthening conferences or consortia to which the parties are members. The transaction was therefore cleared without conditions in phase I of the proceedings.

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<sup>(12)</sup> See for the transportation of vehicles M.2879 — Wallenius/Wilhelmsen.

## La filialisation des services financiers de La Poste (France): une application concrète de la jurisprudence Chronopost

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Le 26 octobre 2005, les autorités françaises ont notifié à la Commission leur décision de placer les activités bancaires et d'assurances de La Poste dans une filiale <sup>(1)</sup> (ci-après La Banque Postale) détenue initialement à 100% par La Poste et créée sous la forme d'une Société Anonyme à directoire et conseil de surveillance ayant le statut d'établissement de crédit.

Le 21 décembre 2005, la Commission a donné son feu vert au transfert des activités bancaires et financières de La Poste à sa filiale, La Banque Postale. La décision de la Commission porte exclusivement sur les mesures induites par la filialisation des services financiers de La Poste et susceptibles de contenir des éléments d'aides d'Etat au titre de l'article 87 paragraphe 1 du traité CE. A l'issue d'une analyse minutieuse, la Commission a estimé que la filialisation en tant que telle des activités financières de La Poste n'induirait pas d'avantage économique dans le chef de La Banque Postale, les autorités françaises ayant pris des engagements pour garantir ce résultat.

La Commission a en particulier examiné de manière approfondie les conditions financières du recours de La Banque Postale aux moyens de La Poste. A la lumière de la jurisprudence Chronopost <sup>(2)</sup>, la Commission a considéré que les rémunérations payées par La Banque Postale à La Poste pour l'utilisation de ses personnels et de son réseau n'incorporaient pas d'éléments d'aides d'Etat au sens de l'article 87, paragraphe 1, du traité CE.

L'analyse de la rémunération des prestations de service par La Poste à La Banque Postale a pour cadre référentiel l'arrêt Chronopost de la Cour du 3 juillet 2003, à la lumière des conclusions de l'Avocat Général TIZZANO dans la même affaire.

En substance, l'arrêt de la Cour de Justice indique que l'appréciation des aides d'Etat et, en particulier l'interprétation du concept de «conditions normales de marché», doit reconnaître la spécificité des entreprises dotées de réseaux qui, histori-

quement, se sont développés pour répondre à des missions d'intérêt économique général au sens de l'article 86, paragraphe 2, du traité CE.

### 1. De l'absence de «conditions normales de marché» et de l'inapplicabilité du test de l'investisseur privé

L'arrêt Chronopost apprécie, à la lumière des règles en matière d'aides d'Etat, la rémunération des prestations de services d'un opérateur postal national, La Poste, à sa filiale, SFMI-Chronopost, société de droit privé, opérant sur le marché du courrier express.

Afin de vérifier si cette rémunération confère à la filiale un avantage économique au sens de l'article 87, paragraphe 1, du traité CE, la Cour désigne comme premier temps de l'analyse le concept de «conditions normales de marché».

La Cour indique d'abord que La Poste est chargée d'une mission d'intérêt économique général au sens de l'article 86, paragraphe 2, du traité CE, le service postal universel qui consiste à assurer la collecte, le transport et la distribution du courrier, au profit de tous les usagers, sur l'ensemble du territoire, à des tarifs uniformes et à des conditions de qualité similaires. Afin d'assurer cette mission, «La Poste a dû se doter ou a été dotée d'infrastructures et de moyens importants (le «réseau postal») lui permettant de fournir le service postal de base à tous les usagers, y compris dans les zones à faible densité de population, dans lesquelles les tarifs ne couvraient pas les coûts générés par la fourniture du service en cause.»

«En raison des caractéristiques du service que le réseau de La Poste doit permettre d'assurer, la constitution et le maintien de ce réseau, [impliquant des coûts fixes très élevés], ne répondent pas à une logique purement commerciale». Par conséquent, le réseau de La Poste n'aurait jamais été créé par une entreprise privée ; il n'a donc pas d'équivalent sur le marché.

La Cour ajoute que la prestation de l'assistance logistique et commerciale de La Poste à sa filiale ne peut être dissociée du réseau de La Poste «puisque celle-ci consiste précisément dans la mise à disposition de ce réseau sans équivalent sur le marché.»

<sup>(1)</sup> Les modifications apportées au cadre réglementaire des activités financières de La Poste sont incluses dans la loi n° 2005-516 relative à la régulation des activités postales du 20 mai 2005 (ci-après la loi postale).

<sup>(2)</sup> CJCE, 3 juillet 2003, Affaires jointes C-83/01 P, C-93/01 P et C-94/01 P, Chronopost, Rec. I-6993.

En ce sens, la prestation de service ne peut faire l'objet d'une valorisation de marché séparée du réseau postal.

La Cour conclut que, pour ces raisons, la situation de l'opérateur postal national n'est pas comparable à celle d'un groupe d'entreprises privées, n'opérant pas dans un secteur réservé, groupe qui n'aurait jamais développé un tel réseau.

«Dans des conditions normales de marché, une entreprise privée qui ne serait pas tenue de maintenir un réseau postal public comparable à celui de La Poste pour garantir la fourniture du service postal universel (en recevant en échange une compensation adéquate de l'État notamment sous la forme d'un monopole légal) ne disposerait pas d'un tel réseau postal et ne pourrait dès lors fournir à l'une de ses filiales une assistance logistique du type de celle en examen.»

En l'absence de «conditions normales de marché», l'Avocat Général TIZZANO explique que pratiquer le test de l'investisseur privé n'est pas à même d'exclure la présence d'un avantage économique dans le chef de la filiale. En effet, «une entreprise privée qui se trouverait dans la même situation que La Poste serait en effet amenée à fixer le montant de la contrepartie de manière à optimiser les profits du groupe dans son ensemble, en tenant naturellement compte également des bénéfices distribués par la filiale opérant dans le secteur du courrier express. Une telle entreprise pourrait ainsi se contenter d'une contrepartie réduite dans le cadre d'une stratégie globale destinée à renforcer la position concurrentielle de la filiale dans le marché du courrier express. Celle-ci pourrait ainsi placer à l'avantage exclusif de la filiale toutes les économies d'échelle résultant de l'utilisation d'un réseau postal déjà détenu pour la fourniture du service universel, aux fins d'augmenter les bénéfices générés par elle et, par là même, l'ensemble des profits du groupe.»

L'avantage économique résulterait «non des économies d'échelle réalisables «dans des conditions normales de marché» à l'intérieur de quelque groupe privé que ce soit, mais du fait d'être contrôlée par une entreprise chargée de fournir le service postal universel, laquelle, à ce titre, détient un réseau postal public financé par l'État par la concession d'un monopole légal.»

Pour pouvoir exclure de manière certaine l'absence d'avantage économique, «il y aurait lieu de comparer le prix versé à La Poste avec celui que cette dernière aurait pu obtenir si elle avait offert sur le marché son assistance logistique et commerciale aux sociétés de courrier express intéressées.»

La Cour conclut que, à défaut d'éléments de référence concrets et objectifs sur le marché, les «conditions normales de marché», qui sont nécessairement hypothétiques, doivent s'apprécier par référence à des éléments objectifs et vérifiables qui sont disponibles. «En l'occurrence, les coûts supportés par La Poste pour la fourniture à sa filiale d'une assistance logistique et commerciale peuvent constituer de tels éléments objectifs et vérifiables».

*Dans le cas d'espèce, la Commission a estimé que le raisonnement développé par la Cour de Justice dans l'arrêt Chronopost était transposable à La Banque Postale étant entendu que:*

- *comme la maison mère est identique, son réseau n'a pas d'équivalent sur le marché;*
- *la prestation des services financiers par La Poste en faveur de La Banque Postale est indissociablement liée au réseau de La Poste.*

*Par conséquent, les «conditions normales de marché» dans le cas d'espèce doivent s'apprécier par référence aux coûts supportés par La Poste pour la mise à disposition du réseau postal dans le cadre de la prestation des services financiers, c'est-à-dire pour l'utilisation par La Banque Postale de tous les éléments du patrimoine de La Poste. Par éléments du patrimoine, la Commission entend tout élément matériel ou immatériel faisant partie intégrante du réseau de La Poste dont la constitution et le maintien relèvent d'une mission d'intérêt économique général. Ainsi, les rémunérations payées par La Banque Postale à La Poste doivent être analysées sur la base des coûts réels de La Poste et non sur la base d'une valorisation hypothétique des éléments de son patrimoine.*

## 2. La qualification de la mesure au titre de l'article 87, paragraphe 1

Dans son arrêt Chronopost, la Cour envisage un double test pour exclure la présence d'un avantage économique dans le chef de la filiale et donc l'existence d'éléments d'aide dans la rémunération payée par la filiale à sa maison mère pour la prestation de services.

### 2.1. Du test de substitution développé par la Cour de justice

La Cour indique que : «Sur cette base, l'existence d'une aide d'État en faveur de la SFMI-Chronopost peut être exclue si, d'une part, il est établi

que la contrepartie exigée couvre dûment tous les coûts variables supplémentaires occasionnés par la fourniture de l'assistance logistique et commerciale, une contribution adéquate aux coûts fixes consécutifs à l'utilisation du réseau postal ainsi qu'une rémunération appropriée des capitaux propres dans la mesure où ils sont affectés à l'activité concurrentielle de la SFMI-Chronopost, et si, d'autre part, aucun indice ne donne à penser que ces éléments ont été sous-estimés ou fixés de manière arbitraire.»

Le test de substitution développé par la Cour est composé de deux branches.

- a) La détermination de l'assiette des coûts totaux de la maison mère et son allocation aux activités de la maison mère

Il incombe à la Commission de vérifier :

- D'une part, si l'assiette des coûts totaux de La Poste, engagés pour la fourniture d'activités économiques, qui servira de base au calcul de la rémunération payée par la filiale à sa maison mère n'est pas sous-estimée.

*Dans le cas d'espèce, l'architecture de fonctionnement de La Banque Postale induit la perméabilité entre La Poste et la Banque Postale. Cette perméabilité naît de l'effet combiné de deux éléments: l'utilisation par la Banque Postale des moyens humains et matériels de La Poste et la rémunération de la fourniture de ces services sur la base des coûts supportés par La Poste. Cette architecture implique que toute modification dans les coûts de production de La Poste utilisés par La Banque Postale est automatiquement transférée à La Banque Postale. Ainsi, en cas d'avantage économique dans le chef de La Poste, les coûts générés par la prestation de service et attribués aux services financiers seraient réduits à due concurrence.*

*La Commission a donc vérifié que l'assiette des coûts totaux de La Poste qui sert de base au calcul des rémunérations payées par La Banque Postale à La Poste pour l'utilisation de son réseau n'était pas sous-estimée. En particulier, la Commission s'est assurée de ce que le financement de La Banque Postale se fasse aux conditions de marché de sorte que La Banque Postale ne bénéficie pas indirectement de la présence d'une garantie illimitée de l'Etat au niveau de La Poste.*

- D'autre part, si le calcul des coûts attribuables aux services prestés par la maison mère à sa

filiale repose sur des principes de comptabilité analytique appliqués de manière cohérente et objectivement justifiables.

