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Regulation 1/2003 and the Modernisation Package fully applicable since 1 May 2004

Céline GAUER, LARS KJOLBYE, Dorothe DALHEIMER, Eddy DE SMIJTER, Dominik SCHNICHELS and Maija LAURILA, Directorate-General Competition, units A-3 and A-4

A. Overview of the new rules

As from 1st May 2004, the new enforcement system for Articles 81 and 82 of the Treaty is fully applicable. With the entry into application of Regulation 1/2003 (1), Regulation 17/62 has been repealed.

The most central feature of the new Regulation is the direct application of Article 81(3) of the Treaty. Under Regulation 1/2003, agreements that fulfil the conditions of Article 81(3) are legally valid and enforceable without the intervention of an administrative decision. The notification and exemption system of Regulation 17 is no longer in force.

Furthermore, the new Regulation represents a great step forward in terms of establishing a level playing field for agreements in the internal market. For the first time in European antitrust history, Article 3 of Regulation 1/2003 obliges Member States' enforcers to apply EC competition law to all cases where trade between Member States may be affected and establishes Article 81 as the single common standard for the assessment of agreements by all enforcers in the European Union.

The new Regulation also paves the way for a greater role of Member States' courts and competition authorities in the enforcement of Articles 81 and 82 and at the same time introduces mechanisms of cooperation between the Commission and these enforcers. In particular, the Commission and the national competition authorities have jointly set up the European Competition Network (ECN) as a platform for close cooperation.

In order to complement Regulation 1/2003 and following extensive consultations, the Commission adopted the 'Modernisation Package' consisting of the new Commission Regulation on details of its antitrust procedures as well as six new Commission notices aimed at providing guidance on a range of aspects that are of particular significance in the new enforcement system. These documents are shortly presented hereafter:

(1) *Commission Regulation 773/2004 of 7 April 2004 relating to the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty* (2)

The Commission Regulation contains detailed rules regarding, in particular, the initiation of proceedings, oral statements, complaints, hearings of parties, access to the file and the handling of confidential information in antitrust procedures conducted by the Commission.

(2) *Commission Notice on cooperation within the network of competition authorities* (3)

This notice sets out the main pillars of the cooperation between the Commission and the competition authorities of the Member States in the European Competition Network (ECN). The notice sets out the principles for sharing case work between the members of the network. In this respect the notice follows the Joint Statement of the Council and the Commission which was issued on the day when Regulation 1/2003 was adopted. Particular arrangements have been found for the interface between exchanges of information between authorities pursuant to Articles 11(2) and (3) as well as 12 of Regulation 1/2003 and the operation

(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, pages 1-25, Regulation as amended by Regulation (EC) No 411/2004 (OJ L 68 of 6.3.2004, p. 1).

(2) OJ L 123 of 27.4.2004, pages 18-24.

(3) OJ C 101 of 27.4.2004, pages 43-53.

of leniency programmes. [1] National authorities of the Member States [2] have signed a statement in which they declare that they will abide by the principles set out in the Commission Notice.

(3) Commission Notice on the co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 EC [3]

The notice is intended to serve as a practical tool for national judges who apply Articles 81 and 82 in conformity with Regulation 1/2003. It assembles the relevant case law of the Court of Justice, thus clarifying the procedural context in which national judges are operating. Particular attention is given to the situation in which the national court deals with a case in parallel with or subsequent to the Commission. Regulation 1/2003 for the first time establishes a firm legal basis for national judges to ask the Commission for an opinion or for information it holds. In addition, the regulation created the possibility for the Commission to submit written and oral observations to the national courts in the interest of coherent application. The notice spells out the modalities of those co-operation mechanisms.

(4) Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty [4]

This notice starts by general information on the work-sharing of the different enforcers and invites potential complainants to make an informed choice of the authority where they lodge their complaint (complaint with the Commission, a national court or national competition authority) in the light of the orientations given. The largest part of the notice contains explanations on the Commission's assessment of complaints in the field of antitrust and the procedures applicable. The notice also includes an indicative deadline of four months, within which the Commission endeavours to inform complainants of its intention to conduct a full investigation on a complaint or not.

(5) Commission Notice on informal guidance relating to novel questions concerning Articles 81 and 82 of the EC Treaty that arise in individual cases (guidance letters) [5]

Regulation 1/2003 pursues the objective that the Commission refocus its enforcement action on the detection of serious infringements. The abolition of the notification system is a crucial element in this context. However, it also seems reasonable that in a limited number of cases, where a genuinely novel question concerning Articles 81 or 82 arises, the Commission may, subject to its other enforcement priorities, provide guidance to undertakings in writing (guidance letter). The notice sets out details about this instrument.

(6) Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty [6]

The effect on trade concept is a jurisdictional criterion, which determines the reach of Article 81 and 82. It also determines the scope of application of Article 3 Regulation 1/2003. Against this background, Member States' delegations in the Council expressed a strong desire for an interpretative notice on this notion. The notice describes the current case law and does not in any way seek to limit the jurisdictional reach of Articles 81 and 82. The notice sets out a rebuttable presumption that trade between Member States is not capable of being appreciably affected when the aggregate annual Community turnover of the undertakings concerned in the products covered by the agreement does not exceed 40 million Euro and the (aggregate) market share of the parties on any relevant market within the Community affected by the agreement does not exceed 5%.

(7) Guidelines on the application of Article 81(3) of the Treaty [7]

The power for the courts and competition authorities of the Member States to apply Article 81(3) is one of the main pillars of the modernisation reform. The notice develops a framework for the

(1) See on this topic the article by Stephen Blake and Dominik Schnichels in this edition, page...
(2) On 1.5.2004, National Authorities of almost all the Member States have signed the statement.
(3) OJ C 101 of 27.4.2004, pages 54-64.
(4) OJ C 101 of 27.4.2004, pages 65-77.
(5) OJ C 101 of 27.4.2004, pages 78-80.
(6) OJ C 101 of 27.4.2004, pages 81-96.
(7) OJ C 101 of 27.4.2004, pages 97-118.

application of Article 81(3) and provides guidance on the application of each of the four cumulative conditions contained in this Treaty provision. For example, the notice lists various types of efficiencies that may constitute objective economic benefits within the meaning of the first condition. It also explains the notion of consumers and the requirement that they must receive a fair share of the efficiency gains resulting from the agreement. The Guidelines build on and further develop the economic approach that was introduced in the guidelines on vertical restraints and horizontal cooperation agreements ([1]). The anti-competitive aspects of the agreement are analysed under Article 81(1) and the pro-competitive elements are analysed and balanced against the anti-competitive elements under Article 81(3).

B. Frequently Asked Questions on the new enforcement system

1) On the Network of competition authorities

How is the work sharing between the Commission and the national competition authorities organised in the network?

The system of Regulation 1/2003 is a system of parallel competences in which all enforcers have the power to apply Articles 81 and 82. In that system, several authorities may be in a position to act against a given infringement, on their own or in parallel. This is important as under the new Regulation, the competition authorities cooperating in the network are expected to focus their action on the most serious infringements of the competition rules, which are often secret and difficult to detect.

If one authority that would in principle be well placed to deal with such a case is temporarily not able to do so (for instance because it has no more resources available), it is in the interest of effective enforcement that another well placed authority can step in. In a more rigid system, the victims of the infringement could do nothing but wait for the first authority to recruit and train new staff or otherwise increase its capacity.

Is it 'the Network' that takes decisions on case allocation?

No. The Network provides the framework for efficient work sharing between the European competition authorities through mutual information about new cases, the possibility to exchange information and grant assistance. The Network as such does however not take any decisions on the division of work between the enforcers. Nor do the Commission or the national competition authorities take decisions 'referring' cases from one to another. The individual Network members start, conduct and possibly close a procedure under their own responsibility, on the basis of Regulation 1/2003, in particular its Article 13, or on the basis of their respective procedural rules.

Does that mean that any authority can deal with any case — could for instance the Finnish competition authority seize itself with an infringement that happens in Greece?

Whilst there are no hard rules for the division of case work — for good reasons — the network notice clarifies that an authority is well placed to deal with a case if three conditions are fulfilled: (1) the behaviour of the parties has substantial effects for the territory in which the authority is based, (2) the authority can effectively gather all relevant information and (3) the authority can effectively bring the infringement to an end. In other words, there needs to be a material link between the infringement and the territory of a Member State for that Member State's competition authority to be well placed.

From a practical point of view this means that in the example given the Finnish authority would not seize itself with an infringement that happens in Greece, as there are already no effects in the Finnish market, not to mention the difficulty of gathering the relevant information and bringing the infringement to an end. On the other hand, if an infringement concerned for instance a shipping line between Italy and Greece, the Greek as well as the Italian competition authority might be well placed to deal with the case, depending on the circumstances.

Does the system not create a risk of forum shopping by complainants?

Forum shopping by complainants is by nature limited: a complainant has always an interest to bring its case before the authority which is in a position to deal effectively with the case. If there are several well placed authorities, it might create a kind of competition between them: this is not a problem and might even contribute to a better enforcement of the competition rules.

([1]) See Commission Notice on Guidelines on vertical restraints, OJ 2000 C 291, page 1, and Commission Notice on Guidelines on the application of Article 81 of the Treaty to horizontal cooperation agreements, OJ 2001 C 3, page 2.

Naturally, it needs to be ensured that there is no duplication of work. The information mechanisms in the European Competition Network allow its members to detect parallel investigations. If thus a complaint is lodged with the Commission and a national authority, only one of these authorities will deal with the case. Regulation 1/2003 makes express provision for the rejection of complaints on the ground that another authority is dealing or has already dealt with a case.

How will the authorities ensure that the confidentiality of information exchanged within the Network be protected?

Under Regulation 1/2003 all competition authorities are bound by a common standard of professional secrecy that ensures protection of business secrets and other confidential information. Whilst the authorities are entitled to exchange information amongst themselves, they must protect the legitimate interests of the market operators concerned.

It is important to note that the same strict standard already applied under the old enforcement system, where the competition authorities of the Member States were fully informed about the cases dealt with by the Commission, including business secrets and other confidential information. Similarly, the Commission had the power to obtain all types of information from the Member States. This system never created any substantial problems. The new Regulation introduces the additional possibility of exchanging information between national competition authorities. Also this information comes under the common standard of professional secrecy.

In practice, the transmission of confidential information between authorities will take place on the basis of encrypted mail or other secure ways of transmission.

Why can competition authorities exchange information amongst themselves and why can they even use the information under certain circumstances as evidence in their cases?

The new system represents a great step forward in terms of establishing a level playing field for agreements in the internal market. In particular it ensures that the EC competition rules apply to all cases affecting trade between Member States. Moreover, it introduces a single standard for assessing agreements.

It is difficult to see why, for the application of this common legal standard to cases which by their very nature have cross-border implications (otherwise they do not fall within the reach of EC competition law), the cooperation between the competition authorities in the internal market should be obstructed by traditional rules prohibiting for instance the exchange of information with 'foreign' administrations.

The procedural rules of the Member States are different. Is there not a risk that the exchange of information and use by another authority would deprive an undertaking of its rights of defence?

Of course information to be used in evidence must be legally obtained by the authority that collects it and it can only be exchanged respecting the safeguards established by the Regulation. However, the mere fact that there are differences in the procedural rules of the Member States should not prevent the exchange for the purpose of applying the common rules on competition. Procedural rules of all Member States and at Community level respect high standards of protection of the rights of defence under the control of independent courts. They are thus mutually compatible and Regulation 1/2003 takes a clear stance that the remaining divergences should not stand in the way of closer cooperation between authorities in the internal market.

How can companies that have applied for leniency with one authority be sure that the information provided by them will not be used by other authorities to start proceedings against them?

Leniency applicants are well protected against investigations from other authorities. The Notice on cooperation within the Network of competition authorities foresees that information exchanged within the Network on newly opened cases will not be used by other members of the Network to start their own proceedings. National competition authorities have agreed to abide by this principle (see above footnote 5).

Moreover information submitted by leniency applicants and information collected by the authority on the basis of the application will not be passed on to any other authority without the consent of the applicant except in two situations:

- Where the applicant has also applied for leniency in the same case before the receiving authority;

- Where the receiving authority commits not to use the information transmitted or any information gathered after the date of transmission to impose sanctions on the leniency applicant or on its staff.