*Dans le cas d'espèce, la Commission a mené une analyse approfondie de la comptabilité analytique de La Poste pour s'assurer que les coûts des facteurs de production de La Poste utilisés par La Banque Postale sont répercutés à cette dernière sur la base de principes de comptabilité analytique «appliqués de manière cohérente et objectivement justifiable». En particulier, la Commission a vérifié que les métiers de La Poste supportaient tous les coûts directs et indirects de La Poste engagés pour la fourniture d'activités économiques.*

- b) Le test de correspondance entre le coût de prestation du service et la rémunération payée par la filiale pour le service presté

Afin d'exclure la nature d'aide de la mesure, la Commission doit enfin pratiquer un test de correspondance entre la rémunération payée par la filiale à sa maison mère et le coût total de la prestation de services pour la maison mère, lequel est calculé sur la base des principes de comptabilité analytique vérifiés au préalable.

La deuxième branche du test envisagé par l'arrêt Chronopost pose des principes qui permettent d'encadrer l'assiette des coûts de La Poste à couvrir par la rémunération payée par sa filiale pour la prestation du service concurrentiel. Ces principes reposent sur les notions économiques de coûts variables et de coûts fixes.

Etant entendu qu'un coût fixe est soit directement, soit indirectement attribuable à une activité, la Commission estime que l'expression «coûts fixes consécutifs à l'utilisation du réseau postal» désigne nécessairement les coûts fixes qui sont attribuables directement ou indirectement à la prestation du service par la maison mère à la filiale. Les coûts fixes indirectement attribuables aux activités concurrentielles doivent couvrir une partie adéquate des coûts fixes résultant du maintien du réseau postal public (en ce compris les coûts fixes communs supportés tant pour la prestation des services concurrentiels à la filiale que pour la fourniture du service universel).

De la sorte, la Commission peut vérifier si «les économies d'échelle résultant de l'utilisation du réseau postal public de La Poste ont été réalisées à l'avantage exclusif de SFMI-Chronopost et si cette

dernière a ou non contribué proportionnellement à la couverture des coûts supportés par La Poste pour le maintien dudit réseau».

Par conséquent, conformément à l'arrêt de la Cour, la Commission considère que l'assiette des coûts de la maison mère à couvrir par la rémunération payée par sa filiale doit inclure tous les coûts attribuables à la prestation du service, c'est-à-dire tous les coûts variables supplémentaires occasionnés par la fourniture du service et une contribution adéquate aux coûts fixes directement et indirectement attribuables à la prestation dudit service (en ce compris lesdits coûts communs, supportés tant pour l'assistance en question que pour la fourniture du service universel) ainsi qu'une rémunération appropriée des capitaux propres dans la mesure où ils sont affectés à l'activité concurrentielle. Le caractère adéquat de la contribution aux coûts fixes doit s'estimer en fonction de l'utilisation relative du réseau postal par les activités concernées.

*Dans le cas d'espèce, la Commission a vérifié que les rémunérations payées par La Banque Postale à La Poste couvraient dûment les coûts visés par l'arrêt Chronopost, c'est-à-dire les coûts variables, les coûts fixes qui sont attribuables directement ou indirectement à la prestation des services par La Poste à La Banque Postale et une rémunération appropriée des capitaux propres dans la mesure où ils sont affectés aux services financiers.*

### **3. Conclusion**

Sur la base de cette analyse approfondie, la Commission a conclu que les conditions financières du recours de La Banque Postale aux moyens de La Poste pour la réalisation de son objet ne conféraient pas d'avantage économique à La Banque Postale et donc ne constituaient pas des aides au titre de l'article 87, paragraphe 1, du traité CE.

## Commission rules subsidy for digital terrestrial television (DVB-T) in Berlin-Brandenburg illegal

*Christof SCHOSER, Directorate-General Competition, unit H-3*

### I. Introduction

On 9 November 2005, the Commission took a final decision regarding subsidies for the introduction of digital terrestrial television (DVB-T) in the German *Länder* of Berlin and Brandenburg. It decided that the subsidies worth some € 4 million granted to commercial broadcasters for the use of the DVB-T network violated European state aid rules because they were liable to distort competition. The subsidies, which had not been notified to the Commission, must be paid back insofar as already paid over to broadcasters. This concerns about half the total amount of the subsidies. This is the first time the Commission has in the area of DVB-T come to decision after having conducted a formal investigation.

### II. Background: The digital switchover in Berlin-Brandenburg

The Commission's investigation into the matter was prompted by complaints lodged by cable operators. These were concerned that the subsidies targeted only the terrestrial platform and thus risked to distort competition among the different TV transmission platforms. On 14 July 2004, the Commission opened a formal investigation procedure and received subsequently comments from several market operators.

The present decision is to be viewed against the background of the digitisation of broadcasting, which is affecting all the currently commonly available transmission platforms, i.e. cable, satellite and terrestrial. The subsidies in question were for terrestrial transmission, which, in analogue mode, can normally accommodate fewer than 10 television channels. In Berlin, however, due to special circumstances up to 13 channels could be broadcast terrestrially in analogue mode. After digitisation, some 30 channels are broadcast terrestrially.

Since the emergence of cable and satellite in the 1980s, the use of terrestrial broadcasting has fallen sharply in Germany. The household reception figures for primary television sets in Germany were on 1 January 2005: 5.2% terrestrial, 55.9% cable and 38.9% satellite. For Berlin-Brandenburg, the share of terrestrial reception was estimated at a similar level.

The *Länder* of Berlin and Brandenburg were the first region in Germany to make joint preparations for the switchover from analogue to digital terrestrial television ('switchover'). In a switchover agreement concluded on 13 February 2002, the media authority of Berlin-Brandenburg ('Mabb'), the public service broadcasters ('PSBs') ARD, ZDF and RBB and the commercial broadcasters RTL Group and ProSiebenSat.1 <sup>(1)</sup> decided on the basic features of the switchover, including a schedule for the individual phases of the switchover and the allocation of a multiplex to each of the five operators <sup>(1)</sup>. The agreement did not, however, specify to what extent the digital switchover would be subsidised.

The first phase of the switchover was launched on 1 November 2002, involving two multiplexes. On 28 February 2003, analogue broadcasting of the national commercial channels came to an end and DVB-T transmission was significantly expanded (second phase). On 4 August 2003 analogue terrestrial broadcasts by all other broadcasters were halted (analogue switch-off).

The rollout of DVB-T concerns in particular two types of operators which may or may not be integrated: network operators, which take care of the transmission of broadcasting signals, and broadcasters, which package content. Both types of operators need to obtain licences for the transmission via certain frequencies.

The network licences were awarded by the national telecommunications regulator at the request of Mabb. As a result, T-Systems, a subsidiary of Deutsche Telekom, was allocated six multiplexes and RBB two multiplexes <sup>(2)</sup>. In practice, T-Systems also operates the two multiplexes allocated to RBB due to an agreement between the two operators. Following a second frequency allocation procedure, one national multiplex was also allocated to T-Systems.

The broadcasting licences were awarded by Mabb. Priority had to be given to the programme channels which were already broadcast in analogue form.

<sup>(1)</sup> A multiplex is a block of digital frequencies used for broadcasting and, in the case of Berlin-Brandenburg, has four channels.

<sup>(2)</sup> On account of coordination problems with Poland, the regulator did not in the end allocate one of the multiplexes foreseen for T-Systems.

The total transmission capacity for broadcasting consisted in seven multiplexes. It was finally allocated as follows: three entire multiplexes and one programme channel on a fourth multiplex to the PSBs. Two programme channels on the fourth multiplex were allocated to FAB and BBC World, which were already present on the analogue network. An entire multiplex was allocated to each RTL Group and ProSiebenSat.1. All this capacity was allocated by decision of Mabb without an open procedure. The capacity of one additional multiplex was opened up to tender individually and finally awarded to Eurosport, Viva Plus, DSF and SWR. The remaining transmission capacity was earmarked for providers of other forms of broadcasting, in particular mobile television transmission (DVB-H).

### III. Mabb's financial support for the switchover

Mabb provided financial assistance for the digital switchover. It concluded with the commercial broadcasting groups ProSiebenSat.1 and RTL Group contracts containing the following key points as regards the assistance to be granted:

- a) Mabb allocated to each of the two broadcasting groups for a period of seven years a multiplex with four programme channels.
- b) The broadcasting groups undertook to broadcast their main television channels via DVB-T for five years as of 1 March 2003, irrespective of the actual coverage.
- c) Mabb made available to the two broadcasting groups grants towards the costs of the digital terrestrial transmission. In the case of RTL Group, the grant amounted to € 265 000 a year, or € 66 250 per programme channel. In the case of ProSiebenSat.1, it amounted to € 330 000 a year, or € 82 500 per programme channel. The grants were payable as of 1 March 2003 for a period of five years.

Mabb concluded similar agreements with FAB and BBC World. For these broadcasters too, Mabb provided a grant towards transmission costs for a period of five years. As for the broadcasters that were *not* broadcast terrestrially before the switchover, Mabb concluded a third type of agreement which was initially valid for only one year. Mabb provided them with a grant of € 65 000 each. In 2004, the respective licences and the public funding were extended to five years. The total amount of Mabb's funding for commercial broadcasters came to some € 4 million. Until the end of 2005, Mabb had granted about half of this amount.

Mabb financed the grants towards commercial broadcasters' transmission costs from its own budget, which essentially receives 2% of the licence fee income accruing to Berlin and Brandenburg. Mabb granted the funding described above only to the commercial broadcasters. The PSBs financed the costs of DVB-T transmission out of the licence fee income accruing directly to them.

## IV. Assessment

### IV.1. Did Mabb's financial support constitute state aid?

**State resources:** In the Commission's view, the financial support granted by Mabb constituted state resources. It was funded from Mabb's budgetary resources. Mabb is a public authority established by the State Media Treaty of the *Länder* of Berlin and Brandenburg. More specifically, the State Media Treaty assigns to Mabb the task of supervising the digital switchover and adopting the necessary measures.

**Economic advantage:** At the level of commercial broadcasters, the subsidy granted by Mabb covered some of their transmission costs via the DVB-T network for a period of five years. The support thus relieved them of expenses which were part of their normal operating costs. Germany argued that the subsidy compensated the commercial broadcasters for giving up their analogue terrestrial transmission ('ATT') licences and did not therefore confer an economic advantage upon them. There are, however, a number of reasons which contradict this argument: The commercial broadcasters present in ATT had already been compensated by the award of DVB-T licences, the subsidy was not conceived or calculated as a compensation payment and Mabb could have limited the ATT licences to the switchover date and could thus have avoided any potential compensation claims.