How will national competition authorities be bound by the principles set out in the Commission notice?

The national competition authorities are normally not bound by a Commission Notice which only creates legitimate expectations as far as the Commission is concerned. However, with regard to the Notice on the cooperation within the Network of competition authorities, the vast majority of Member States' competition authorities have signed a declaration that they will abide by the principles set out in the Notice. The mutual information in the Network is organised in such a way that only those authorities who have committed to these principles receive information on leniency cases. In order to obtain detailed information contained in a leniency application, the receiving authority will have to sign a declaration that it will not use the information transmitted or any other information gathered thereafter to impose sanctions on the leniency applicant.

In this respect it should also be noted that the competition authorities that operate leniency programmes have a clear interest not to undermine the functioning of their programmes by circulating the leniency information without appropriate guarantees for their leniency applicant.

2) On direct application of Article 81(3)

Do the Guidelines on the application of the exception rule of Article 81(3) not impose too heavy burdens on undertakings?

The Guidelines strike a reasonable and necessary balance between on the one hand the application of the prohibition rule of Article 81(1) and on the other hand the exception rule of Article 81(3). It is important to keep in mind that in recent years the application of the prohibition rule of Article 81(1) has been re-thought considerably. As stated in the Guidelines, for Article 81(1) to apply the agreement must produce negative effects on the market by allowing the parties to obtain, maintain or strengthen market power. In the absence of hardcore restrictions, Article 81(1) only applies where the parties have a sufficient degree of market power to produce a negative impact on the market. This means that Article 81(1) only applies when the competitive process and consumers are likely to suffer.

In such circumstances it is necessary to follow an equally strict approach under Article 81(3). Article 81(3) should only apply when the restrictive agreement is reasonably necessary to produce efficiencies that compensate consumers for the likely negative effects of the restrictions. For the restrictions to be acceptable firms should produce real evidence to that effect. It is not sufficient that they make unsubstantiated assertions. The *quid pro quo* is that plaintiffs and enforcers have to make a real case under Article 81(1). Both elements are contained in the Guidelines which thereby create a balance between Article 81(1) and Article 81(3) based on sound economic principles.

Are European judges equipped to apply Articles 81 and 82 and Article 81(3) in particular?

Judges understand and decide on a large range of complex matters. Moreover, in particular in civil litigation, courts to a large extent rely on the submissions of the parties. In competition cases, the lawyers representing the parties will be able to explain the economic rationale of both Article 81(1) and 81(3). They can base themselves on the guidance available from the Commission, including but not limited to the Guidelines for the application of Article 81(3). Furthermore, in addition to the possibility of referring preliminary questions to the European Court of Justice, Regulation 1/2003 gives national courts the right to ask for information or for an opinion from the Commission in case they should encounter a question on which they would like to receive such additional input. Apart from this, the Commission also grants financial support to training programmes for national judges.

Will it still be possible to obtain an exemption decision or a comfort letter from the Commission after 1 May 2004?

No. Under the new Regulation, a party before a national court or national competition authority that wants to invoke Article 81(3) does not need a Commission statement to do so. The agreement, decision or conduct in question must be found legal if the party can show that it fulfils the conditions set out in Article 81(3).

Against this background, there is no place any more in the new system neither for exemption decisions nor for their informal replacement, 'comfort letters'. Accordingly, after 1 May 2004, there will be neither formal exemption decisions nor new comfort letters, nor will existing ones be prolonged.

3) *On transitional questions*

What about existing exemption decisions and comfort letters?

As a transitional rule, Regulation 1/2003 provides that existing exemption decisions remain in force until their expiry. However, the Regulation also maintains the legal mechanism by which the Commission may withdraw an exemption if the facts change fundamentally and the exemption is no longer merited.

Comfort letters issued before 1 May 2004 may remain useful for undertakings or associations of undertakings as a starting point for the assessment of their legal situation under Articles 81 and 82 EC, taking account of the extent to which factual or legal circumstances relevant for their case may have evolved in the meantime. National courts, when assessing a case under Articles 81 or 82 EC, could still take a comfort letter into account. This is for the national court in question to decide.

What about pending complaints and on-going investigations?

As a general rule, these procedures continue under the provisions of the new Regulation 1/2003 as from 1 May 2004. The Regulation provides that the procedural steps concluded before 1 May 2004 under the old law remain valid.

What about pending notifications?

The transitional provisions in Regulation 1/2003 provide that notifications still pending on 1 May 2004 lapse as from that date.

The Regulation also provides that Commission proceedings started under the old regime can continue under the new Regulation. For pending cases based on a notification, this implies that the Commission may either close the file following the lapsing of the notification. It may however also consider that a case should be further investigated. In that case, it continues the file as an ex officio investigation. The orientation will depend on the circumstances of the individual case, the gravity of any competition problem involved and the Commission's enforcement priorities.

Leniency following Modernisation: safeguarding Europe's leniency programmes

Stephen BLAKE, Directorate-General for Competition, unit E-2 and Dominik SCHNICHELS, Directorate-General for Competition, unit A-4 (1)

1. Introductory

With the entry into application of Council Regulation No 1/2003 (2), the first of May 2004 not only marked the expansion of the European Union from fifteen to twenty-five Member States but also ushered in a new era in the enforcement of European competition law. For the first time not only the Commission but also the national competition authorities of the Member States (NCAs), together with national courts, have the power within their respective territories to apply the competition rules of the Treaty in full (3). Moreover, when applying their national competition law to conduct which is in breach of those rules, the NCAs and national courts are now obliged also to apply Articles 81 or 82 of the Treaty (4). National merger laws are excluded from these provisions.

The public enforcement of Articles 81 and 82 is thus the shared responsibility of the Commission and the NCAs, which together form a network of public authorities known as the 'European Competition Network' (ECN). Save where they judicially review the decisions of NCAs, the role of the national courts, on the other hand, is largely confined to the sphere of private enforcement (5).

Under the Regulation the Commission and the NCAs are required to apply the European competition rules in close cooperation (6). To facilitate this and, in particular, to ensure the efficient division of work and the effective and consistent application of the rules, the Regulation makes a number of detailed provisions for the sharing of information and consultation about cases and for the exchange of information for use in evidence (7). The Regulation also makes provision for cooperation between the Commission and NCAs on the one hand, and the national courts, on the other (8).

This article is concerned with one aspect of this new regime, namely the implications for leniency applicants whether under the Commission's leniency programme or that of an NCA (9).

2. General principles

Article 23 of Regulation 1/2003 sets out the sanctions which may be imposed by the Commission for breaches of Articles 81 and 82 of the Treaty. As regards the sanctioning powers of the NCAs, on the other hand, the Regulation provides only that NCAs may 'take ... decisions ... imposing fines, periodic penalty payments or any other penalty provided for in their national law' (10). The sanctioning regimes of the Commission and the NCAs are not, therefore, harmonised by the Regulation. In the case of the NCAs this is left to be determined by the national laws of the relevant Member State.

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(1) Special thanks to Eddy de Smijter (unit A-4) and Petra Krenz (unit A-4) for their assistance in the preparation of this article.

(2) 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 of 4.1.2003, page 1.

(3) Articles 5 and 6 of the Council Regulation.

(4) Article 3 of the Council Regulation.

(5) The structure of the NCAs varies between Member States. In a number of Member States the various functions of the NCA are divided between different bodies which in some cases include a court. References in this article to national courts do not include such courts when they act as an NCA.

(6) Article 11(1) of the Council Regulation.

(7) Articles 11, 12 and 14 of the Council Regulation.

(8) Article 15 of the Council Regulation.

(9) The term 'leniency programme' is used in this article to describe all programmes which offer either full immunity or a significant reduction in the penalties which would otherwise have been imposed on a participant in a cartel, in exchange for the freely volunteered disclosure of information on the cartel which satisfies specific criteria prior to or during the investigative stage of the case, and does not cover reductions in the penalty granted for other reasons. This definition is the same as that used in the Commission notice on cooperation within the Network of Competition Authorities (OJ C 101, 27.4.2004, page 43). The Commission's leniency programme is set out in the Commission notice on immunity from fines and reduction of fines in cartel cases (OJ C 45, 19.2.2002, page 3).

(10) Article 5 of the Council Regulation.

Consistent with this approach, the decision as to whether or not to adopt a leniency programme, together with the precise terms of any such programme, is also left to each ECN member, acting within the limits of the laws to which it is subject. Thus, whilst leniency programmes have been adopted both by the Commission and in a significant number of Member States, this is not universally the case ([1]). By the same token, the precise terms of the leniency programmes which have been adopted, although sharing many features in common, are not identical.

It follows from this that there is no leniency programme common to all ECN members to which a cartel participant may apply. Equally, an application for leniency to one authority will not count as an application for leniency to another authority. As a result, a prospective leniency applicant may be advised to apply to more than one authority within the ECN.

Although this has attracted criticism on the part of some businesses and their advisers ([2]), it is important to recognise that in this respect the situation since 1 May 2004 is no different from that which existed previously. Whilst prior to 1 May NCAs would not necessarily have applied European competition law ([3]), cartel members, then as now, nevertheless risked being sanctioned by the NCAs whose territories were affected by the infringement, if not under the European competition rules then under the national competition law of the relevant Member State ([4]). Where Regulation 1/2003 has, however, introduced relevant changes is, first, the increased scope for the exchange of information within the ECN and, second, the provision in Article 11(6) of the Regulation that the opening of proceedings by the Commission in a case automatically deprives NCAs of their competence to treat that case not only under Articles 81 and 82 but also, by virtue of Article 3, under their national competition law ([5]).

3. The exchange of leniency information within the ECN

Leniency applicants by definition volunteer self-incriminating information concerning a cartel or cartels in which they have participated. They do so in exchange for either full immunity or a significant reduction in the penalties which would otherwise have been imposed. In many cases the application also triggers the initiation of an investigation which would not otherwise have taken place. Actual or potential leniency applicants are understandably sensitive about the subsequent disclosure both of the information which they have volunteered and of information which the authority's investigation later uncovers and which, but for the leniency application would not have come to light.

The provisions for the exchange of information within the ECN are, therefore, not surprisingly a source of potential concern for leniency applicants. Recognising the need to avoid discouraging cartel members from applying for leniency, the Commission and NCAs have sought to address these concerns via the Commission notice on cooperation within the Network of Competition Authorities (the Network notice) ([6]). The Network notice addresses two possible concerns. The first potential concern is that as a result of the cooperation provisions in Article 11 of the Regulation a leniency application to one authority within the ECN might trigger an investigation by another ECN member to which the applicant has not also applied for leniency. The second potential concern is that the information which a leniency applicant has volunteered to one authority within the ECN, together with any information which that authority may obtain as a consequence, might be transmitted to another ECN member under Article 12 of the Regulation and used as evidence to impose sanctions on the applicant.

([1]) A list of those authorities which operate a leniency programme is published on the Commission's web-site at http://europa.eu.int/comm/competition/antitrust/legislation/authorities_with_leniency_programme.pdf.

([2]) See Contributions received in response to the public consultation on the 'Modernisation Package', published on the Commission's web-site at http://europa.eu.int/comm/competition/antitrust/legislation/procedural_rules/comments.

([3]) Not all NCAs were empowered to do so by their national legislation. Others were so empowered, but were also free to apply only their national competition law.

([4]) The latter invariably included provisions modelled on Articles 81 and 82.

([5]) Article 9(3) of Council Regulation No. 17/62 (OJ 13 of 21.2.1962, page 402), which Regulation 1/2003 replaced, provided that the NCAs of the Member States remained competent to apply Articles 81(1) and 82 'As long as the Commission [had] not initiated any procedure under Articles 2 [(negative clearance)], 3 [(termination of infringements)] or 6 [(decisions pursuant to Article 81(3)) of that Regulation]'. The Regulation was silent, however, on the application by the NCAs of their national competition law (see case 14/68 *Walt Wilhelm* [1969] ECR 1, paragraph 3).

([6]) OJ C 101 of 27.4.2004, page 43.

3.1. Article 11

Under Article 11(3) of the Regulation, an NCA when acting under Article 81 or 82 must inform the Commission before or without delay after commencing the first formal investigative measure. The Regulation also provides that the information may be made available to other NCAs. The Commission has accepted a similar obligation to inform NCAs under Article 11(2) of the Regulation. In practice, this will be done in each case by means of the completion of a standard form containing limited details of the case, such as the authority dealing with the case, the product, territories and parties concerned, the nature and suspected duration of the alleged infringement and the origin of the case. With one important exception (see below), the information thus submitted will be made available to all ECN members ([1]).

These provisions apply equally to cases that have been initiated as a result of a leniency application. In such cases, however, the Network notice provides that the information thus submitted to the ECN may not be used by another ECN member as the basis for starting an investigation on its own behalf, whether under Articles 81 or 82 or, in the case of NCAs, under their national competition or other laws ([2]).

Another ECN member will not be precluded from investigating the case altogether. It will still be free to open an investigation if it receives sufficient information to enable it to do so from another source, such as a complainant, an informant or another leniency applicant. It would not, however, be able to solicit such information. Moreover, it is important to appreciate that the risk to the leniency applicant of another authority independently receiving information and initiating an investigation on its own behalf is not a consequence of Regulation 1/2003. Rather, the same risk existed before 1 May 2004 and is quite independent of and separate from the cooperation provisions of the Regulation.

What is new to the Regulation, however, is the possibility for another ECN member, irrespective of whether or not it has received information from an independent source, to ask the authority to which the leniency application was made to provide it with information under Article 12 of the Regulation. This is the second potential concern for leniency applicants that is addressed by the Network notice.

3.2. Article 12

Under Article 12 of the Regulation ECN members may exchange information and use it in evidence for the purpose of applying Articles 81 or 82. This is an enabling power; there is no duty on an ECN member to transmit information to another member under Article 12. The Network notice sets out how ECN members will exercise their discretion under Article 12 in relation to leniency cases ([3]).

These provisions of the Network notice apply to two categories of information. The first category covers information that has been voluntarily submitted by a leniency applicant. The second category covers information obtained during or following an inspection or by means of or following any other fact-finding measure which, in each case, could not have been carried out except as a result of a leniency application.

Under the Network notice, such information may only be transmitted under Article 12 of the Regulation in one of three ([4]) circumstances ([5]).

- The first circumstance in which such information may be transmitted to another ECN member is where the leniency applicant has consented to the transmission of the information which it has voluntarily submitted as part of its leniency application ([6]).
- The second circumstance is where the ECN member requesting transmission of the infor-

([1]) See also paragraphs 16 to 19 of the Network notice.

([2]) Paragraph 39 of the Network notice.

([3]) Paragraphs 40 and 41 of the Network notice.

([4]) For the avoidance of doubt, the Network notice also makes explicit that where information has been collected by an ECN member under Article 22(1) of the Regulation on behalf of the ECN member to which the leniency application was made, such information may be transmitted to the latter authority, notwithstanding that the information might otherwise technically be covered by the restriction on the transmission of information obtained during or by means of an inspection or other fact-finding measure that could not have been carried out except as a result of the leniency application.

([5]) These conditions will apply to the protected information irrespective of whether or not the applicant meets the criteria for leniency under the programme of the relevant authority; suffice it that the information was either voluntarily submitted as part of a leniency application or was obtained as a result of or following an inspection or other fact-finding measure that could not have been carried out but for such an application.

([6]) It should be noted that the transmission of information under Article 12 of the Regulation does not normally require the prior consent of the party that provided the information. This also applies to confidential information. Such information is protected by the provisions of Article 28 of the Regulation.

mation has also received a leniency application relating to the same infringement from the same applicant. Thus, once a leniency applicant has made the decision to apply to more than one authority within the ECN, it must accept that the authorities to which it has applied will no longer require its consent in order to exchange information amongst themselves. The one proviso to this is that at the time the information is transmitted it must not be open to the applicant to withdraw its leniency application from the authority to which the information is to be transmitted ([1]).

- The third circumstance is where the authority to which the information is transmitted has given certain guarantees concerning the use to which the information, or any information which it may subsequently obtain, may be put.

The guarantee which an authority must give in order to receive protected leniency information in circumstances where the leniency applicant has neither consented to the transmission of the information nor made a parallel application to that authority is very wide. The authority requesting transmission of the information must guarantee that not only the information transmitted to it but also any other information that it may subsequently obtain, will not be used either by it or by any other authority to which the information is subsequently transmitted to impose sanctions on any of the following: the leniency applicant; any other person covered by the transmitting authority's leniency programme (for example, the subsidiaries of the applicant); or any employee or former employee of either of the former two. It follows from this that, unless the receiving authority was already in possession of sufficient evidence to impose a sanction on the transmitting authority's leniency applicant, the guarantee will de facto confer on the latter immunity from any fine which the receiving authority might otherwise have imposed on it ([2]). A copy of the guarantee will be provided to the leniency applicant.

3.3. Enforceability of the Network notice

The Network notice is a Commission notice. As such, the provisions described above will create legitimate expectations on which leniency applicants may rely but only insofar as the Commission is concerned. The Network notice alone does not bind NCAs.

For this reason, where a case has been initiated as a result of a leniency application the Network notice provides that any information relating to that case which has been submitted to the Commission under Article 11(3) of the Regulation will only be made available to those NCAs that have committed themselves to respecting the principles set out in the Network notice. The same applies where a case has been initiated by the Commission as a result of a leniency application under the Commission's leniency policy ([3]).

All of the NCAs have been invited to sign a declaration, acknowledging the principles of the notice and declaring that they will abide by them. The terms of the declaration are set out as an annex to the Network notice. With only a few exceptions, all of the NCAs had done so by 1 May 2004. These include all of the NCAs that operate a leniency programme. Thus, irrespective of the NCA to which the application was made, protected leniency information will only be transmitted to another ECN member in one of the three circumstances described above.

A list of the authorities that have signed the declaration is published on the Commission's website ([4]). Those NCAs that have not yet done so will be free to opt in at a later stage.

4. Leniency applications to the Commission and Article 11(6)

The other area in which the Regulation has made a difference for leniency applicants is in the provisions of Article 11(6). This article provides that the initiation by the Commission of proceedings relieves the NCAs of their competence to apply Articles 81 and 82. By virtue of Article 3 of the Regulation, the NCAs' competence to apply their national competition law is also thereby removed. In such cases, leniency applicants to the Commission are arguably placed in a more favourable

([1]) This proviso is necessary so as not to nullify provisions such as that in the Commission's leniency programme that allow an applicant for immunity to withdraw its evidence if it fails to meet the requirements for conditional immunity (point 17, Commission notice on immunity from fines and reduction of fines in cartel cases (OJ C 45 of 19.2.2002, page 3).

([2]) This is quite independent of whether or not the applicant qualifies for immunity in the proceedings being brought by the authority that gathered the protected leniency information.

([3]) Paragraph 42 of the Network notice.

([4]) http://europa.eu.int/comm/competition/antitrust/legislation/list_of_authorities_joint_statement.pdf.

position under Regulation 1/2003 than they were previously (1).

This does not mean, however, that by applying for leniency to the Commission a leniency applicant can avoid completely the risk of being sanctioned by an NCA, as there is no guarantee that the Commission will necessarily initiate proceedings in the case. Given the very serious nature of cartel infringements, the Commission is clearly likely to do so where the cartel is Europe- or world-wide or where more than three Member States are involved (2). In the case of more local cartels, however, the Commission may choose not to investigate but to focus its limited resources on other cases.

To apply for leniency exclusively to the Commission and rely on Article 11(6) of the Regulation, in particular in the case of a purely national or regional cartel leaves the applicant open to the risk that another cartel member may in the meantime apply for leniency to the relevant NCA or NCAs. If the Commission should choose not to take up the case but to leave it to the NCA(s), the applicant which applied only to the Commission would be likely to find itself at a disadvantage relative to the cartel member that applied to the NCA(s).

5. To which authority or authorities should the leniency application be made?

Any cartel member that is considering whether or not to blow the whistle on a cartel will necessarily as part of the same process need to identify the authority or authorities to which its leniency application should be made. This is necessarily a matter for the cartel member to decide with the benefit of its own legal advice.

In some cases a cartel participant may be advised to apply not only to authorities within the European Union but also to authorities in other jurisdictions, such as, for example, the United States, Canada or Australia. As concerns the European Union, the prospective applicant will need first to identify those authorities which have competence to impose sanctions within the territory affected by the infringement (3). Having excluded those authorities that do not have a leniency programme, it will then need to decide which of the authorities that have jurisdiction over the case is most likely to deal with it (4). Finally, it will need to decide in respect of each authority whether it wants to make an application. This will no doubt be a delicate exercise, taking into account many different factors, including in each case, the risk of otherwise being sanctioned by the authority in question (for example, if another cartel member were to apply to that authority for leniency), the nature and size of the potential sanctions that the authority may impose, the particular terms of the authority's leniency programme and the costs of making a leniency application to it. The outcome in each case will turn on its particular facts.

Clearly it would be possible for the cartel member to apply to all relevant authorities, thus securing its position under the leniency programme of each authority with jurisdiction to impose sanctions. Businesses and their advisers make the point that this may be both difficult and costly. Realistically, however, an applicant would be unlikely, at least in the vast majority of cases, to need to consider applying for leniency to more than a maximum of four authorities within the ECN, including the Commission. This follows from the principles of case allocation within the ECN set out in the Network notice (5). These envisage the possibility of parallel action by a maximum of two or three NCAs, each acting for its respective territory. Where the effects of the infringement are felt in more than three Member States, on the other hand, the Network notice indicates that the Commission is likely to be considered best placed to act, although there is admittedly no guarantee that it will do so (6).

(1) See judgment of the ECJ in *Walt Wilhelm* (case 14/68 [1969] ECR 1).

(2) See paragraph 14 of the Network notice.

(3) Assuming that trade between Member States is affected and that Article 81 therefore applies these will always include the Commission.

(4) The Commission and the NCAs will apply the principles of allocation as set out in the Network notice at paragraphs 5 to 15. These principles should not be confused with the rules governing jurisdiction. For example, it is possible for several authorities to have jurisdiction in relation to a case, but for those authorities to agree amongst themselves that only one or some of them should deal with it. This will depend in particular on whether the authority or authorities that deal with the case will be able effectively to bring the infringement to an end and, where appropriate, to sanction the infringement adequately.

(5) Paragraphs 8 to 15.

(6) The allocation principles set out in the Network notice are not rules of jurisdiction on which parties can rely. Rather, they are general principles for the allocation of cases, the underlying purpose of which is to ensure the efficient and effective enforcement of competition law within the Community.

Certainly for a Europe- or world-wide cartel it is the Commission that is most likely to investigate the case and it would clearly make sense for leniency applicants in such cases to apply to the Commission, even if, depending on the particular circumstances of the case, they may choose out of prudence also to apply to one or more NCAs. At the other end of the spectrum, it would clearly be sensible for leniency applicants in the case of purely national cartels to apply to the NCA of the Member State concerned. The assessment for those cases which fall in between will inevitably be more difficult. As mentioned above, the situation in this respect is no different under Regulation 1/2003 than under its predecessor, however (1).

6. Cooperation with national courts

In addition to the requirement that the Commission and the NCAs must apply the European competition rules in close cooperation (2), Regulation 1/2003 also makes provision for cooperation between the Commission and the NCAs on the one hand, and the national courts of the Member States, on the other.

In particular, the Regulation provides that the national courts may in proceedings for the application of Articles 81 or 82 ask the Commission to transmit to them information in its possession or its opinion on questions concerning the application of the Community competition rules (3). This provision is essentially a reflection of the duty of loyal cooperation that already exists under Article 10 of the Treaty (4).

Given that proceedings before the national courts for the application of Articles 81 or 82 may include claims for damages for losses suffered by a party as a result of the infringement of those Articles, a cartel participant would understandably be concerned if the information which it voluntarily submitted to the Commission as part of a leniency application were subsequently to be transmitted to a national court and relied on to support a claim for damages against it. This concern is addressed in the Commission Notice on the cooperation between the Commission and courts of the EU Member States in the application of Articles 81 and 82 EC (5) (the Cooperation with courts notice).