At the network level, it appeared that the network operator T-Systems received an indirect advantage stemming from Mabb's subsidy<sup>(3)</sup>. Under agreements between Mabb and the commercial broadcasters — of which the financial support was an integral part — T-Systems had the guarantee that the two major commercial broadcasters in particular, which together account for about 90% of total German TV advertising revenue and for close on half of German TV viewing, would use its network for five years. In addition, compared

<sup>(3)</sup> Even though RBB rolls out part of the DVB-T network (two multiplexes), it cannot be considered a beneficiary because these multiplexes are used only by PSBs which do not receive any subsidy from Mabb.



with a situation in which no subsidy is granted, T-Systems might have been able to charge commercial broadcasters higher transmission prices than under normal market conditions because the subsidy provided the broadcasters with more funds for this particular purpose. It is however not possible to establish to what extent the transmission fees charged by T-Systems and not being subject to price regulation exceed market prices.

**Distortion of competition:** The Commission found that the allocation procedures neither for the network licences nor for the broadcasting licences were such as to ensure that the selective economic advantage deriving from Mabb's subsidy would be eliminated or minimised so as to prevent a distortion of competition. Indeed, at the level of broadcasters, the majority of licences were not subject to any open procedure. At network level, the tender procedures were characterised by a high degree of uncertainty and intransparency coupled with a strong position of the incumbent terrestrial network operator T-Systems.

The measure also distorted competition in that the share of the transmission costs covered by the subsidy was not the same for all commercial broadcasters. The share varied between 28% and 50% per DVB-T channel<sup>(4)</sup>. Moreover, RTL Group and ProSiebenSat.1 were allocated more channels in DVB-T than previously in ATT. In contrast, FAB and BBC World continued to have only one terrestrial channel each and, accordingly, received funding only for this one channel.

The Commission also considered that the measure was **selective** in so far as the subsidy was granted to broadcasters who used the DVB-T platform rolled out by T-Systems and did not, for example, support broadcasters who used other transmission platforms. The measure can therefore be regarded as 'sectoral aid'. On the *retail market*, the selective support and 'artificial' development of DVB-T affected the viewers' decision between the different broadcasting platforms. In the case of Berlin-Brandenburg, there was also empirical evidence of the substitutability between the different transmission platforms and, more particularly, of the competitive effect of the DVB-T launch on cable.

**Effect on trade:** Finally, the Commission considered that the measure affected trade between Member States in view of the international activities of the companies directly and indirectly concerned, for example, the RTL Group, ProSiebenSat.1, Deutsche Telekom.

<sup>(4)</sup> The share varies not only as a result of differences in the absolute amount of the subsidy per DVB-T channel but also because of differences in the channel transmission prices as charged by T-Systems.

## IV.2. *Is the aid compatible?*

In the final decision, the Commission specified a number of principles to consider when assessing the compatibility of public support for the digital switchover. The present article is however focused on the specific case of Berlin-Brandenburg.

### *Did the aid correct a market failure?*

The Commission confirmed that the digitisation of broadcasting in general is an objective of common interest. There is, however, no general justification why only the digitisation of the terrestrial platform should be aided and not that of other transmission platforms. In order to decide whether the aid was necessary and proportionate, the Commission tried to identify the presence of market failures specific to switchover on the terrestrial platform.

The Commission recognised that the digital switchover may indeed have been hampered by two types of market failures: a coordination problem between market players, which must agree on a timetable in order to ensure a short switchover period, and by positive externalities because the *social* benefit of more channels and services in the DVB-T network may exceed the *private* benefit of the incumbent broadcasters in switching since they risk, for example, being exposed to more competition for audience and advertising.

While these market failures may, in principle, justify a departure from the principle of technological neutrality, they could not serve as justification for the aid granted in the present case. The broadcasters did not own the frequency spectrum but operated on the basis of licences limited in time. Accordingly, the authorities could have resolved the coordination problem by setting a common expiry date for all analogue licences. This was the approach followed, for example, in Bavaria. Moreover, in the switchover agreement the commercial broadcasters RTL Group and ProSieben Sat.1 had committed to the digital switchover before it was clear that they would receive subsidies. The Commission also considered that the aid was not an appropriate instrument for encouraging a prompt analogue switch-off and the release of frequencies. Regulatory intervention in respect of the transmission licences was, once more, an example of a less distortive means of achieving the same goal and realising the positive externalities.

The Commission considered, moreover, that there were no indications for other types of market failures. In particular, it did not find any convincing evidence that the digitisation of broadcasting transmission in Berlin-Brandenburg was hampered by a structural competition problem or that DVB-T could help in resolving certain market

rigidities. Instead, the market appeared capable of supporting various platforms so that the use of state aid to steer the market in a certain direction was not needed and might discourage the development of alternatives such as DSL. The Commission also rejected the view that the existence of uncertainty may have prevented innovations in this market. As suggested by the launch of other transmission platforms (satellite, ADSL), there was no particular reason to believe that the market could not cope with this type of risk. Moreover, there are *Länder* — Hessen is one example — in which DVB-T was launched without public support.

The Commission also investigated whether the aid could be justified by the promotion of innovation and specific advantages of the terrestrial platform. It was suggested that the DVB-T network would serve to promote innovation by offering interactivity and additional capacity for new media and telecom services. It would also have specific advantages such as portability and mobility. However, technical constraints limit the use of the DVB-T network for interactivity and mobile reception. Moreover, in Berlin-Brandenburg neither the capacity allocation nor the public support was focused on any innovative media or telecom services in particular.

Accordingly, the Commission was not convinced that the aid was an appropriate, necessary and proportionate instrument to correct a market failure and to promote the roll-out of DVB-T.

*Did the aid compensate a service of general economic interest?*

The Commission considered, firstly, that national authorities have to define a service of general economic interest ('SGEI') clearly and entrust it explicitly to a particular undertaking. In the present case, Germany seemed to have made the SGEI argument on an *ad hoc* basis. In fact, the

alleged public service compensation was paid to the *commercial* broadcasters, which, in contrast to the PSBs, were not charged with any public service task. Instead, supporting the transmission costs of commercial broadcasters conferred an advantage on their normal commercial operation.

The arguments that the aid was needed to achieve digitisation of broadcasting transmission and to promote pluralism are not specific to the terrestrial platform. Cable and satellite can also contribute to the achievement of such objectives. Since these alternative platforms have greater transmission capacity, it appears that they are at least equally suitable for achieving a quick and smooth switch-over process and that they also have an important role to play in ensuring pluralism through a broad range of broadcasting channels.

Other SGEI arguments invoked by Germany, such as the promotion of innovation and the strengthening of competition among different TV platforms, were dismissed essentially on the same grounds as noted above. There were serious doubts as to the necessity and the proportionality of the aid in respect of these objectives.

## V. Conclusion

The Commission concluded that the subsidy granted by Mabb to the commercial broadcasters constituted aid within the meaning of Article 87(1). The aid is not compatible with the common market. It was not notified by the Member State to the Commission and was illegally put into effect without Commission authorisation. It therefore had to be recovered from the commercial broadcasters involved.

## State aid to digital decoders: proportionality is needed to meet common interest

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### 1. Introduction

In December 2005 the Commission decided to open formal investigation proceedings on the subsidy provided by Italy to consumers buying a certain type of decoders allowing the view of digital television programs. The decision is relevant for various reasons. It clarifies that even state aid measures which pursue an objective of common interest — as in this case the digitisation of TV — are subject to control of proportionality and should not introduce unnecessary distortions. It discusses the scope of the Article 87(2)(a) derogation for measures having social character and the qualification as state aid of advantages granted indirectly to undertakings. The decision also provides an example of how the compatibility of an aid measure can be discussed in relation to its ability to correct a market failure or address a cohesion problem.

### 2. Description of the measure

#### 2.1. The context

The Commission's investigation into the matter was prompted by two complaints lodged by competitors of incumbent terrestrial television operators in Italy, namely Europa 7 — an Italian company with a broadcasting concession<sup>(1)</sup> — and Sky Italia — the monopolist in the Italian market for satellite pay-TV broadcasting.

The measure is to be viewed against the background of the digitisation of broadcasting, which is affecting all the currently commonly available transmission platforms, i.e. cable, satellite and terrestrial<sup>(2)</sup>. The prime benefit of digitisation is the increased transmission capacity, which is particularly relevant for terrestrial TV in view of the limited availability of frequency spectrum. In two communications between 2002 and 2005 the Commission expressed its support to the digitisation of broadcasting.

There are in Italy two main TV broadcasting platforms: satellite, on which the main free to air chan-

nels are available plus those of Sky Italia accessible via subscription or pay per view agreements; and terrestrial, on which operate 4 national broadcasters — RAI (free to air), Mediaset (free to air and pay per view), La 7 (free to air and pay per view) and Prima TV (free to air) — and 78 local operators. For the time being, cable — operated by Fastweb — and X-DSL — operated by Fastweb and Telecom Italia's Rosso Alice — have small penetration.

Terrestrial remains the major means of television viewing in Italy, with a penetration of roughly 19 millions households over a total of 22 millions. The main players in terrestrial TV are the public service broadcaster (RAI) and commercial broadcaster Mediaset, each with three channels and accounting together for approximately 90% of the TV audience in Italy. Penetration of satellite TV mostly consists of the 3 million customers subscribing to Sky Italia. At the end of 2005 the two digital platforms — terrestrial and satellite — were expected to have more or less the same number of viewers<sup>(3)</sup>;

The aid in question is for terrestrial transmission, which in Italy is the only platform to still use analogue mode. Digital mode can normally accommodate more television channels than analogue mode. As from the end of 2003 digital transmissions started alongside with analogue broadcasting (so called 'simulcast phase'). The switch over to the digital mode was to be completed as from the 1 January 2007 and the transmission in analogue mode should be switched off.

In the meantime, according to the 'Gasparri Law'<sup>(4)</sup> regulating the sector in Italy, only broadcasters already transmitting with the analogue technology are permitted to apply for experimental digital authorisations and/or digital licences. There is no formal obligation for analogue operators to give back the frequencies used for transmissions in analogue format after the switch-off.

<sup>(1)</sup> Europa 7, however, has not been able to operate due to the fact that the national authorities never allocated to it the necessary frequencies.

<sup>(2)</sup> Therein DVB-T stands for digital video broadcasting over a terrestrial network. Other forms of digital video broadcasting are DVB-S (by satellite) and DVB-C (by cable).

<sup>(3)</sup> COM(2005) 541 'Communication from the Commission on reviewing the interoperability of digital interactive television services pursuant to Communication COM(2004)541 of 30 July 2004' containing data of June 2005 and projection on the number of consumer benefiting of the measure by the Italian authorities.

<sup>(4)</sup> Law n.112 of May 3, 2004.

In December 2005, five multiplexes (frequencies' blocks including one or more programmes) for digital terrestrial had been licensed in Italy. RAI had two multiplexes, Mediaset one, Telecom Italia/TV International and D-Free (TF1 and HCS) one each. Under the Italian regulatory regime, network operators holding more than one digital licence must give access to 40% of their bandwidth to independent content providers.

The TV market was once characterised by mass viewing of free-to-air TV in terrestrial mode and by pay-TV offer on satellite. The introduction of digital terrestrial TV and the development of cable and Internet are modifying this pattern. Indeed, as from January 2005, Mediaset and Telecom Italia (through LA7) have launched on T-DVB a pay TV service for premier league soccer matches based on prepaid cards. The pay TV services are allowed, in the prepaid card form, by the digital interactive technology embodied in the decoders which are subsidised with the measure.

## 2.2. *The measure*

The measure provides for a public grant of €150 in 2004 (€70 in 2005) to be awarded to consumers who purchase or rent decoders capable of receiving programmes broadcast using digital terrestrial technology and correlative interactive services, and earmark a total budget of €220 million for the purpose over the years 2004 — 2005. It has to be remarked that the subsidy is not available for decoders not receiving digital terrestrial signals even if they allow the reception and utilization of the interactive services. The grant for decoders for the cable technology is conditional on the fact that a terrestrial content providers had agreed with the cable managers terms for the provision of the T-DVB signal via cable.

More than 1.350.000 citizens have bought a subsidized decoder. It is suggested that the large volume of sales allowed scale economies in production and a fall in the consumer price of interactive decoders from 300/350 Euro to around 150 Euro.

The main reasons put forward by the Italian Authorities to justify the measures are: (i) improved use of frequencies expanding pluralism and TV offering; (ii) promotion of economic development based on information and communication technologies; (iii) dissemination of e-society services among the very many TV users thanks to the interactive operability of the decoders; and (iv) advancement of the European Community policy in favour of the development of open standards.

The Italian Authorities clarified that the subsidy is granted to consumers for purchasing or leasing a decoder that allows the reception of a non-

encrypted digital signal with 'no additional cost for the consumers and the content provider'. According to the Italian authorities, 'reception of non-encrypted digital signal' has to be interpreted as the decoder's capacity of executing any interactive service provided by any broadcaster. This would therefore be a synthetic expression to indicate that the decoder must permit non-encrypted interactive functions (i.e. it must be not only 'interactive' but it also must allow for 'interoperability'). These are decoders with an open standard — i.e. of the kind supported by Commission's policy — for the programming interface (API) of which MHP is the almost unique example.

## 3. **Does the measure constitute aid?**

At this stage the Commission considered that the measure at hand could constitute state aid, since all conditions laid down in article 87(1) appeared to be fulfilled. The most relevant aspect is that the Commission considered that, even if the direct beneficiaries are final consumers, the measure could benefit indirectly (i) the producers of decoders; (ii) the television broadcasters operating on digital terrestrial platforms; and (iii) the operators of the networks that carry the signal. Since most content providers and network operators in Italy are vertically integrated and each broadcaster is strongly characterised by its presence on a particular platform, the main concern for the Commission was the consequent distortion on the markets for TV audience, the advertising market for free to air TV and the subscriptions market for pay TV.

As for the broadcasters using T-DVB/C-DVB, the measure helps them in creating and developing their audience at a faster pace, by favouring the diffusion of the technologies necessary for the reception of their signal. The same advantage accrues to the operators of the terrestrial network that are not vertically integrated with broadcasters.

It should be noticed that the complainant Sky Italia took, at its own cost, similar initiatives, like providing its subscribers a free decoder and antenna. Indeed, one has to consider that digital terrestrial broadcasting does not only compete with other free to air offers but also with pay-TV. Examples from commercial practice confirm the link between platform and programming as certain broadcasters market their decoders bundled with pre-paid pay-TV cards. In this respect, the complainant stresses that the aid allows the T-DVB broadcaster to enter the markets related to the pay-TV transmission of football games.

Finally, the Commission doubted that the measure constitutes aid for producers of decoders because it was unclear if it is possible to draw a distinc-

tion between different categories of producers of various types of decoders and because it was also unclear whether the measure selectively favours producers of decoders as a sector. It seemed that the aid does not selectively advantage any type of producer of decoders on the basis of place of production nor that manufacturers of decoders compete with operators in other sectors that cannot benefit indirectly from the measure. Moreover, it was considered possible that the measure in question does not seek, through its object or general structure, to create an advantage for decoders' manufacturers but it is the inherent effect of any such policy. The Commission invited comments on this aspect.

#### 4. Doubts on compatibility

The decision identifies the possible legal grounds for compatibility of this measure as: (i) article 87(2)(a), aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; (ii) article 86(2), providing a derogation for services of general economic interest; and (iii) article 87(3)(c) aid for the development of a certain economic activity.

The Commission held the preliminary view that Article 87(2)(a) derogation did not seem to apply here because, according to Commission's practice, the term social character refers to an aid addressing the need of underprivileged part of the population, which is not the case here. Likewise, the Article 86(2) derogation did not seem to apply to the present case. Indeed, the aid is granted to consumers and it is not intended as compensation for the net additional cost of providing a public service that had previously been clearly defined and formally entrusted.

Finally the decision assesses if the conditions for the application of article 87(3)(c) are fulfilled, i.e. whether the measure develops an economic activity — the digital transmission of terrestrial television signals — without affecting trading conditions to an extent contrary to the common interest.

First, the transition from analogue to digital broadcasting and the diffusion of open standards for interactivity are to be considered objectives of common interest. Indeed, the Commission itself considered that the transition from analogue to digital broadcasting ('digital switchover') has great advantages in terms of more efficient spectrum usage and increased transmission possibilities. These will lead to new and better quality services and to wider consumer choice. Therefore the Commission actively supports digital switchover as underlined in the Action Plan eEurope 2005

and in the two Communications relating to the digital switchover<sup>(5)</sup>; In the communication on interoperability of digital interactive television services<sup>(6)</sup> the Commission also stresses the relevance of 'interactivity' and 'interoperability' and in particular the Commission '*takes measures to promote the voluntary adoption of open standards. The Commission stresses how 'one way of reducing the additional costs to consumers of equipment incorporating standard execution engines such as MHP is to subsidise purchases at the level of the consumer. Member States may therefore offer consumer subsidies.'*

Second, the Commission gauges whether the aid addresses a market failure and, after recognising that the digital switchover may be delayed if the process is left entirely to market forces, it reviews possible justifications for government intervention such as the coordination problem, the compensation for consumers in need to update their analogue equipment, the strengthening of competition between the different distribution platforms, the existence of externalities and the promotion of innovation via the supply of interactivity.

Finally, under 87(3)(c) the Commission has to assess whether the distortions of competition and effect on trade are limited, so that the overall balance is positive. In this case the Commission took the preliminary view that the very design of the measure introduced unnecessary distortions of competition. In particular, the circumstance that satellite operators are explicitly excluded has the effect of strongly distorting competition in the very concentrated pay-TV market. In these circumstances, a subsidy which directs consumers towards one of the platforms can be highly distortive.

Therefore the Commission concluded that the balancing exercise provided for by article 87(3)(c), between positive developments allowed by a given measure and its negative effects on competition indicated that, while the measure addresses objective of common interest, it creates an unnecessary distortion in favour of the incumbent terrestrial television broadcasters. Therefore, at the current stage of the analysis, the Commission is not convinced that the measure, if aid, can be deemed compatible under article 87(3)(c) EC.

<sup>(5)</sup> COM(2002) 263 final, 'eEurope 2005: An information society for all', COM(2003)541 final, "Communication from the Commission on the transition from analogue to digital broadcasting (from digital 'switchover' to analogue 'switch-off')", and COM(2005)204 final, 'Communication from the Commission on accelerating the transition from analogue to digital broadcasting'.

<sup>(6)</sup> See footnote 4.

## The restructuring of Huta Czestochowa — the Commission's decision finding compliance with private creditor test but ordering recovery of some previously granted restructuring aid

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On 5 July 2005, the Commission took a hybrid decision deciding on the one hand that the restructuring of Huta Czestochowa (hereinafter HCz) does not involve state aid. This cleared the way for the sale of the company to the Ukrainian steel producer Donbass. On the other hand, the Commission found that some measures, which were granted prior to the present restructuring, were incompatible restructuring aid, and had to be recovered. This was the first recovery case in a new Member State.

### 1. The restructuring of HCz and the private creditor test

The decision in its positive part is a 'no aid' decision, where the Commission accepted to apply the private creditor test as regards a debt waiver combined with a debt for equity swap, which is as such unprecedented.

In fact, the Commission was confronted with the restructuring of HCz, one of Poland's main steel producers. The company had been in financial difficulties since some time and liquidation proceedings had been commenced at the end of 2002. It had therefore been struck from a list of beneficiaries under the nation steel restructuring programme for Poland, which was the basis for Protocol No 8 to the Accession Treaty of Poland, which exceptionally allowed the listed beneficiaries to obtain restructuring aid <sup>(1)</sup>.

However, in October 2003 the Polish government issued a law which allowed the state to write off public debts in companies in difficulty in order to restructure them. To this end, creditors having claims deriving from public law (e.g. social security or tax office) and from commercial transactions (e.g. from the delivery of energy or loans) were put in two different groups, which in exchange for a waiver of their claims received different assets, which were to be sold in order to pay parts of the claims <sup>(2)</sup>.

(1) Cf. Protocol No. 8 of the Accession Treaty on the restructuring of the Polish steel industry, OJ L 236, 23.9.2003, p. 948.

(2) See for details the discussion of the opening decision in Competition Policy Newsletter 2004, Number 3, p. 69.

The waiver of public debt implied forgiving state revenue, which could have constituted state aid, where no private creditor would not have done the same in a similar situation. To this end, the Commission recalled that according to settled case law, where a debtor in financial difficulties is proposing to reschedule debt in order to avoid liquidation, each creditor must carefully balance the advantage inherent in obtaining the offered sum according to the restructuring plan and the sum he would be able to recover following possible liquidation of the firm; if liquidation brings better proceeds than restructuring, any waiver of debt within restructuring will in principle be state aid <sup>(3)</sup>. In the opening of proceedings on 19 May 2004, the Commission indicated doubts that the waivers, in particular those of the public creditors holding public claims (i.e. the public institutional creditors), meet the private creditor test.