As is explained in the Cooperation with courts notice, the Commission's duty to disclose information to national courts is not without limit. In particular, the Commission may refuse to transmit information for overriding reasons relating to the need to safeguard the interests of the Community or to avoid any interference with its functioning and independence, in particular by jeopardising the accomplishment of the tasks entrusted to it (6). The Cooperation with courts notice makes clear that the Commission would not, for this reason, transmit to a national court information voluntarily submitted by a leniency applicant without the consent of that applicant (7).

7. Concluding remarks

In this article we have identified two areas of potential concern for a cartel member that is considering applying for leniency, whether to the Commission or to an NCA. The first possible concern arises from the provisions in Regulation 1/2003 for cooperation and the exchange and use in evidence of information amongst the Commission and the NCAs making up the ECN. The second potential concern flows from the Commission's duty to cooperate with the national courts of the Member States.

As regards the ECN, whatever difficulties may be encountered when deciding the authority or authorities to which a leniency application should be made, it is important to recognise that these difficulties are not the result of Regulation 1/2003. The situation in that respect is no worse now than it was previously. Whilst this is not an excuse for complacency on the part of the Commission or the Member States, it does serve to show that some of the comments regarding the supposed negative consequences of Regulation 1/2003 have been misplaced.

(1) Council Regulation No. 17/62 (OJ 13 of 21.2.1962, page 402) as last amended by Regulation (EC) No. 1216/1999 (OJ L 148 of 15.6.1999).

(2) Article 11(1) of the Council Regulation.

(3) Article 15(1) of the Council Regulation.

(4) See case C-2/88 Imm. *Zwartveld* [1990] ECR I-3365, 16 to 22 and case C-234/89 *Delimitis* [1991] I-935, 53, both cited in paragraph 15, footnote 37 of Commission Notice on the co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 EC (OJ C 101 of 27.4.2004, page 54).

(5) OJ C 101 of 27.4.2004, page 54.

(6) See case C-2/88 Imm. *Zwartveld* [1990] ECR I-4405, 10 and 11; case C-275/00 *First & Franex* [2002] ECR I-10943, 49 and case T-353/94 *Postbank* [1996] ECR II-921, 93, cited in paragraph 26, footnote 45 of the Cooperation with courts notice.

(7) Paragraph 26 of the Cooperation with courts notice.

Where the Regulation does alter the situation, the potential concerns for leniency applicants are, as we have shown, neutralised by the provisions of the Network notice. Indeed, for those cartel cases where the Commission initiates proceedings, the situation is arguably made more certain for leniency applicants under the Regulation than under its predecessor.

As regards the potential concerns that may flow from the Commission's duty to cooperate with the national courts, this too is not a new issue, since the duty to cooperate already existed under Article 10 of the Treaty. Leniency applicants can nevertheless take comfort from the reassurance given in the Cooperation with courts notice, namely that the Commission will not, without the consent of the leniency applicant, transmit to a national court information which has been voluntarily submitted to it under its Leniency notice.

As a consequence of the above, a cartel participant that is considering applying for leniency, whether to the Commission or to one or more NCAs, should not in our view hesitate to do so now if it would have felt comfortable making an application under the old Regulation. In this respect it should also be remembered that any authority that operates a leniency programme has a strong interest in ensuring that its programme is not undermined. Rather, it will want to be able to continue to rely on its programme as a valuable tool for detecting one of the most serious and damaging violations of competition law: namely, cartels.

Commission adopts new safe harbour for licensing of patents, know-how and software copyright

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The European Commission has adopted on the 7th of April new rules for applying competition policy to the licensing of patents, know-how and software copyright. The new block exemption regulation, Commission Regulation (EC) No 772/2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements (the TTBER), was adopted together with a set of guidelines, Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (the Guidelines) ([1]). These new rules facilitate licensing. From the 1st of May licensing agreements benefit from an improved safe harbour, saving many agreements from individual scrutiny. The new rules reduce the regulatory burden for companies, while ensuring an effective control of licensing between companies holding significant market power. The new rules will contribute to the dissemination of technology within the EU and thereby contribute to the Lisbon targets. The new policy is part of the fundamental reform of the European Union's enforcement rules for antitrust which has entered into force on the 1st of May 2004.

Licensing is important for economic development and consumer welfare as it helps disseminate innovations and allows companies to integrate and use complementary technologies and capabilities. However, licensing agreements can also be used for anti-competitive purposes. For instance, when two competitors use a license agreement to divide markets between them, or when an important licensor excludes competing technologies from the market. As competition is one of the main driving forces of innovation and competitiveness, it is important to find the right balance between protecting competition and protecting intellectual property rights.

Licensing agreements that restrict competition are caught by Article 81(1) of the Treaty. However, in the vast majority of cases licensing agreements also produce positive effects. These positive effects may in many cases outweigh the possible restrictive effects. The TTBER creates a safe harbour for a good deal of such licensing agreements where the balance is positive. For agreements not covered by the safe harbour the Guidelines explain the application of Article 81 to individual cases.

Background

Article 81 (1) of the EC Treaty prohibits agreements which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. Under Article 81(3) an anti-competitive agreement may be exempted from the prohibition of Article 81(1) if the positive effects brought about by the agreement outweigh its negative effects. The Commission can 'block exempt' categories of agreements of the same nature and did so in 1996 for the licensing of patents and know-how with the technology transfer block exemption Regulation n° 240/96. ([2]) The new rules replace Regulation 240/96 which has been criticised for its narrow scope of application and its formalistic character and that many have said has contributed to a 'strait-jacket' effect. In December 2001 the Commission adopted a mid-term Evaluation Report as required by this Regulation. This was taken as an opportunity to start a thorough review of our policy towards intellectual property licensing agreements.

Most of 2002 was spent consulting stakeholders on the Evaluation Report. This consultation showed that many considered the 1996 Regulation to be too narrow in scope, too prescriptive and too legalistic. The Commission then worked out the details of a new block exemption regulation and a set of guidelines, which were adopted by the Commission for consultation purposes just before the summer break of 2003. These texts were discussed

([1]) Published respectively in OJ L 123 and OJ C 101, both of 27.4.2004. Also available on the website of the Directorate-General for Competition at: http://europa.eu.int/comm/competition/antitrust/legislation/entente3_en.html#technology

([2]) Commission Regulation (EC) 240/96 of 31 January 1996 on the application of Article 81(3) of the Treaty to certain categories of technology transfer agreements, OJ L 31 of 9.2.1996. For an evaluation of this Regulation, see the Commission's Evaluation Report, COM(2001) 786 final.

with Member States in September 2003 and were published for consultation of industry and consumer organisations and other interested third parties on the 1st of October 2003.

The public consultation took place during the months of October and November 2003. Industry and others showed a keen interest and the Commission received over 70 submissions, in general of a high quality and often providing detailed comments on the proposals. Submissions were received from industry and trade associations, from law and IP societies, from individual law firms, from national authorities, from individual companies, from universities and from consultants. While in general welcoming the replacement of the 1996 Regulation with a more economic and flexible approach, the comments were critical on a number of important aspects of the proposals. The Commission carefully read and analysed all comments and made substantial revisions to the draft proposals. The revisions remedied a good deal of the concerns expressed and helped to improve the resulting level of legal certainty, one of the concerns often expressed. The revised proposals were discussed with and supported by Member State authorities in a meeting in February 2004.

The new rules

The new rules are firmly aligned on the Commission's new generation of block exemption regulations and guidelines for distribution agreements and horizontal co-operation agreements, while not ignoring the differences that obviously exist between licensing and distribution or licensing and R&D agreements. This was also requested by many of those who commented on the Evaluation Report of December 2001. The new rules therefore have the following general characteristics:

— The new block exemption Regulation is based on having a back list only. By doing away with the white and grey lists of the 1996 Regulation, the strait jacket effect is avoided: whatever is not explicitly excluded from the block exemption is now exempted. This leaves companies more freedom to devise their licensing agreements according to their commercial needs;

— The scope of the new rules is extended by covering all types of technology transfer agreements for the production of goods or services. The new Regulation covers not only patent and know-how licensing but also designs and software copyright licensing, as requested by many of those who commented on the Evaluation Report. Where the Commission does not have the powers to adopt a block exemption regulation, as for patent pools and for copyright licensing in general, the Guidelines give clear guidance as to future enforcement policy ([1]);

— The new rules make a clear distinction between licensing between competitors and licensing between non-competitors. In particular the applicable hardcore list should differ. Competition problems are more likely to arise in licensing between competitors than in licensing between non-competitors;

— The TTBER provides the safe harbour only below certain market share thresholds, 20% cumulative for licensing agreements between competitors and 30% each for agreements between non-competitors (see articles 3 and 8). Market shares need to be calculated both for the relevant affected product market(s) and technology market. The market share on the technology market is, however, defined in terms of the market share of products produced with the licensed technology and thus based also on the product market. For market share calculation normally sales value data of the preceding calendar year are to be used and a 2 year grace period is foreseen in case the relevant threshold is exceeded;

— A licence agreement can not benefit from the block exemption if it contains a so-called hardcore restriction of competition (see below);

— Some restrictions are excluded from the benefit of the block exemption while the remainder of the agreement can continue to benefit from the block exemption (see article 5). This concerns in particular obligations on the licensee to exclusively grant back or assign severable improvements to or new applications of the licensed technology and no-challenge clauses.

The hardcore list

The hardcore list in article 4 of the TTBER specifies the restraints which are considered very serious restrictions of competition. If such a hardcore restriction is found in a licence agreement, this denies the benefit of the block exemption to the whole agreement and also makes individual application of Article 81(3) unlikely. The list makes a distinction between licensing between competitors and between non-competitors.

([1]) Council Regulation No 19/65/EEC, the enabling regulation, only allows adoption of block exemption regulations for transfer of technology agreements between two parties and concerning industrial property rights.

As for licensing between competitors the following are hardcore restrictions (see article 4(1)):

— Price fixing;

— Output limitation;

— Allocation of markets or customers;

— Restricting the licensee to exploit its own technology;

— Restricting the parties to carry out R&D, unless such is indispensable to prevent disclosure of licensed know-how.

As for licensing between non-competitors the following are hardcore restrictions (see article 4(2)):

— Vertical price fixing;

— Restriction of the licensee's passive sales;

— Restriction of the licensee's active and passive sales inside a selective distribution system.

Both for licensing between competitors as for licensing between non-competitors article 4 contains specific exceptions to the hardcore list. This extends the scope of the block exemption to cover a number of commonly used restrictions such as field of use restrictions, active and passive sale restrictions between licensor and licensee to protect their exclusive territories, captive use restrictions and others.

The Guidelines

The Guidelines provide guidance on the application of the TTBER and on the application of Article 81 outside the scope of the block exemption. The Guidelines make it very clear, as is also done in the recitals of the Regulation, that there is no presumption of illegality outside the safe harbour of the block exemption provided that the agreement does not contain a hardcore restriction of competition. In particular, there is no presumption that Article 81(1) applies merely because the market share thresholds are exceeded. Individual assessment based on the principles described in the Guidelines is required.

In order to promote predictability beyond the application of the TTBER and to confine detailed analysis to cases that are likely to present real competition concerns, the Commission has created a second safe harbour within the Guidelines. It takes the view that outside the area of hardcore restrictions Article 81 is unlikely to be infringed where there are four or more independently controlled technologies, in addition to the technologies controlled by the parties to the agreement, that may be substitutable for the licensed technology at a comparable cost to the user.

The Guidelines provide not only a general framework for analysing licence agreements, but also contain specific sections on the application of Article 81 to various types of licensing restraints, in particular royalty obligations, exclusive licensing and sales restrictions, output restrictions, field of use restrictions, captive use restrictions, tying and bundling and non-compete obligations. The Guidelines also contain a section on the assessment of technology pools, that is arrangements whereby two or more parties assemble a package of technology which is licensed not only to contributors to the pool but also to third parties. Agreements establishing technology pools and setting out the terms and conditions for their operation are not — irrespective of the number of parties — covered by the block exemption but are addressed in that section of the Guidelines.

Conclusion

These new rules represent an important improvement compared to the 1996 Regulation in terms of clarity and scope. While providing more freedom to companies to draw up licence agreements according to their commercial needs, they will also enhance the protection of competition and therewith innovation. The new rules in addition bring about an important degree of convergence between the application of competition policy to licence agreements in the EU and US.