After the Commission had launched its in-depth investigation, Poland produced, with the help of external experts, a comprehensive analysis of all claims concerned, including the proceeds the public creditors could have expected in bankruptcy. These proceeds could now be compared to the proceeds the creditors could expect in restructuring after the debt write off. Because the price of the production assets had risen, given the *hausse* in the steel sector, the amount of claims to be written off had actually been diminished so that restructuring had become more attractive, in particular for the public institutional creditors. Only for three public institutional creditors with strong sureties restructuring remained less favourable than liquidation. They did eventually not agree to the restructuring.

On the basis of the comprehensive analysis of the claims, the Commission was now able to conclude that restructuring offered for every public creditor a better solution than bankruptcy (as regards the three creditors who did not agree to restructuring there existed no more issue of state aid as no claims were waived). This was also the case as regards the public creditors holding commercial claims. However, in one case, there occurred at first sight a

(3) C-342/96 *Tubacex* [1999] ECR I-2459, para. 46; C-256/97 *DMT* [1999] ECR I-3913, para. 21 (and para. 38 of Advocate General Opinion); case T-152/99 *HAMSA*, [2002] ECR II-3049, para. 167.

minimal advantage in liquidation vis-à-vis restructuring. The Commission found that nevertheless the public creditor, which was the local electricity provider, acted within its commercial interest, as it ensured that its client was kept in business instead of being put into liquidation, which would have implied to discontinue the delivery of energy and thus to lose income.

In addition, the Commission found that the evaluation had to be based on a realistic bankruptcy scenario, which takes for example into account that bankruptcy proceedings might be more time and cost intensive than restructuring. Moreover, while the proceeds in restructuring through the sale to a strategic investor were evident, it was not at all ensured that the assets were to be sold for a similar price in bankruptcy proceedings. This finding was confirmed by the behaviour of the private creditors, who were indeed willing to opt for restructuring even if they were losing significantly more in restructuring than in liquidation.

## 2. Recovery of the aid granted between 1997 and 2002

The Commission also investigated whether the company had received any previous restructuring aid prior to the ongoing restructuring. Poland admitted that in anticipation of the national restructuring plan HCz had been provided with restructuring aid amounting to approximately € 4 million. The aid had been granted between

1997 and 2002. The Commission concluded that these aids were incompatible restructuring aid and ordered Poland to recover them.

It should be noted that the respective recovery concerns a point in time dating before accession, where the Commission normally has no jurisdiction to exercise state aid control under Article 88 EC and to order the recovery of illegal aid. However, the recovery was ordered under Protocol No. 8 to the Accession Treaty, which covers a time-frame starting before and continuing after accession. It authorises a limited amount of restructuring aid for certain companies granted during the years from 1997 to 2003, i.e. before accession and forbids any further state aid for restructuring purposes to the steel industry between 1997 and 2006. In that respect, the rules clearly differ from other provisions of the Accession Treaty such as the interim mechanism set out in Annex IV (the 'existing aid procedure'), which only concerns state aid granted before accession in so far as it is 'still applicable after' the date of accession. The Protocol can therefore be regarded as *lex specialis* which, for the matters that it covers, supersedes any other provision of the Act of Accession. Consequently, while Articles 88 EC would normally not apply to aid granted before accession and which is not applicable after accession, the provisions of the Protocol extend state aid monitoring under the EC Treaty to any aid granted for the restructuring of the Polish steel industry between 1997 and 2006.

## **Commission's suspension injunction against illegal tax exempt fund in Greece**

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On 20 October 2005, the Commission opened a formal investigation procedure and in the same decision adopted for the first time a suspension injunction on a tax exempt reserve fund scheme in Greece.

### **Description and assessment**

Article 2 of the Greek Law 3220/2004 allows companies to place up to 35% of their profits from year 2004 and up to 50% from 2003 to special accounting funds. These profits are exempt from the 35% corporate income tax. In order to be eligible for the measure, the companies must operate in one of the 23 specified sectors (among others, production of textile materials and basic metals, manufacturing of automobiles, energy production, mining, intensive agriculture and fishery, large international trading companies and specific tourism undertakings). The funds created are designated to finance investment and operating costs in various projects such as expansion and modernisation of plants and buildings, purchase of new equipment or vehicles, environmentally-motivated investments, leasing costs, studies, training, patent registration, restructuring plans and many others.

The Commission considered this measure to constitute state aid because it, firstly, relieves the undertakings from their obligation to pay tax on a substantial part of their income and thus confers an advantage on them; secondly, state resources are involved, as the Greek state foregoes tax revenues when exempting profits placed in the special accounting funds; it favours only companies

engaged into specific activities in pre-determined sectors, it is thus selective; and finally, affectation of competition and trade cannot be excluded since most of the sectors concerned are involved in intense intra-Community trade. Because Greece introduced the aid without notifying it to the Commission, the measure is unlawful. The measure and its individual provisions were assessed under all relevant provisions of the Community state aid rules. As the measure does not appear to meet the criteria of any of the applicable rules, the Commission expressed its doubts about its compatibility.

### **Suspension injunction**

The Commission had before adopting the decision invited Greece to suspend the aid and to present comments on such a proposal. In their reaction the Greek authorities did not commit themselves to stop exempting profits from years 2003 and 2004. This means that companies that would submit their tax declarations for 2004 could claim directly in front of the tax authorities the benefits from this measure that clearly constitutes unlawful aid. Therefore the Commission has ordered Greece to suspend immediately the granting of state aid before a final decision will be taken.

This is the first time in the recent years that the Commission adopted a suspension injunction. It may serve as a signal that in the future it will not hesitate to use this instrument in cases where competition is distorted through the granting of unlawful aid.



## Exemptions from the fuel excise tax for alumina production

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On 7 December 2005, the European Commission adopted a partially negative decision on full exemptions from the excise tax on mineral oils used in the production of alumina in France, Ireland and Italy. The exemptions date from the 1990s and, although alumina production is an energy intensive process, the aid is not directly related to the current pressure arising from high energy prices. The case illustrates, however, under what conditions aid can be approved. The case is also a good example of confusion on the State aid rules in the light of the Council's competences in the field of energy taxes.

Alumina is a white powder produced from bauxite. It is the raw material for aluminium.

Article 6 of Council Directive 92/82/EEC of 19.10.1992 on the approximation of the rates of excise duties on mineral oils <sup>(1)</sup> established a minimum rate of excise duty on heavy oil. Successive Council Decisions have authorised Ireland and Italy (as from 1993), and France (as from 1997) to exempt from excise duty mineral oils used as fuel for alumina production. The last Council Decision dates from 2001, covering the period until the end of 2006. There is only one producer of alumina in each of the Member States concerned. The exemptions were in fact granted only for alumina production in the regions in which these companies were located, namely the Shannon Region, Sardinia and the Gardanne.

On 1 January 2004 Council Directive 2003/96/EEC restructuring the Community framework for the taxation of energy products and electricity <sup>(2)</sup> became applicable, repealing Council Directive 92/82/EEC. Alumina production is a metallurgical and electrolytic process involving chemical reduction, so the energy used in its production falls outside the scope of the new Directive pursuant to Article 2(4)(b) second indent.

The tax exemptions are highly selective: they benefit only one single production process in only one region and de facto only one beneficiary in each of the Member States. The other conditions of State aid are evidently met as well: the exemption provides an advantage to the beneficiaries which is financed by (foregone) state resources and, as alumina and

aluminium markets are dominated by large conglomerates, the aid is likely to affect trade. The fact that energy use for alumina production does no longer fall within the scope of the new Energy Tax Directive may not change this assessment: it appears unlikely that the exemptions can be considered as general measures within the nature and logic of the respective energy tax systems.

The State aid rules for exemptions from environmental taxes can be found in points 47 and 53 of the Community guidelines on State aid for environmental protection <sup>(3)</sup>. Full exemptions may be justified when the recipient firms conclude agreements with the Member State concerned whereby the firms undertake to achieve environmental protection objectives which have the same effect as the tax measure. Member States must ensure strict monitoring of the commitments entered into by the firms and the agreements must stipulate the penalty arrangements applicable if the commitments are not met. Full exemptions are also allowable where a Member State makes a tax reduction subject to conditions that have the same effect as the agreements.

Without such agreements or conditions, the tax exemption cannot be a full exemption. Part of the tax should remain payable in order to provide firms with an incentive to improve environmental protection. Where the reduction concerns a Community tax, the amount effectively paid by the firms after the reduction must remain higher than the Community minimum. Where the reduction concerns a domestic tax imposed in the absence of a Community tax, the firms eligible for the reduction must nevertheless pay a significant proportion of the national tax. In the Commission's practice, 20% of the tax otherwise payable is generally considered to constitute a significant proportion. These rules apply in the first place to exemptions put in place when the taxes are introduced, but under certain conditions they can also be applied to exemptions from existing taxes.

In their comments, the beneficiaries submitted that they had undertaken significant environmental investments in return for the exemptions. However, they had not concluded any agreements with the Member States concerned. Nor were the tax exemptions subject to conditions that would

<sup>(1)</sup> OJ L 316, 31.10.1992, p. 19.

<sup>(2)</sup> OJ L 283, 31.10.2003, p. 51.

<sup>(3)</sup> OJ C 37, 3.2.2001, p. 3.

ensure the same effect as such agreements. Furthermore it appears that the environmental investments did not go beyond what was necessary to comply with relevant legislation or beyond what was feasible from a commercial point of view. The minimum tax rate established by Directive 92/82/EEC amounted to € 13 per tonne heavy fuel, so for the period that this Directive applied, the Commission concluded that the exemptions constituted incompatible State aid insofar as the beneficiaries did not pay a rate of EUR 13.01 per tonne of fuel. The Commission considered, however, that until its decision to launch a formal investigation procedure, given the specificities of the case and in particular the fact that these exemptions had been authorised by Council Decisions based on Commission proposals, the beneficiaries could legitimately expect that the measures in question did not involve incompatible State aid. So the incompatible aid actually has to be recovered only for the period between 3 February 2002 and 31 December 2003.

As from 1 January 2004, fuel used for alumina production does no longer fall within the scope of the new Energy Tax Directive, so according to the rules the beneficiaries should pay at least a

significant proportion of the tax. Given the significant changes introduced by the new Directive, the Commission will, however, seek further information before reaching a decision for this period. A formal notice inviting interested parties to comment will be published soon in the Official Journal.

In any event, pursuant to the ‘Deggendorf jurisprudence’<sup>(4)</sup>, the Commission may have to require effective recovery from the beneficiaries of all incompatible aid before any further aid can be paid out.

In conclusion, neither Member States nor beneficiaries should rely exclusively on authorisations by the Council under Community provisions on energy taxes. State aid, even when authorised by the Council or falling outside the scope of the new Energy Tax Directive, has to be notified to the Commission and approved before it can be put into effect. The Commission’s practice on exemptions from environmental taxes actually shows that such exemptions may be compatible with the common market. It is, however, up to the Member States to ensure that the conditions of the Environmental aid guidelines are met.

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<sup>(4)</sup> Judgment of the Court of 15 May 1997 in the case C-355/95 P, *Textilwerke Deggendorf GmbH v Commission and Federal Republic of Germany*, Rec. 1997, p. I-2549.

## Applying the Market Economy Investor Principle to State Owned Companies — Lessons Learned from the German Landesbanken Cases

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### Introduction

The Market Economy Investor Principle (MEIP) is in the Commission's practice one of the entry points for economic analysis in State aid cases. Its purpose is to establish the extent to which an aid measure confers an economic advantage on the recipient of the aid. In many cases, determining the size of the economic advantage is fairly straightforward, i.e. for direct subsidies granted to firms. However, often the situation is much less clear. The assessment of the state aid character of a measure is particularly difficult in cases where the State intervenes by means of measures which are comparable to that of private investors, for example by making equity investments or providing loans or loan guarantees.

In such cases, the Market Economy Investor Principle (or one of its derivatives, like the Private Creditor Principle) becomes relevant. According to the MEIP the credit approved or the investment undertaken should be considered as state aid in the meaning of Article 87(1) if the (monetary) compensation the State receives in exchange is lower than what a private investor would have requested under such circumstances. The exact quantification of the economic advantage received becomes relevant in particular when the aid is found unlawful and has to be repaid by the aid beneficiary to the aid granting State authority (so called 'recovery').

One group of cases which has contributed significantly to the further development of the market investor principle are the German Landesbanken cases. While only touching on the specificities of those cases the following article summarizes some of the methodological issues raised during the investigation of those cases. In the following the article first sets out some general principles in

assessing the MEIP. Thereafter, specific assessment issues when analysing public capital injections into public firms will be discussed. The article starts with a brief description of the German Landesbanken cases.

### The German Landesbanken cases — a brief review

At the beginning of the Nineties, the introduction of the Own Funds and Solvency Directives required German public banks to take up large amounts of new capital in order to maintain their level of activities. That capital was in some cases provided by the German federal states (*Länder*), which partly or fully owned the banks, by way of a transfer of public housing and other assets. The financial transfers triggered a complaint by the Association of German Private Banks (BdB) as they were under the same obligation to increase their solvency ratios without, however, being able to rely on public support. The complaint concerned seven banks, of which WestLB was at the centre of attention and was acting on behalf of all of them. In 1999, the Commission adopted a first negative decision concerning the transfer to WestLB and ordering the recovery of some € 800 million. In 2003, the Court of First Instance annulled the decision taking the view that the Commission had not sufficiently explained its calculations but confirming the decision on the substance. A new decision on all seven banks was taken in 2004. In its decision on WestLB the Commission asked Germany to recover illegal state aid of ca. € 979 million plus interest (2).

In addition, in 2002 the German authorities and the Commission agreed on the abolition of the public-law guarantee mechanism (so called 'Anstaltslast' and 'Gewährträgerhaftung') in favour of the Landesbanken from July 2005 on (3). The abolition of the state guarantees triggered a further round of capital increases aiming at strengthening the core capital of the Landesbanken. Recently, the Commission authorised two of those capital increases and a special fund transfer for three Landesbanken

(1) The CET has contributed at various instances to the application and development of the MEIP for these cases. It has to be stressed, though, that the main burden of work has been carried out by various case teams of DG COMP. In particular, reference has to be made to the internal working group on that topic and the recent case team including M. Cambas, J.L. Colson, M. Löffler, Y. Simon. Michael Tröge was visiting DG Competition when the paper was written. The views expressed are those of the authors and not of the European Commission.

(2) See IP/04/1261.

(3) See IP/02/343.

after having investigated in-depth the compliance of those measures with the MEIP <sup>(4)</sup>.

## Empirical assessment of public capital injections

### *Evaluating investments — general considerations*

The literature on financial theory provides a rather simple principle of when a private investor will carry out an investment project: an investment is individual rational if the expected return on this investment is higher than the opportunity cost of capital, i.e. the return that the investor can expect to make with other investments of similar risk in the capital markets. This principle holds for all rational and risk adverse private investors. Built upon this principle some clarifications can be formulated:

First, a private investor will estimate the overall return on his investment at the time the investment is made. This ex-ante expected return on the investment on which investors base their decisions can be very different from the ex-post achieved return. Second, risky investments in financial markets will not only yield a higher return in case of success but also a higher average return. Therefore, when making a risky investment a rational investor expects at least the return he could achieve with equivalent risk in the financial markets. In other terms risky investments have a higher (opportunity) cost of capital. Third, from an economic point of view only investments with returns that exceed the opportunity cost of capital can be considered to be profitable. Investments producing a lower return are not economically profitable, even if they produce positive accounting earnings. Fourth, the expected return for investors does not necessarily have to come directly from the investment project or even the company. A rational investor may accept low returns on a specific investment, if this investment produces high positive returns for the same investor from other assets. In any case, investors will want to clearly identify and quantify these 'externalities'. Fifth, an investor is exclusively interested in the return on his investment. The marginal profitability of the investment project for the company and the accounting profitability of the company can be useful for determining the return for the investor but are essentially different concepts.

In practical terms, when assessing the conformity of an investment with the MEIP it is necessary to evaluate the average return an investor can reasonably expect on his investment at the time the

investment was made and to identify the opportunity cost of capital, i.e. the return that could have been expected with an investment of similar risk in the financial markets. The standard approach for determining the expected average return on an investment and its opportunity cost of capital will be discussed in the next section.

### *Measuring Expected Average Return on the Investment*

Often returns are calculated in terms of accounting returns, where some type of earning number is divided by book value of equity (ROE), assets (ROA) or investment (ROI). However, these accounting returns <sup>(5)</sup> should in general not be considered as a correct measure for an investor's expected average return. Private investors might use these ratios to evaluate smaller investments because they are easy to understand and can be conveniently calculated using existing management information. However, accounting returns are calculated on an annual basis, whereas a rational investor will consider the return over the entire life time of the project. Averaging out expected annual return numbers will not lead to correct results. Returns arriving far in the future would be overvalued which could give a wrong impression of the investment's profitability. In addition, accounting information is historic information about the company and therefore better adapted to evaluate ex post performance of the firm than ex ante expected performance of the investments. Accounting earnings are also very sensitive to the company's accounting choices and can therefore be easily manipulated. Last but not least investors are not really interested in accounting earnings but care about their monetary gains i.e. the cash flows they receive from their investment.

In fact, the economically most meaningful way to determine an expected average annual return is to calculate the internal rate of return (IRR) of the investment. The IRR is not based on accounting earnings in a given year, but takes into account the stream of future cash flows that the investor expects to receive over the entire lifetime of the investment. Given a stream of future cash flows the IRR is calculated by numerically solving the following equation:

$$- \text{Investment} + \sum_{i=1, \dots, \infty} \frac{\text{Expected Cash Flow}_i}{(1 + \text{IRR})^i} = 0$$

The crucial input for calculating the IRR is the correct forecast of future cash flows. In case of an

<sup>(4)</sup> See IP/05/1096.

<sup>(5)</sup> There exist several alternative concepts developed by consultancies like EVA<sup>®</sup> (economic value added), MVA<sup>®</sup> (market value added) or ROCE.

equity investment this means that a realistic and detailed business plan for the undertaking has to be developed. The earnings forecasts obtained with this business plan are then transformed into cash flow numbers by adjusting for non cash items such as depreciation and change in working capital.

Of course the expected IRR on an equity investment can be influenced by overly optimistic or pessimistic business plans. It is essential here to check the plausibility of the key assumptions that have been used to construct the forecast. It is in this context that accounting returns and other accounting ratios can be helpful. Forecasted accounting returns, growth rates, margins and balance sheet ratios should be in line with the company's historical performance and industry benchmarks.

A number of additional technical problems often arise in practice:

- The cash flows received by an equity investor are dividends, and indeed this is what the investor is interested in most. Dividend streams are however difficult to forecast as they depend on the company's distribution policy. Therefore forecasts are usually not made for dividends but for 'Free Cash to Equity'. Free Cash to Equity can be considered as 'potential dividend', it only depends on the underlying profitability of the business.
- Equity investments do not have a clearly defined horizon. To limit the analysis, it is however standard practice to establish detailed cash flow forecasts only for a finite number of income streams, typically between 5 and 10 years. Revenues arising further in the future can then be taken into account by assuming that they will grow at a constant rate. This constant growth rate should however be chosen carefully and the sensitivity of the expected return with respect to slight changes in the growth rates should be verified. In case the investment's expected return depends critically on the choice of the growth rate, cash flow forecasts based on a detailed business plan should be established for a longer horizon.

### *Determining the opportunity cost of capital*

In principle, it is possible to obtain the lowest average return an investor would be willing to accept by looking at industry benchmarks. The appropriate benchmark for equity investments should, however, not be historical returns but the 'forward looking' returns an investor can expect to achieve by buying shares of a similar risk in the stock market. This return can be estimated, for example by calculating an IRR for an investment in equity of a sample of quoted companies. In this case the

observed stock price would correspond to the cost of an investment and free cash flow forecasts provided by financial analysts can be used to estimate the income stream the investor receives in exchange.

However, these estimates for a company's cost of capital have proven to be highly unreliable. Therefore the minimum required return is almost always derived through a theoretical 'Asset Pricing Model'. Advanced financial theory has proposed a number of different Asset Pricing Models, however the industry standard for the determination of the cost of equity is still the Capital Asset Pricing Model (CAPM), developed by Sharpe and Lintner in 1965. The CAPM postulates that the expected return on a risky investment should be determined by adding a risk premium to the return on a risk free investment. In perfect capital markets this risk premium will only depend on the non diversifiable risk of the investment, measured by its beta coefficient. The expected return can be expressed in the following way:

$$E(R_i) = r_f + \beta_i \cdot [E(R_m) - r_f]$$

In practice, the value of the risk free rate is approximated by the yield on a treasury bond. The beta of the company's share is directly drawn from a professional data provider in case the company is stock market quoted. The beta of non-listed companies can be approximated using betas of comparable listed companies and making an adjustment for differences in leverage. The market risk premium is typically estimated as the historical return difference between a broadly based market index and treasury bonds.

It should be noted that on a theoretical basis different estimation methods for the value of the beta as well as for the equity risk premium can be defended, which can yield to significant differences in the cost of capital estimate. The industry however works with rather well defined standard procedures which will yield a rather narrow range of 3-4% for realistic cost of equity estimates.