Existing State aid in the acceding countries

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Background

The mechanism

In order to prevent incompatible aid from being 'imported' into the EU on the date of accession, a system was set up for examining measures which were put into effect in the Acceding Countries before 1 May 2004 and are still applicable after that date (the existing aid mechanism). The purpose of this mechanism is to provide Acceding Countries and economic operators with legal certainty as regards State aid measures that are applicable after the date of accession. The system applies to State aids in all sectors of activity, except for the transport and agricultural sectors, for which different provisions apply.

The Accession Treaty

The Accession Treaty defines as existing aid three categories of measures:

First, aid measures put into effect before 10 December 1994 are automatically considered as existing aid from the date of accession.

Second, measures submitted by the Acceding Countries in 2002 were examined by the Commission in the light of the state aid acquis. Measures considered to be in line with the state aid rules were qualified as existing aid and included in the list annexed to the Accession Treaty. This list was finalised in November 2002.

Third, for measures not accepted to the Treaty list and for those submitted after its finalisation, the so-called 'interim procedure' for existing aid was introduced. Under this procedure, Acceding Countries may submit to the Commission aid measures once they are approved by the national state aid authorities. The Commission services assess these measures as to their compatibility with the state aid rules. Measures submitted to the Commission before 1 May 2004 will be considered as existing aid from the date of approval by the Commission.

When the Commission has serious doubts about the compatibility with the Treaty of an aid measure submitted under the interim procedure it shall take a decision to initiate the formal investigation procedure. This decision enters into effect on the date of accession.

Difference between new aid and existing aid

All measures still applicable after the date of accession, which constitute state aid but do not fulfil the conditions of existing aid set out above, shall be considered as new aid upon accession.

The qualification of a measure as existing aid as opposed to new aid has very important consequences for the following reasons:

— The Commission can immediately initiate the formal investigation procedure with regard to new aid not cleared under the interim procedure, either on its own initiative or following complaints by interested parties. If the aid is found to be incompatible with the Treaty, the Commission shall by decision order it to be recovered from the beneficiaries.

— In contrast to new aid, an existing aid measure is 'protected' from actions of the Commission since it is subject to a co-operation procedure between the Commission and the Member State. In this context, the Commission invites the Member State either to repeal or to modify the existing aid measure in order to ensure compliance with the State aid rules. In case the Member State does not agree with the Commission proposal, the latter may also in this case open the formal investigation. However, no recovery can be ordered with respect to aid disbursed before the closure of the formal investigation.

— Structural funds money is available to Acceding Countries from 1 January 2004. Structural funds and Phare programs often include measures involving state aid. According to the Structural Funds Regulation, Community funds may not be used to co-finance state aid measures that have not been previously approved by the Commission.

Overall, the interim procedure provides Acceding Countries with legal certainty as regards state aid measures which are still applicable after accession. This is why the Commission has strongly encouraged the Acceding Countries to submit in a timely manner all state aid measures to the Commission so as to allow it to decide which measures can be considered as existing aid and those which cannot, before 1 May 2004.

Statistical overview of the existing aid mechanism

First phase — Treaty list

During the first phase of the existing aid mechanism (establishment of the Treaty list in 2002), the ten Acceding Countries submitted 320 measures. Out of these, 222 measures (69%) were approved by the Commission and have been listed in the Accession Treaty. The breakdown by country is as follows:

Table 1 —
Measures approved for the Treaty list

CY	CZ	EE	HU	LV	LT	MT	PL	SK	SI	Total
31	120	3	21	6	3	7	7	9	15	**222**

Note: CY — Cyprus, CZ — Czech Republic,
EE — Estonia, HU — Hungary,
LV — Latvia, LT — Lithuania,
MT — Malta, PL — Poland,
SK — Slovakia, SI — Slovenia.

All Acceding Countries were invited to re-submit the measures which were not included in the Treaty list during the interim procedure phase.

Second phase — interim procedure

During the interim procedure phase, which lasted from the beginning of 2003 until the end of April 2004, Acceding Countries submitted 559 measures.

A large number of these measures have not been approved by the Commission yet. This in no way means that they are problematic. Most of them have been submitted only recently, so that no decision has been reached so far. For a significant amount of measures, the information so far submitted is incomplete and exchanges of information are on-going. Other measures have been considered not to be applicable after accession or have been withdrawn by the Acceding Countries. A number of pending cases are likely to lead into an opening of the formal investigation procedure. However, a large majority are very likely to be approved.

The commission's state aid policy on activities of public service broadcasters in neighbouring markets

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1. Introduction

1.1. Public service broadcasting

Traditionally public service broadcasters provided radio and television programmes through a limited number of analogue channels. For technical and strategic reasons relating to the scarce availability of the analogue spectrum, Member States exercised a strict control over the broadcasting sector. Competition only emerged in the 80's when additional transmission means, such as satellite and cable, became available. Yet — as opposed to other sectors — broadcasting has not been entirely liberalised. Moreover, it is not foreseeable — nor deemed desirable — that the activity would be left to the market alone and that public service broadcasting would disappear.

Although certain quality norms can be imposed on private broadcasters, it is generally felt that public service broadcasting is necessary for society. It has been argued that public service broadcasting can supply a quality that is not achievable by market players, even with heavy regulations. Market players are purely driven by economic considerations and have no incentives to broadcast costly programmes that do not generate sufficient revenues.

The status of public service broadcasting is recognised in a special protocol that is attached to the Treaty of Amsterdam [2]. In this Protocol Member States declared that public broadcasting plays an important role in fulfilling the democratic, social and cultural needs of societies and that Member States can provide funding to operators for fulfilling these needs.

Member States have laid down the remit of public broadcasters in national law. Considering the Amsterdam Protocol, it is beyond discussion that the remit of public service broadcasting can be defined in broad terms. A mission obliging a given broadcaster to provide 'a wide selection of programmes, including news, general information, education, art, sports and entertainment' can therefore be accepted.

As Member States have certain wishes on the availability of programmes and their quality, they are willing to make available considerable amounts of money for organising public service broadcasting. In 2001 about 15 billion € of public funds were granted to public broadcasters in the Member States. These funds can be based on direct budgetary support, a licence fee or on a combination of public funds.

The broad definition of public service broadcasting, especially when there is room for interpretation, may lead to what one may call a 'mission creep [3]'. In addition, the total cost of providing the public service may become very high. Various Member States have solved the high cost burden by introducing dual financing (public financing + advertising) and allowing that public service broadcasters carry out commercial activities. This, in turn, can create problems of cross-subsidisation and drifts into parallel markets

1.2. Neighbouring activities of public broadcasting companies

Given the broad task of public service broadcasting, there is a constant occasion to move into neighbouring markets. Both vertical and horizontal integration in neighbouring markets takes place.

Providing information in television programmes on certain products can lead to entering this product market itself, as every viewer is also a potential buyer of the product. A programme on cooking may lead to the publication of cookery books. In addition, also the need to buy certain products, programmes but also events, can lead to setting up neighbouring activities. One can thus

(1) This text reflects the personal opinion of the authors. It does not intend to represent the views of DG Competition or, *a fortiori*, of the Commission.
(2) Protocol on the system of public broadcasting annexed to the Treaty.
(3) The process by which a mission's methods and goals change gradually over time.

notice that public radios have moved into the organisation of events such as mega dance parties and that public television stations have set up film production companies.

Moreover, technological developments significantly contributed to the expansion of public broadcasting activities outside the traditional scope of broadcasting. Due to the convergence of markets that transmit information goods, the internet now has become the playground of direct competition between the written press and broadcasters to attract viewers and to sell advertising space. Both publishing companies and public broadcasters have introduced on-line news sites.

It is cost efficient to move into neighbouring markets, as the cost structure of the media industry involves substantial economies of scale in content production. Once created, the (digitised) content can always be provided to an additional person at zero marginal cost of production. Especially websites are cost-efficient tools to convey information to the public. Firstly, many of the costs of production are already covered by the public service broadcasting task ([1]). Secondly, most distribution costs are borne by the users of the information who pay for their PC and for the communication cost, either through telephone or satellite communication cost or subscription to a broadband line. As digital technology is cheaper than analogue technologies the entry barriers are low, which reduces the risk of monopolies and increases pluralism.

Although the television programmes and internet services (partly) use the same content, the nature of the two services is different. Most of the original considerations to regulate broadcasting, such as frequency scarcity, need to preserve pluralism, reach of whole population are not necessarily valid for new media services. Whereas in free-to-air broadcasting bundled television programmes of a fixed content are transmitted to the whole population through a very limited number of channels, the internet is a many-to-many interactive medium where the individual consumer can request a whole range of varied information to meet his/her own specific need.

The Commission received a number of complaints alleging that the entrance of a public broadcaster in neighbouring markets distorts competition in these markets where often private operators are active already. Contrary to the complaints that the Commission received in the nineties, now most of the complaints on public broadcasting come from companies that are active outside the broadcasting sector, such as publishing and new media companies, film production companies and companies providing technical broadcasting services.

2. State aid

Aid granted by Member States to public service broadcasters, which distorts competition, is incompatible with the common market, insofar as intra-Community trade is affected. In the field of public service broadcasting, the Commission has accepted that Article 86(2) EC can constitute a derogation from the State aid ban, as the public service broadcasting task can be considered as a service of general economic interest (SGEI).

Article 86(2) of the Treaty provides that companies, which have the task to provide a SGEI shall be subject to the rules of the Treaty, insofar as the application of these rules does not obstruct the performance of the assigned task. The Commission has clarified its policy in the broadcasting field in a Communication on the application of State aid rules to public service broadcasting (Broadcasting Communication) ([2]).

The Broadcasting Communication lays down the principle that the State aid to public service broadcasting should be proportionate to the net costs of providing a clearly defined and entrusted public service broadcasting task. Whenever a public broadcaster carries out commercial activities in neighbouring markets, the Commission has to ensure that market rules are followed. This means that no cross-subsidisation should take place to commercial activities. Below, under section 2.1, it will be illustrated how the Commission has applied this principle in its decisions.

Public service broadcasters have claimed that certain activities in neighbouring markets should not be considered as a commercial activity, but as part of their broad public service task. Due to media convergence the term ‘broadcasting’ would be outdated and the public service remit of public broadcasters should be understood as providing ‘information services’ to society. It shouldn't

([1]) In the broadcasting sector the Commission allows that, when the same resources are used to perform public service and non-public service tasks, the costs are allocated on the basis of the difference in the firm’s total costs with and without the non-public service activities.

([2]) Communication on the application of State aid rules to public service broadcasting, OJ C 320 of 15.11.2001, page 5.

matter through which means their programmes are broadcasted, being either digital channels, Internet or telephone networks.

Below under section 2.2, it will be illustrated under which conditions the Commission can accept that public broadcasters carry out activities in neighbouring markets as a SGEI.

2.1. Cross-subsidisation to non-public service activities in neighbouring markets

In its decision on ZDF Media Park the Commission assessed whether the investment by a subsidiary of the German public broadcaster in a theme park related to the programmes of ZDF constituted incompatible State aid ([1]). As the subsidiary acted as a private investor and all transactions would be done at market conditions, the Commission concluded that no cross-subsidisation from the broadcasting fees took place. So, no State aid was involved.

Recently, the Commission has analysed the annual financing of a number of free-to-air general interest channels of public broadcasters ([2]). DG Competition's services have sent letters to Italy, Spain, France and Portugal explaining which measures they should implement to ensure for the future that the recurrent financing systems of the public service broadcasters comply with State aid rules. DG Competition's services have proposed that the Member States put in place safeguards to avoid future spill-over State aid to neighbouring markets.

For this purpose (i) separate accounting should be applied between commercial and public service activities in accordance with the Transparency Directive, (ii) mechanisms need to be introduced to avoid over-compensation of public service costs, (iii) market prices have to be applied for the commercial activities, and (iv) the arm's length relationship has to be followed between the public service broadcaster and its commercial subsidiaries.

2.2. State funding for public service activities in neighbouring markets

In other decisions the Commission has analysed whether activities of public broadcasters, which fell outside the scope of the traditional public service task of providing free-to-air public service channels of general interest, could be accepted as a public service.