The CAPM should theoretically hold for all investments; however, it is normally only applied to identify the appropriate returns on equity type instruments. Risk adjusted returns for fixed income investments, i.e. loans and bonds are usually determined by comparison with well established market benchmarks. In this case risk is not measured in terms of beta, but simply characterized by an

external rating provided by a rating agency such as Standard and Poor's or Moody's. Professional data providers will then provide a range of returns corresponding to a debt instrument with a given rating and a given maturity. In fact, the appropriate remunerations for fixed income instruments can be given with high precision. Unless the company is in financial distress, returns can be typically narrowed down to an interval of less than 30 basis points, which makes it usually very easy to evaluate the state aid character of a debt injection <sup>(6)</sup>.

### *Reasoning in present values*

The basic principles of evaluating investments have so far been formulated in terms of returns. An alternative approach is to evaluate the investment decision in terms of present values, which leads to equivalent but often more intuitive results. The present value of a stream of future cash flows can be understood as the amount of money that would have to be invested in the financial markets today to obtain this stream of future cash flows. It can be calculated by discounting the stream of future cash flows at the appropriate return i.e. at the cost of capital. For example, to estimate the value of an equity stake in a non quoted company investment banks would typically use a Discounted Cash Flow (DCF) approach, i.e., determine the present value of the cash flow rights attached to this equity by discounting them at the cost of equity capital.

If the present value of the future cash flows received is higher than the investment which is supposed to generate these cash flows an investor will consider the investment to be economically profitable. This would be exactly the case if the internal rate of return of the project exceeds the minimum required rate of return, i.e. the cost of capital.

Present values are especially convenient for evaluating equity investments, because they should correspond to observed market values. This gives an additional possibility to cross check the plausibility of return estimates for equity investments. In the case of equity issues for quoted companies the issue price should not deviate significantly from the observed market price. In case no market prices are available, the value of equity can be estimated by comparing the company to stock market quoted benchmarks, using ratios such as the price/ earnings ratio. Cross industry comparisons based on price/ earnings ratios only are rather sensitive, however, given their dependency on a range of factors like the leverage of the company and its expected growth.

<sup>(6)</sup> Note that for debt-like instruments with convertibility feature more complex calculations are necessary.

### *Applying the MEIP*

Carrying out the MEIP test for a public investment in a private company is a straightforward application of the techniques described above. The MEIP test requires two steps: First, it has to be established what return the investor can realistically have expected on his investment, given historical performance of the company and given the future cash return to which he has acquired contractual rights. Second, this return has to be compared to a realistic risk adjusted return that an investor could have expected by investing in capital markets.

Reasoning in terms of values gives an additional possibility to verify the MEIP which is especially practical for equity issues. Instead of looking at the return for the investor it can be sufficient to look at the price of the equity sold. If the issue price is higher than the prices obtained through different valuation methodologies the investor does not receive an appropriate return. The application of the MEIP converges to the following test: First, the equity stake acquired by the state has to be evaluated, e.g. by using a DCF and/ or a multiple approach. Second, the theoretical value of the stake has to be compared to the price paid, i.e. to the amount of money invested by the state.

### **Assessing Investments in Public Companies**

#### *Limits of the MEIP test for investments in public companies*

The approach described above is limited, however, when investments in public companies are at stake. Here the State acts both in its role as existing shareholder and as a new investor. In these situations the State can increase the return on an investment in new equity by decreasing the price of the equity instruments to be sold. In particular the return on an equity investment in a profitable company can be always made higher than the opportunity cost of capital. It will therefore be possible to structure the equity issue in a way which satisfies the MEIP principle for the new investment.

What happens is of course that by decreasing the price for the newly issued equity, the company will dilute the value of the existing shareholders' equity. The existing shareholders will in fact subsidize the new equity issue through a loss of value of their equity. This should not be a concern in case the company is privately owned, as it can be assumed that private shareholders will not accept dilution of their wealth. The situation is different, however, in the case of an equity issue for a public company. The State, as an owner of the existing shares, may accept the dilution of its equity. It is after

all irrelevant whether the firm receives a subsidy directly through a capital injection or indirectly as a decrease in the value of the public owner's existing shares.

In consequence, applying the MEIP to the new equity issue only, will impose limited constraints on the state's ability to subsidize the company. Even the participation of private shareholders in the new equity issue does not imply that the whole transaction has been taken place according to the principles of a market economy. In fact, only the presence of private investors among the old as well as the new investors can be taken as some safeguard against capital injection violating the MEIP.

#### *A refined MEIP test for public companies*

To make sure that a public company has neither been subsidized directly through the capital injection nor indirectly through dilution of the public owner, the MEIP has to be applied not only to the State in its role as new investor, but also to the State as the owner of the existing company. This can be done simply by extending the approach described above to existing shareholders as well to new investors. The most straightforward way of doing this would be to evaluate how the capital increase affects the present value of future cash flows received by existing shareholders. What makes this approach difficult, however, is that most equity injections do not only change cash flows but also the company's risk and therefore the appropriate discount factor. Therefore a decrease in expected future cash flows for existing shareholders ('earnings dilution') can increase or lessen the value of their equity ('value accretion or dilution' respectively), depending on whether the discount factor decreases or increases.

An alternative approach is based on the fact that the company can only appropriately remunerate new shareholders without cross subsidy from the old shareholders if the capital raised is invested profitably. It is therefore sufficient to analyze the overall profitability of the investment, in addition to the profitability of the new equity issue for the new shareholders. If the MEIP holds for the new investors and generates wealth for the company it is clear that the profitability of the new investment has not been achieved by a cross transfer from old investors.

For instance, in the recent Landesbanken cases the objective of the capital injection was to increase the company's capital adequacy ratio, not to make a specific investment project. Hence, the focus of the assessment was on the overall increase in the company's value due to the capital injection and only to a lesser extent on the profitability of the investment. It was required, therefore, to prove that the total value after the capital injection ('post money valuation') exceeds its value before the capital injection ('pre money valuation') plus the amount of capital invested. In this case there is 'value creation' through the investment and in this case new shareholders can be given an appropriate return without diluting the wealth of existing shareholders.

To sum up, a meaningful application of the MEIP to capital injection in public companies requires a refined test. First, it has to be shown that the new investment is profitable for the new investors. Second, it has to be shown that the return for the new investors has not been achieved by a dilution of existing shareholders.





### *News from the Chief Economist*

- *European State Aid Control: an economic framework:*  
Hans W. Friederiszick/Lars-Hendrik Röller/Vincent Verouden

[http://europa.eu.int/comm/dgs/competition/cce\\_publications.htm](http://europa.eu.int/comm/dgs/competition/cce_publications.htm)



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## Directorate-General for Competition — Organigramme (16 April 2006)

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— Liberalisation directives, Article 86 cases	<i>Christian HOCEPIED</i>	02 29 60427/02 29 52514
2. Media	<i>Arianna VANNINI</i>	02 29 64209
3. Information industries, Internet and consumer electronics	<i>Cecilio MADERO VILLAREJO</i>	02 29 60949/02 29 65303
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4. Mergers	<i>Dietrich KLEEMANN</i>	02 29 65031/02 29 99392

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Deputy Head of Unit	<i>Zsuzsanna JAMBOR</i>	02 29 87436
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3. Mergers	<i>Paolo CESARINI</i>	02 29 51286/02 29 66495
Deputy Head of Unit	<i>Maria REHBINDER</i>	02 29 90007
	<i>Guillaume LORIOT</i>	02 29 84988

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3. Cartels III	<i>Dirk VAN ERPS</i>	02 29 66080
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4. Cartels IV	<i>Flavio LAINA</i>	02 29 69669
	<i>Ewoud SAKKERS</i>	02 29 66352

**DIRECTORATE G****State aid I: Cohesion and competitiveness**

1. Regional aid	<i>Humbert DRABBE</i>	02 29 50060/02 29 52701
Deputy Head of Unit	<i>Robert HANKIN</i>	02 29 59773/02 29 68315
2. Industrial restructuring	<i>Klaus-Otto JUNGINGER-DITTEL</i>	02 29 60376/02 29 66845
3. R&D, innovation and risk capital	<i>Karl SOUKUP</i>	02 29 67442
4. Environment and Energy	<i>Wouter PIEKE</i>	02 29 59824/02 29 67267
	<i>Jorma PIHLATIE</i>	02 29 53607/02 29 69193

**DIRECTORATE H****State aid II: Network industries, liberalised sectors and services**

1. Post and others services	<i>Loretta DORMAL-MARINO</i>	02 29 58603/02 29 53731
2. Financial services	<i>Joaquin FERNANDEZ MARTIN</i>	02 29 51041
3. Telecommunications and Media	<i>Jean-Louis COLSON</i>	02 29 60995/02 29 62526
Deputy Head of Unit	<i>Eric VAN GINDERACHTER</i>	02 29 54427
	<i>Sandro SANTAMATO</i>	02 29 93447

**DIRECTORATE I****State aid policy and strategic coordination**

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2. Strategic support and decision scrutiny	<i>Alain ALEXIS</i>	02 29 55303
3. State aid network and transparency	<i>Nicola PESARESI</i>	02 29 92906
4. Enforcement and monitoring	<i>Wolfgang MEDERER</i>	02 29 53584/02 29 65424
	<i>Dominique VAN DER WEE</i>	02 29 60216

**Reporting directly to the Commissioner**

Hearing officer	<i>Serge DURANDE</i>	02 29 57243
Hearing officer	<i>Karen WILLIAMS</i>	02 29 65575

## New documentation

### European Commission Directorate-General Competition

*This section contains details of recent speeches or articles on competition policy given by Community officials. Copies of these are available from Competition DG's home page on the World Wide Web at <http://europa.eu.int/comm/competition/speeches/>*

#### Speeches by the Commissioner, 1 September 2005 — 31 December 2005

*21 November: **Better Regulation of Professional Services** — Neelie KROES — Brussels (UK Presidency)*

*17 November: **Innovation from a Business Perspective: the State Aid Aspects** — Neelie KROES — Brussels, European Commission*

*21 October: **One Year In: Continuity, Concentration and Consolidation in European Competition Policy** — Neelie KROES — Fiesole, Italy (IBA's Ninth Annual Competition Conference)*

*17 October: **Damages Actions for Breaches of EU Competition Rules: Realities and Potentials** — Neelie KROES — Paris, France (Cour de Cassation)*

*23 September: **Preliminary Thoughts on Policy Review of Article 82** — Neelie KROES — New York, U.S.A. (Fordham Corporate Law Institute)*

*22 September: **Enhancing Actions for Damages for Breach of Competition Rules in Europe** — Neelie KROES — New York, USA (Harvard Club, New York)*

*15 September: **European Competition Policy — Delivering Better Markets and Better Choices** — Neelie KROES — London (European Consumer and Competition Day)*

*3 September: **Competition must drive European competitiveness in a global economy** — Neelie KROES — Cernobbia, Italy (Villa d'Este)*

#### Speeches and articles, Directorate-General Competition staff, 1 September 2005 — 31 December 2005

*1 December: **Efficiency gains from mergers** — Frank VERBOVEN, Johan STENNEK and Lars-Henrik ROELLER — Chapter 3, Edward Elgar (UK)*