In *BBC-24 hour news* ([3]), the UK authorities intended to extend BBC's public service remit by adding a special news channel. In its decision the Commission accepted that the new digital broadcasting channels could be considered as a public service and argued that the delivery platform could not change the public service qualification, as long as its programme concept and its funding arrangements remained unchanged ([4]). As the legislative and administrative framework left room for doubt as to what was defined as a public service and what not, the Commission concluded it was of decisive importance that there was an official entrustment to the BBC of the task of providing a specific public service.

In *nine digital BBC services* ([5]) the Commission assessed the extension of the public service remit by adding nine new thematic digital radio and television channels. The Commission accepted the new services as an additional public service broadcasting task, as they addressed the democratic, social and cultural needs of the society ([6]). Again the Commission stressed the need for a formal prior entrustment of the new public service task. The Commission considered that a clear and precise identification of the activities covered by the public service remit, and the conditions under which such activities have to be performed, is important for non-public service operators, so that they can plan their activities.

Recently, the Commission analysed whether new Internet activities performed by the BBC (Digital Curriculum) ([7]), where free educational software material was provided for schools and students, could be considered as a SGEI. The Commission did not share the opinion of the UK authorities,

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([1]) NN 2/2002, *Germany, ZDF Mediapark Mainz-Lerchenfeld,* OJ C 137 of 8.6.2002.

([2]) The article *'State aid and broadcasting: state of play'* by Depypere, Broche and Tigchelaar in the Competition Policy Newsletter of Spring 2004 describes the analysis that the Commission carried out in these cases.

([3]) NN 88/98 *Financing of a 24-hour advertising-free news channel out of licence fee by BBC*, OJ C 78 of 18.3.2000, page 6.

([4]) *BBC 24-hour news channel,* paragraph 57.

([5]) N 631/2001 *BBC Licence Fee* of 22.5.2002, OJ C 23 of 30.1.2003.

([6]) *Broadcasting Communication,* paragraph 34 and N 631/01 *BBC licence fee,* paragraph 27.

([7]) N 37/2003 *BBC Digital Curriculum,* OJ C 271 of 12.11.2003.

that the service was part of the BBC educational public service broadcasting mission. Although the Commission did not agree upon the broadcasting nature of the service, as it missed the 'close association' with television and radio activities, it found the aid compatible under Article 86(2) EC as a SGEI in the field of education.

From the above, it can be deducted that the Commission does not base its analysis of the compatibility of the State aid on the technical transmission means, but looks at the nature of the additional service.

Considering the broad definition of the public service broadcasting task and the intensive competition that takes place in the broadcasting sector and its neighbouring markets, it is very important for competitors to know the borders of the public service task of public broadcasters.

Public authorities need to take the changes in the broadcasting sector into consideration when defining and entrusting additional public service tasks. This means that the authorities should evaluate whether the original arguments to define a service as a SGEI are still valid, given the new circumstances. It can be debated whether providing a bundle of digital channels, which includes a news channel, a sport channel and an entertainment channel is similar to providing a general interest channel that offers a mix of programmes, including news, sport and entertainment.

Let us take the example of football. The inclusion of football matches on a general interest channel is based on the argument that the viewer will continue to watch a cultural programme after the football match. Also the argument has been made that public service channels need to attract a substantial part of the population to avoid marginalisation and thereby loose the support from society as a whole. However, these arguments seem weaker in a situation where football is broadcasted on a special purpose channel. The recording and subsequent broadcasting of matches seems to lack editorial input and no other programmes are broadcasted. In addition, the availability of many digital channels fragments the audience into subgroups of viewers, making it difficult to reach a substantial part of the population with one specific channel.

Similarly, in a context of growing interactivity, the authorities should consider how far the broadcasters will be allowed to provide increasingly personalised public services through the 'back-office' of the programmes. For example by offering SMS-services concerning weather forecast or sport results or by offering personalised language lessons through the internet.

3. Conclusion

Public broadcasters have to follow market rules when they carry out commercial activities that fall outside the scope of the public broadcasting remit. Safeguards should be in place to prevent cross-subsidisation from public service activities to commercial activities.

In principle Member States are free to define SGEI and the task of the Commission is limited to check possible manifest errors. The definition should leave no doubt as to whether an activity which is performed by the public service broadcaster is intended by the Member State to be included in the public service remit or not. It cannot be upon the discretion of the public broadcaster to interpret the broadly defined public service broadcasting task.

Member States should make clear why additional services have to be carried out as SGEI and what the need and special characteristics of such services are compared with services offered by commercial operators ([1]) ([2]) ([3]). We expect that the technical evolution, with the spreading of digital TV and interactive services, will further increase the relevance of these questions.

([1]) See paragraph 9 of the Communication from the Commission on SGEI (2001/C 17/04) *'(...) it is necessary for the relevant public authorities to act in full transparency, by stipulating with some precision the needs of the users for which SGEI are being established (...)'.*

([2]) Judgement of 10.12.1991, Case 179/90, *Merci convenzionali porto di Genova v Siderurgica Gabrielli,* [1991] ECR I-5889, par. 27, Judgement of 13.12.1991, Case 18/88, *Régie des télégraphes et des téléphones v GB-Inno-BM,* [1991] ECR I-05941, par. 22.

([3]) The relevance of this issue is also addressed in the article *'Compensation for services of general economic interest: some thoughts on the Altmark ruling',* by Santamato and Pesaresi in the Competition Policy Newsletter of Spring 2004, page 17.

Competition day in Dublin

On 29th April 2004 the Irish Competition Authority hosted the 9th European Competition Day (an event organised by the competition authority of the Member state holding the EU Presidency in collaboration with the Commission).

The issue of 'Promoting Competition for the Benefit of Consumers' attracted more than 250 participants from various Member states and an important Irish presence lead by the Tánaiste and Minister of the Department of Enterprise, Trade and Employment Ms Mary Harney TD, and Mr. John Fingleton, Chairperson of the Irish Competition Authority. The program of the day included the following:

- Competition, Productivity and Growth in Small Open Economies
- Allowing Competition to Work: Liberalisation, Ownership and Regulation

Extracts from Commissioner Mario Monti's Speech at the Competition Day in Dublin 29/4/2004

'Competition policy is currently going through important times of change. This is essential to make the competition rules more effective in a European Union of 25 States fully integrated in a globalised economy. The new regulatory framework, which is timed to become operational on the 1st of May in line with the expansion of the EU, is more efficient and sensible: competition authorities will intervene only in cases which affect consumers negatively'. (...) 'The competitive performance of industry should not deflect from the positive impact of competition policy on consumer welfare'. (...) 'Competition law and effective enforcement are consumers' best friends.'

'On my appointment as Commissioner for Competition, I pledged that I would give central importance to the consumer. (...) The competition authorities have a role to play in taking account of input from consumers. Public awareness of the importance of vigorous competition policy is a valuable ally. The Competition authorities through-out the world need support and understanding from consumers of the interest they have in healthy competition. Awareness of this is gradually increasing in Europe.'

'However, it is of crucial importance that we have active consumers and consumer associations which provide the competition authorities with market information, given that it is consumers who are usually on the receiving end of anti-competitive practices. While a simple letter from one consumer is rarely enough, a series of complaints or a complaint submitted by a consumer association, where the conduct complained of is likely to affect the interests of its members, can normally provide the Commission with a basis to open an investigation. I see here a role of increasing importance for consumer organisations.'

'Another aspect of importance for consumers, which is complementary to the enforcement of the EU competition rules by the public authorities, is the possibility for private parties to ask national courts to grant damages resulting from illegal behaviour or to order the termination of illegal behaviour. As ruled by the European Court of Justice, the full effectiveness of Article 81 would be at risk if it were not open for an individual to claim damages for losses caused by an infringement of competition law. It is well established that private enforcement of the EU competition rules is currently lagging behind public enforcement. This negatively impacts on compliance incentives and the efficiency of the EU competition rules.'

'The Commission is committed to a proactive, modern and effective competition policy. Not only will this ensure that the market functions in such a way as to maximise benefits for consumers, but it also gives consumers an unparalleled opportunity to participate in the fight against violations of the competition rules.'

European Competition Day in Amsterdam, 22 October 2004

The next European Competition Day will take place in Amsterdam (The Netherlands) on the 22nd of October. The Competition Day is jointly organised by the Netherlands Competition Authority and the Market Enforcement Directorate of the Dutch Ministry of Economic Affairs, in co-operation with the European Commission with the following theme: ***'compete!'***

It is the responsibility of undertakings to comply with the competition rules and compete with each other. The main instruments which ensure compliance are:

- Public enforcement by public bodies
- Private enforcement through civil proceedings;
- Compliance: internal codes of conduct.

Some questions to be addressed are: why are some Member States behind on private enforcement and how can this be changed? How can undertakings be encouraged to implement compliance programmes? How is consumer welfare ensured by enforcement. Do YOU have the answers to these questions? Could YOU provide a solution?

Do not hesitate to join the Competition Day on 22nd of October in the Okura Hotel in Amsterdam. On the evening of arrival, the 21st of October we will welcome you with an informal drinks reception.

Further information on how to register can be obtained via this address: competition@minez.nl

EU-China dialogue on Competition formalised with the signature of Terms of Reference on May 6 2004

Andrés FONT GALARZA, Directorate-General Competition, unit A-5

The European Commission and the Chinese Government signed on May 6 an agreement on a structured dialogue on Competition. This is the first such competition dialogue embarked on by China and it will help foster the interests of both European and Chinese companies when doing business in each other's territory.

China has recently adopted provisional rules on mergers and antitrust and has drafted a comprehensive antitrust law which is in the legislative agenda of the National People's Congress.

China understands that competition policy is a key element of a modern economy and a must to achieve an effective single market. DG Competition has been supportive of the Chinese initiatives in the competition field even if there are aspects in the laws that could certainly be improved. In particular, DG Competition wants to ensure a non-discriminatory framework for business operating in China. Due to its particularities, the European competition model can be a very good source of inspiration for China. Both parties have therefore initiated a regular dialogue on their respective competition systems.

Commissioner Monti visited Beijing in November 2003 and Director General Philip Lowe in April 2004. As a result of these preparatory missions Commissioner Monti signed detailed Terms of Reference for a dialogue on competition policy on May 6 with the Minister of Trade Bo Xilai, in the presence of the Prime Minister Wen and President Prodi. The text can be found on DG Competition's website. The Terms of Reference provide for bilateral meetings both in Brussels and in Beijing in order to discuss the latest developments in the competition policy at each jurisdiction and exchange views on all areas of competition policy. The dialogue will, in particular, deal with:

- Antitrust law and enforcement, including an exchange of views on new developments on legislation and on the fight against international cartels,
- Merger control in a global economy,
- Liberalisation of public utility sectors as well as state intervention in the market process,
- Technical and capacity building assistance to China in the field of competition policy.

DG Competition will also provide technical assistance to China in the competition policy field under the existing EU-China cooperation framework. The Terms of Reference are being followed by frequent contacts at technical level between DG Competition and the Chinese officials in charge of China's emerging competition system.

The launch of the new ICN Cartel Working Group

Georg ROEBLING, Directorate-General Competition, unit A-5

Following its successful events in Naples (2002) and Merida (2003), the recent Seoul Annual Conference of the International Competition Network ([1]) (ICN) brought together for a third time more than 100 senior anti-trust officials to promote cooperation and convergence in international competition policy. The conference, one of the largest competition conferences ever organised on the Asian continent, was also attended by a significant number of advisors from the private sector, the consumer movement, and academia.

The conference was marked by two major highlights: the adoption by all ICN Members of a set of **four new Recommended Practices for the review of multi-jurisdictional mergers** ([2]) , and the creation of a new key project, the **Cartel Working Group.**

In Seoul, ICN Members invited DG Competition of the European Commission and the Hungarian Office of Economic Competition to assume the overall responsibility for the new Cartel Working Group. At the same time, after two intensive years at the helm of the ICN's Working Group on Capacity Building and Competition Policy Implementation (CBCPI WG), the Commission was able to pass on this task into new hands. The Korean Fair Trade Commission and the Secretariat for Economic Monitoring of Brazil's Ministry of Finance were nominated as new joint chairs for the (renamed) Competition Policy Implementation Working Group.

New Cartel Working Group

Until the Seoul conference, the ICN had focused on mergers and on advocacy/capacity building, complementing its extensive work in those areas only with discussions on the rather specific subject of anti-trust enforcement in the regulated sectors. Yet there has always been universal agreement that for a body like the ICN, comprising almost all of the world's existing anti-trust authorities, it could only be a matter of time until the issue of cartels would come onto its agenda.

Against this backdrop, ICN member agencies in Seoul decided that the time had come to remedy this gap, and to begin discussions on how to better cooperate in the fight against cartels, and to gauge the scope for convergence across jurisdictions.

For many anti-trust agencies, the fight against cartels, and in particular against hardcore cartels (i.e. cartels directed at price fixing, bid rigging, market sharing and market allocations) is at the heart of their enforcement activity. The fight against international cartels is also a key element in the creation of well-functioning governance mechanisms in a globalising world.

As is noted in the mandate creating the Cartel Working Group, globalisation has created worldwide markets for many products and services, but it also presents certain challenges to competition authorities. They are faced with cartel activity that is increasingly cross-border. For competition agencies that remain national or regional, the pursuit of international cartels is, for both legal and practical reasons, particularly demanding.

At the same time, the mandate of the Cartel Working Group recognises the need to address the challenges of anti-cartel enforcement also at the domestic level by sharing agencies' experiences.

In all its works, the new Working Group will exercise care to respond to the interests and needs of younger competition agencies, which typically represent developing and transition economies.

The new Cartel Working Group will be able to build on the important work already undertaken in other *fora,* such as the OECD and the WTO. Moreover, the success of the Merger Working Group is already providing some useful inspiration as to how this project could make a real impact on agencies' daily enforcement and advocacy work in the cartel area.

However, one must also be aware of the constraints that any attempt at international convergence in the fight against cartels has to contend with. One of the key challenges for the

(1) Complete information on the ICN, including all relevant conference material discussed at the Seoul conference, is available www.internationalcompetitionnetwork.org.

(2) For a presentation of these Recommended Practices, as well as of other issues on the agenda in Seoul see *Roebling, Ryan* and *Sjöblom,* The International Competition Network (ICN) two years on, 3 Competition Policy Newsletter (2003), page 37.

Cartel Working Group will be to do justice to the diversity of legal systems which govern the anti-cartel work of ICN member agencies. By way of illustration, suffice it to recall that some jurisdictions prosecute cartels as a criminal offence, whilst others have opted for a civil administrative prosecution system. These differences between the legal systems inevitably have repercussions on, for example, agencies' competencies, on the tools that they can use to detect cartels, on the entity that can be prosecuted (companies and/or individuals), and on the sanctions that can ultimately be imposed on offenders (e.g. fines and/or imprisonment). This diversity will make the elaboration of such non-binding yet aspirational global standards in the form of 'Recommended Practices' a task that will be at least as challenging as it has been in the merger area.

The Structure of the Cartel Working Group

The Cartel Working Group has organised its substantive discussions in two subgroups:

A **first Subgroup,** led by the US Department of Justice and its Brazilian counterpart, the Secretariat of Economic Law at the Ministry of Justice, will work on the basic concepts related to the necessity and benefits of the fight against cartels. The mandate envisages that this Subgroup would define categories of hard core cartels, their harmful economic impact on the market and their negative effects on consumers.

It remains to be seen in which format the Subgroup will present its first conclusions to the ICN's 4th Annual Conference, scheduled for June 2005 in Bonn. Apart from a comprehensive stock-taking exercise, it would however, and despite the aforementioned challenges, not be unrealistic to expect that a number of Guiding Principles, or similar recommendations, could be put forward.

A **second Subgroup,** jointly chaired by the Canadian Competition Bureau and the Australian Competition and Consumer Commission, seeks to support competition agencies in the development and refinement of their practical enforcement techniques. To this end, agencies will share with their peers their experiences on a range of investigation techniques. The list of suitable issues for discussion is long but likely to include, at some stage or another, such key tasks as how to detect cartels with or without leniency applications, how to conduct productive inspections, how to collect evidence that will withstand scrutiny in court, and how to operate an effective leniency program.

Also this group is still reflecting on how to present the results of its work to the Bonn conference. There is however an idea emerging of building up, over the next few years, a manual which would summarise successful investigation techniques. In addition, this group will also be responsible for the preparation of the International Cartel Workshop (ICWS), a training event directed at the staff of agencies involved in cartel investigations. The next ICWS will take place in Sydney in November 2004.

Private enforcement of Community competition law: modernisation and the road ahead

Donncadh WOODS, Ailsa SINCLAIR and David ASHTON, Directorate-General Competition, unit A-1

I – Background

The decentralisation of the enforcement of Community antitrust law set in place by Regulation 1/2003 (1) ('the Regulation') envisages enforcement not only by the competition authorities of the Member States, but also a complementary role for enforcement through litigation between private parties before the national courts. When drafting its proposal for the Regulation, the Commission was aware that its monopoly on Article 81(3) represented a major obstacle to more extensive application of the competition rules by national courts. (2) The Regulation eliminates the exemption monopoly of the Commission, and as a result national judges will be able to rule on whether Article 81(3) is applicable. Article 6 of the Regulation states that national courts shall have the power to apply Articles 81 and 82 (in their entirety). The elimination of the exemption monopoly and the related abolition of the notification system will stimulate private parties to have more frequent recourse to national courts in actions for damages. Moreover, Article 3 of the Regulation provides that national courts shall apply Community competition law to anticompetitive behaviour which may affect trade between Member States where they apply national competition law to such behaviour. It is anticipated that private enforcement will thus increase as a result of the Regulation.

Indeed, recital 7 of the Regulation explicitly foresees the possibility of private actions for damages for breach of Community competition law. It provides as follows:

> National courts have an essential part to play in applying the Community competition rules. When deciding disputes between private individuals, they protect the subjective rights under Community law, for example by awarding damages to the victims of infringements. The role of the national courts here complements that of the competition authorities of the Member States.

The recent Commission Notice on complaints emphasises the complementary nature of public and private enforcement of the competition rules. (3) The Notice states that 'the Commission holds the view that the new enforcement system established by Regulation 1/2003 strengthens the possibilities for complainants to seek and obtain effective relief before the national courts.' (4) Moreover, the notice states that 'public enforcers cannot investigate all complaints'. (5)

The recent case law of the Community courts has also emphasised the importance of enforcement by private parties of Community competition law. In its ruling in *Courage v Crehan,* (6) the ECJ held that national courts must provide a remedy in damages for the enforcement of the rights and obligations created by Article 81 EC. The Court held as follows:

> The full effectiveness of Article [81] of the Treaty and, in particular, the practical effect of the prohibition laid down in Article [81(1)] would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition.
>
> Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert,

(1) Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the EC Treaty, OJ L 1, 4.1.2003.

(2) White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty of 28 April 1999 at para 100.

(3) Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty, OJ C 101, 27.4.2004, pp 65-77, part II A and B (paras 7 to 18). Cf. in particular para 9: 'Regulation 1/2003 pursues as one principal objective that Member States' courts and competition authorities should participate effectively in the enforcement of Articles 81 and 82'.

(4) *Ibid,* para 18.

(5) *Ibid,* para 8.

(6) Judgment of the ECJ of 20 September 2001 in Case C-453/99 *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* [2001] ECR 1.

which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community. ([1])

The central role of private enforcement to modernisation and the importance of private enforcement as a complementary enforcement mechanism to public enforcement was highlighted by Commissioner Monti in his interview in the recent special edition of the Competition Policy Newsletter ([2]) and his speech at the European Competition Day at Dublin in April. ([3]) The Commissioner emphasised that the possibility for victims of anticompetitive behaviour, including consumers, to claim compensation for losses caused by such behaviour would strengthen the deterrent effect of the competition rules and help to create a stronger culture of compliance with, and enforcement of, those rules. The lack of private enforcement in Europe has been identified by commentators as a principle weakness in the EU competition enforcement system. ([4])

II – The advantages of private enforcement

It is anticipated that greater private enforcement of Community competition law would have *inter alia* the following advantages: ([5])

- It would increase deterrence against infringements and increase compliance with the law.
- The victims of illegal anticompetitive behaviour would be compensated for loss suffered.
- Private enforcement is an effective way to deal with certain types of cases, especially those involving a commercial dispute between two parties and those where the claimant has close access to evidence concerning the defendant's business activities.
- The Commission and the national competition authorities do not have sufficient resources to deal with all cases of anticompetitive behaviour.
- Actions before the courts can offer speedier interim relief to undertakings than public proceedings.
- Courts can order the unsuccessful party to pay the successful party's legal costs. An undertaking's legal costs are not recoverable in the case of a complaint to a public authority.
- Private actions will further develop a culture of competition amongst market participants, including consumers, and raise awareness of the competition rules.

III – Successful private action in Europe to date

The case law in Europe showing successful claims for damages for breach of Community law to date is limited. It should be noted though that many actions may be settled out of court and details are rarely public, as secrecy is normally a condition of settlement, so that the small number of known cases may represent only the tip of a much bigger base of litigation.

In the English courts it appears that, prior to the judgment of the Court of Appeal in the *Crehan* case (see below), there had been one action for breach of Community competition law in which infringement has been established, the Article 82 action brought by Hendry and Williams against the snooker world governing body, ([6]) though in that case no damages were awarded. On 21 May this year the English Court of Appeal gave judgment in the *Crehan* case, ([7]) the same proceedings in which the ECJ had established the principle of the availability of damages for breach of Community competition law in an earlier Article 234 reference. The Court overturned the earlier judgment of the High Court ([8]) and found that the claimant was entitled to damages to the amount of just over £130,000. This is the first case in the English courts in which damages have been awarded for breach of competition law.

([1]) *Ibid,* paras 26 and 27.
([2]) Policy Newsletter special edition, 'The EU gets new competition powers for the 21st century'.
([3]) Speech entitled 'Proactive competition policy and the role of the consumer', Dublin Castle, Dublin, 29 April 2004.
([4]) See for example the interview with Professor (Ordinario) Luigi Prosperetti in *Corriere della Sera,* 19 April 2004 *('Tra i due Antitrust preferisco Monti')* in the context of the Microsoft case.
([5]) See also para 16 of the Notice on complaints.
([6]) Judgment of the High Court of 5 October 2001 in *Hendry, Williams et al v The World Professional Billiards and Snooker Association Limited.*
([7]) Judgment of the Court of Appeal of 21 May 2004 in *Crehan v Inntrepreneur* [2004] EWCA 637.
([8]) Judgment of the High Court of 26 June 2003 in *Crehan v Inntrepreneur et al* [2003] EWHC 1510 (Ch).

In Italy by contrast there does not appear to have been any successful damages actions for breach of Community competition law. (1)

In Germany the only such action which could be characterised as successful was in fact a declaratory action and no damages were awarded. In *British Telecommunications plc. and Viag Interkom GmbH/Deutsche Telekom* (2) the court held that the defendants had acted in breach of Article 81(1) prior to the effective date of the exemption granted to a telecoms joint venture by the Commission and that they could be liable in damages pursuant to Section 823(2) of the German Civil Code in conjunction with Article 81(1) and under Section 1 of the *Gesetz gegen Wettbewerbsbeschränkungen* (GWB). However, no damages were actually awarded because the claimants had only sought before the District Court a declaratory judgment that they were entitled to damages. Subsequently, pending appeal of the proceedings to the Bundesgerichtshof, the claimants withdrew the action following a settlement.

There appear to be more successful damages actions to date in France than in the other principal European jurisdictions. (3) For example, in 1996, in *Eco System/Peugeot,* the Paris Commercial Court awarded damages of approximately € 245,000 to Eco System for losses in its operating results caused by Peugeot's infringement of Article 81 as established by the European Commission in an earlier decision adopted in 1991. The most notable French case to date is perhaps that of *Mors/Labinal,* which concerned the supply of tyre pressure indication systems for aircraft. In 1998 the Paris Cour d'Appel awarded damages of approximately € 5 million to the claimant for breach of both Articles 81 and 82. (4) The same court had previously decided, in 1993, that there had been an infringement of those provisions. (5) The Cour d'Appel in its 1993 judgment had decided on liability and ordered the defendants to pay a provisional amount of damages while referring final assessment of quantum to a later hearing.