*1 December: **Ökonomische Analyse des Begriffs „significant impediment to effective competition“** — Andreas STROHM and Lars-Henrik ROELLER— Münchner Kommentar*

*14 October: **Competition developments affecting the maritime sector** — Lowri EVANS — London (European Maritime Law Organisation)*

*22 September: **Some elements to enhance damages actions for breach of the competition rules in articles 81 and 82 EC** — Sven NORBERG — Fordham, New York, USA (32nd Annual International Antitrust Law & Policy Conference)*

*20 September: **Antitrust Economics — Catalyst for Convergence?** — Lars-Henrik ROELLER — Washington D.C., USA (George Mason Law Review Symposium)*

*1 September: **Using economic analysis to strengthen competition policy enforcement** — Lars-Henrik ROELLER — Modelling European Mergers: Theory, Competition Policy and Case Studies*

#### Community Publications on Competition

**New publications and publications coming up shortly**

- *Report on Competition policy, volume 2*
- *Competition policy newsletter, 2006, Number 1— Spring 2006*
- *Merger remedies study*
- *The Economics of Horizontal Mergers: Unilateral and Coordinated Effects*
- *Study on methods to analyse the impact of state aid on competition*

By Rainer Nitsche (CRA International) Paul Heidhues (University of Bonn and CEPR) (EUROPEAN ECONOMY. ECONOMIC PAPERS. No. 244. February 2006. European Commission. Brussels. 190 pp. Tab. Free.) KC-AI-06-244-EN-C; ISBN 92-79-01185-5; ISSN 1725-3187.

[http://europa.eu.int/comm/economy\\_finance/publications/economic\\_papers/2006/economic\\_papers244\\_en.htm](http://europa.eu.int/comm/economy_finance/publications/economic_papers/2006/economic_papers244_en.htm)

Information about our publications as well as PDF versions of them can be found on the DG Competition web site:

<http://europa.eu.int/comm/competition/publications>

The annual report is available through the Office for Official Publications of the European Communities or its sales offices. Requests for free publica-

tions should be addressed to the representations of the European Commission in the Member states and to the delegations of the European Commission in other countries, or to the Europe Direct network.

All publications can be ordered via the EU bookshop on this address: [bookshop.eu.int](http://bookshop.eu.int)



## Press releases

1 September 2005 — 31 December 2005

All texts are available from the Commission's press release database RAPID at: <http://europa.eu.int/rapid/> Enter the reference (e.g. IP/05/14) in the 'reference' input box on the research form to retrieve the text of a press release. Note: Language available vary for different press releases.

### Antitrust

**IP/05/1695 — 22/12/2005** — Competition: Commission warns Microsoft of daily penalty for failure to comply with 2004 decision

**IP/05/1656 — 21/12/2005** — Competition: Commission fines four firms € 75.86 million for rubber chemical cartel

**IP/05/1634 — 20/12/2005** — Competition: Commission launches consultations on facilitating damages claims for breaches of EU competition law

**IP/05/1626 — 19/12/2005** — Competition: Commission publishes discussion paper on abuse of dominance

**IP/05/1586 — 14/12/2005** — Competition: Commission proposes repeal of exemption for liner shipping conferences

**IP/05/1581 — 13/12/2005** — Competition: Commission improves rules for access to the file in merger and antitrust procedures

**IP/05/1565 — 12/12/2005** — Competition: Commission welcomes changes in ETSI IPR rules to prevent 'patent ambush'

**IP/05/1508 — 30/11/2005** — Competition: Commission fines 16 firms € 290 million for industrial bags cartel

**IP/05/1441 — 17/11/2005** — Competition: Commission receives improved commitments from FAPL over sale of media rights

**IP/05/1432 — 16/11/2005** — Competition: Commission proposes to revise Block Exemption for IATA passenger tariff conferences

**IP/05/1421 — 15/11/2005** — Energy: Member States must do more to open markets; competition inquiry identifies serious malfunctions

**IP/05/1408 — 10/11/2005** — Competition: Commission publishes study on impact of repealing exemption for liner shipping conferences

**IP/05/1315 — 20/10/2005** — Competition: Commission fines companies € 56 million for cartel in Italian raw tobacco market

**IP/05/1227 — 05/10/2005** — Competition: Commission imposes a € 49.5 million fine on Peugeot for obstructing new car exports from the Netherlands

**IP/05/1215 — 05/10/2005** — Competition: Commission appoints Trustee to advise on Microsoft's compliance with 2004 Decision

**IP/05/1208 — 30/09/2005** — Competition: new rules for car distribution bring dealers greater freedom to compete across the EU

**IP/05/1140 — 14/09/2005** — Competition: Commission fines producers of industrial thread a total of € 43.497 million for cartels

**IP/05/1089 — 05/09/2005** — Competition: Commission urges Member States to step up efforts to open professional services to competition

### State aid

**IP/05/1685 — 22/12/2005** — State aid: Commission investigates aid to Polish building company Chemobudowa Kraków

**IP/05/1683 — 22/12/2005** — State aid: Commission opens investigation into the state aid awarded to Institut Français du Pétrole

**IP/05/1682 — 22/12/2005** — State aid: Commission endorses the € 270.5 million prolongation of the Economic and Fiscal Regime of the Canary Islands

**IP/05/1670 — 21/12/2005** — European Commission authorises Italian investment aid to railway transport in Autonomous Province of Trento

**IP/05/1669 — 21/12/2005** — Aid for renegotiating expensive debts in Greece

**IP/05/1657 — 21/12/2005** — State aid: Commission opens inquiry into subsidy for digital decoders for terrestrial TV in Italy

**IP/05/1655 — 21/12/2005** — State aid: Commission refers Spain to Court of Justice for failure to recover illegal aid from Basque companies

**IP/05/1654 — 21/12/2005** — State aid: Commission gives go-ahead to conversion of the financial services business of La Poste into a subsidiary

**IP/05/1653 — 21/12/2005** — State aid: Commission adopts new regional aid guidelines for 2007-2013

**IP/05/1558 — 09/12/2005** — State aid: latest Scoreboard confirms that downward trend in the overall level of aid has levelled off

**IP/05/1549 — 08/12/2005** — State aid: Commission investigates support to Greek vehicle producer

**IP/05/1548 — 08/12/2005** — State aid: Commission approves IRAP tax deductions for job creation in Italy

**IP/05/1543 — 07/12/2005** — State aid: Commission opens investigation into UK scheme to support paper production from waste paper

**IP/05/1542 — 07/12/2005** — State aid: Commission requires partial repayment of aid for alumina production in France, Ireland and Italy

**IP/05/1541 — 07/12/2005** — State aid: Commission approves € 140 million support to Snecma for an R&D project

**IP/05/1540 — 07/12/2005** — Commission begins detailed examination of aid granted by SNCB to Inter Ferry Boats

**IP/05/1517 — 01/12/2005** — State aid: Commission closes formal investigation on CO2 taxation system in Slovenia following changes to legislation

**IP/05/1466 — 24/11/2005** — State aid: Commission denies delivery date extensions for cruise ship at Italian yard

**IP/05/1465 — 24/11/2005** — State aid: Commission prohibits real estate transfer tax exemption for housing companies in Berlin

**IP/05/1455 — 23/11/2005** — State aid: Commission opens investigation into long term power purchase agreements in Poland

**IP/05/1454 — 23/11/2005** — State aid: Commission opens probe into Polish machinery company Huta Stalowa Wola

**IP/05/1407 — 10/11/2005** — State aid: Commission opens formal investigation into long term power purchase agreements in Hungary

**IP/05/1406 — 10/11/2005** — State aid: Commission endorses German innovation programme

**IP/05/1396 — 09/11/2005** — State aid: Commission approves new scheme to support innovative audiovisual works in France

**IP/05/1394 — 09/11/2005** — State aid: Commission rules subsidy for digital terrestrial TV (DVB-T) in Berlin-Brandenburg illegal; explains how digital TV can be supported

**IP/05/1393 — 09/11/2005** — State aid: Commission opens inquiry into proposed subsidy to Ford's plant in Genk, Belgium

**IP/05/1390 — 09/11/2005** — European Commission authorises changes to a French aid scheme to promote less polluting transport

**IP/05/1334 — 24/10/2005** — State aid: Commission orders repayment of € 2.4 million subsidy paid to Componenta Corporation in Finland

**IP/05/1333 — 24/10/2005** — State aid: Commission endorses public funding for broadband in Kärnten, Austria

**IP/05/1331 — 24/10/2005** — State aid: Commission opens inquiry into funding for broadband in Appingedam (Netherlands)

**IP/05/1325 — 21/10/2005** — State aid: Commission requires Greece to suspend illegal tax exempt fund and opens investigation

**IP/05/1317 — 20/10/2005** — State aid: Commission approves UK's NESTA Invention and Innovation Programme supporting new innovative firms

**IP/05/1316 — 20/10/2005** — State aid: Commission invites interested parties to comment on the UK project "Investbx"

**IP/05/1312 — 20/10/2005** — European Commission authorises Czech Republic to grant € 74 million aid to its coal industry

**IP/05/1231 — 06/10/2005** — State aid: Commission endorses public funding for broadband communications in Midlands and South West of England

**IP/05/1191 — 27/09/2005** — State aid: application of Bolzano scheme deemed illegal, but new implementing criteria approved

**IP/05/1169 — 21/09/2005** — State aid: Commission launches public consultation on measures to improve state aid for innovation

**IP/05/1139 — 14/09/2005** — Commission finds that Greece has granted illegal State aid to Olympic Airways and Olympic Airlines

**IP/05/1111 — 08/09/2005** — State aid: Commission opens probe into restructuring aid for Renault in France

**IP/05/1110 — 08/09/2005** — State aid: Commission agrees delivery date extension for two tankers at Portuguese yard

**IP/05/1103 — 07/09/2005** — State aid: Commission opposes Italian tax breaks for certain investment vehicles

**IP/05/1102 — 07/09/2005** — State aid: Commission opens inquiry into tax reductions in Sicily

**IP/05/1096 — 06/09/2005** — State aid: Commission endorses € 1.2 billion capital increases for

German Landesbanken HSH Nordbank and Bayern LB and transfer of public fund as silent participation in Landesbank Hessen-Thüringen

### Merger

**IP/05/1706 — 23/12/2005** — Mergers: Commission clears acquisition of Danish Elsam and Energi E2 assets by Vattenfall

**IP/05/1705 — 23/12/2005** — Mergers: Commission approves acquisition by Basell of Société du Craqueur de l'Aubette and related assets

**IP/05/1704 — 22/12/2005** — Mergers: Commission clears the planned acquisition of Bax Global by Deutsche Bahn

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