There are some examples of successful damages actions for breach of Community competition law from other European jurisdictions. In a judgment of the Swedish Supreme Court of 2002, (6) the Swedish Civil Aviation Administration (Luftfartsverket) was obliged to repay SAS approximately € 66 million (SKr600 million) and SAS was relieved from paying approximately € 44 million (SKr400 million) to the Luftfartsverket on the basis of a finding by the court of a discriminatory pricing practice on the part of the Luftfartsverket relating to Arlanda airport. (7) In the Netherlands, in *Theal BV and Watts/Wilkes* (8) the claimant filed a complaint with the Commission and also sued for damages before the national courts. Prior to the eventual adoption by the Commission of a decision finding that the defendants' practice of precluding parallel imports was in breach of Article 81, (9) the District Court of Amsterdam decided that the defendants were in breach of Article 81 and awarded damages to the claimant. (10)

IV – Some obstacles to private enforcement

In the *Crehan* judgment, the ECJ gave some potential guidance as to the remedial and procedural conditions for private actions for breach of Community competition law, but there are a number of outstanding questions which remain unanswered and are, at present, left to national law. Some aspects of these issues are outlined below.

(1) There have however been successful actions for damages for breach of national antitrust law in Italy: see *Telsystem/SIP-Telecom* (judgments of the Corte d'Appello of Milan of 18 June 1995 and of 24 December 1996), *Albacom/Telecom Italia* (judgment of the Corte d'Appello of Rome of 20 January 2003) and *Bluvacanze Spa/I Viaggi del Ventaglio Spa et al* (judgment of the Corte d'Appello of Milan of 30 April 2003).

(2) [1998] CMLR 114 (Landgericht, Düsseldorf).

(3) There are also, as in Italy, recorded successful actions for breach of national competition law before the French courts (see for example the *UGAP/CAMIF* case, judgments of the Paris Cour d'Appel of 13 January 1998 and 22 October 2001).

(4) CA Paris, 30 September 1998, *Europe,* December 1998, comm. no 410.

(5) CA Paris, 13 May 1993, *Europe,* July 1993, comm. no 300, upheld by the *Cour de Cassation* on further appeal (Cass Com, 14 February 1995, *Bull IV,* no 48, *Europe*, April 1995, comm. no 146.)

(6) *Luftfartsverket v SAS* (Case T33-00).

(7) The repayment remedy in this case may be distinguishable from a pure damages claim.

(8) Judgment of the Amsterdam District Court of 11 January 1979 (unreported).

(9) Decision of 19 February 1977 (OJ L 39/19).

(10) Damages were to be assessed in a separate procedure, but because of the defendant's subsequent bankruptcy this never occurred.

Standing

In the case of *Max Boegl Bauunternehmung et al/ Hanson Germany,* (1) the Berliner Landgericht held that purchasers of cement at cartel prices could not claim damages unless they had been individually targeted by a market-sharing cartel. The court reasoned that it was not enough that prices in the market in which the purchasers were buying were affected as a whole by the cartel. A requirement of individual targeting may restrict, in particular, the scope for inter-state actions. Standing under the law of some of the other major civil law jurisdictions, such as for example Italy, also appears to be narrow. It should be noted however that the *Max Boegl* judgment is under appeal before the Kammergericht. (2) Furthermore, the current draft (3) of the 7th amendment to the GWB in Germany, which is intended to amend the GWB in light of EC modernisation, provides that market participants are to be protected by Articles 81 and 82 EC even if they are not directly targeted by the infringing behaviour. In contrast, in the recent *Provimi* judgment, (4) the English High Court held that a claimant has standing to sue the subsidiary of a cartelist even where, firstly, the subsidiary implemented the cartel price without knowledge of the cartel, and secondly that claimant made no actual purchase from the subsidiary in question (see further below in relation to the latter point, which also concerns causation).

Discovery

The common law lawyer is under an obligation towards the court to disclose all evidence, both supportive and harmful to his case, (5) whereas lawyers in civil law systems are, generally speaking, obliged only to produce to the court those materials which are necessary to prove the case. The civil law lawyer cannot rely on the disclosure obligation on the other party to obtain the evidence needed to prove his case to the extent that the common law lawyer can. This is subject to the power in civil law systems for the parties to apply in certain circumstances to the judge for an order for disclosure of material from the other parties to the proceedings or from third parties. In this case however, it appears that the order in question often has to be made in respect of pre-identified documents. This is key in limiting the potential for discovery of evidence in such a system. Therefore, the potential claimant in civil law jurisdictions needs to have at his disposal sufficient evidence to satisfy the burden of proof before launching an action, (6) whereas the common law system offers more scope for launching actions on the grounds that evidence favourable to the claim might be found during discovery.

Collective actions

Some form of collective action can enable consumers and other parties with a small individual claim to bring an action. Otherwise, such parties may not have sufficient incentive to bring a claim, particularly when set against the possibly high legal costs involved. Class actions as recognised in US procedure are not common in the procedural systems of the Member States of the EU. The key feature of a US class action is that an individual, including a lawyer, can bring a claim on behalf of an unidentified group of plaintiffs. Instead, the principal EU jurisdictions tend to favour, if anything, representative actions brought, in the field of antitrust actions, by consumer associations. Provision to this effect exists for example in the antitrust laws of the UK and Germany. In the UK, consumer associations specified by the Secretary of State can bring actions for damages on behalf of two or more individual consumers before the Competition Appeal Tribunal (the specialised competition court established by the Enterprise Act) on the back of an infringement decision made by a public authority (either the Office of Fair Trading or the European Commission). (7) General English civil procedure also offers the Group Litigation Order (GLO) mechanism 'to provide for the case management of claims which give rise to common or related issues of fact or law'. (8)

In Germany, the present section 33 of the GWB allows for an action for an injunction to be brought before the courts by 'associations for the promotion of trade interests provided the association has

(1) Judgment of the Berliner Landgericht of 27 June 2003 (AZ 102 O 134/02 Kart).
(2) AZ 2 U 13/03 Kart. It is understood that the hearing is scheduled for November.
(3) Draft dated 26 May 2004.
(4) The judgment of the High Court of 6 May 2003 in *Provimi Limited v Trouw (UK) Limited et al* 2003 EWHC 961 (Comm).
(5) Civil Procedure Rules (CPR) 31.6 for standard disclosure in English civil proceedings.
(6) The French *Nouveau Code de Procédure Civile* states explicitly (Article 146(2)) that requests for documents from the other party or third parties cannot be made 'en vue de suppléer la carence de la partie dans l'administration de la preuve'.
(7) Section 47B of the Competition Act 1998, as inserted by section 19 of the Enterprise Act 2002.
(8) CPR 19.10 (Group Litigation Orders are covered by CPR 19.10-19.15).

legal capacity'. The current draft of the 7th amendment would extend the possibility for bringing injunction actions to consumer associations as well. The present section 33 applies strictly only to breaches of German competition law, (1) but the provisions of the new draft s33 would apply to breaches of EC and national competition law. There is no actual provision for trade or consumer associations to bring damages actions in either the present or the proposed s33 (the UK antitrust procedural rules cover instead damages actions and not actions for injunctive relief). The proposed 7th amendment would though establish the possibility for trade and consumer associations to bring actions to recover the infringer's profits in relation to breach of national and EC competition law, though the associations would have to then transfer the proceeds of these actions to the Treasury. (2)

In Sweden, recent legislation (3) provides for different types of collective action, including actions brought by a non-profit-making association that represents consumer interests in disputes between consumers and undertakings, and private actions brought by an individual on behalf of a group. However, other provisions of Swedish law restrict at present the standing of consumers to bring antitrust actions.

Indirect purchasers

The law of some Member States, such as Italy (4) and Sweden, appears to limit standing to claimants who can show a direct injury, such that actions by consumers or their representative associations become significantly more difficult to bring. The effect of the German decision in *Max Boegl* (above) would appear to have a similar effect as to standing for consumers. However, it has been argued that under Community law recovery would not be limited to direct purchasers. (5)

Proving the infringement

Establishing the infringement of Article 81 or 82 can be difficult for claimants. For example, in two notable recent actions before the English courts for breach of Community competition law, *Crehan* (before the High Court) and *Arkin,* (6) the judge found that there had been no substantive infringement of Article 81 *(Crehan)* or Article 82 *(Arkin).* However, as noted above, the Court of Appeal in *Crehan* subsequently overturned the High Court, finding that Article 81 had been infringed by the defendant. In doing so the Court of Appeal relied heavily on Commission decisions in different proceedings in relation to the same market and on the Commission's preliminary conclusions in relation to the agreement in question.

Burden of proof

It appears to be the case that discharging the burden of proof can be a deterrent to private enforcement. This is because it can be very difficult for claimants to amass sufficient evidence to prove their claim. (7) To help address this problem, in Germany section 20(5) of the GWB puts the burden of proof on the defendant to disprove the abuse in cases of abuse of dominance brought by SMEs where there appears to be a violation 'on the basis of specific facts and in the light of general experience'. The defendant is required to clarify those aspects of its business activities 'which cannot be clarified by the competitor... but which can be easily clarified, and may reasonably be expected to be clarified' by the defendant. This provision applies strictly only to national law. The French system provides for a different mechanism: the ministre chargé de l'économie can intervene to submit observations with a view to helping the claimant establish breach. (8) This appears capable of application in proceedings for breach of Community competition law, but does not appear to have been so invoked yet.

(1) See section 96 of the GWB.

(2) s34a of the current draft.

(3) The Act on Class Actions, 2002:599, which entered into force on 1 January 2003.

(4) See *inter alia* the judgment of the *Corte di Cassazione* dismissing for lack of standing a consumer action seeking annulment of a bank loan for violation of Article 81 EC (*Corte di Cassazione*, Sez I, 4 March 1999, n 1811). The court held that Articles 81 and 82 protected primarily undertakings and not consumers.

(5) See the General Report in the 1998 report of the FIDE on the application of Community competition law on enterprises by national courts and national authorities at p 44, referring to the case law of the Community court on the protection of Community law rights by the national courts.

(6) Judgment of the High Court of 10 April 2003 in *Arkin v Borchard Lines Limited et al* [2003] EWHC 687.

(7) Compare Article 2 of Regulation 1/2003, which provides that the burden of proving an infringement of Article 81(1) or of Article 82 rests on the party alleging the infringement, while the burden of proving that the conditions of Article 81(3) have been met rests with the party seeking to rely on that provision (i.e. the defendant).

(8) Article L470-5 Com. Code.

Causation

It can be difficult to attribute loss specifically to the defendant's behaviour rather than to other factors such as a general economic slowdown or even the claimant's own business strategy. In the English case of *Hendry,* it appears to have been difficult for one of the claimants to argue successfully for the existence of damage caused by loss of a business opportunity. ([1]) Attributing loss to the claimant's behaviour breaks the causal link and the English court found to this effect (obiter) in *Arkin.* In *Provimi* (above), the court held in relation to causation that selling on the market at a fixed price could be held to have caused loss to a purchaser, even though that purchaser did not purchase from the infringing undertaking in question. The court reasoned that in conditions of competition, the seller could be expected to provide the product at a lower price to the benefit (either direct or in terms of the downward pressure this would have put on prices charged by other sellers) of such purchaser.

Calculation of damages

It does not seem to be the case that the courts of any EU jurisdiction have developed a coherent approach to the quantification of damages in antitrust cases. National courts appear often to address this issue by turning to the methods of calculating damages available in normal civil proceedings.

Case law of the English courts has indicated a preference for a straight-forward approach to the quantification of damages, rather than opting for sophisticated analysis, such as econometric analysis. In *Arkin* for example the judge stated (obiter) that in his view the court should take a ‘commonsense’ approach to the quantification of damages. ([2]) The claimants in *Hendry,* although successful in establishing an infringement, were unable to recover any damages partly because they did not provide any evidence of loss. Both the High Court and the Court of Appeal in *Crehan* gave great weight to the evidence of the claimant's expert accountant witness in relation to the quantification of the claimant's lost profits. The High Court had assessed quantum of damages at around £1,300,000 but the Court of Appeal reduced this to around £130,000. The principal difference between the two courts' methods of quantification was that the High Court awarded damages for loss of profits as between the date of the injury (when Crehan surrendered the lease of the pub he was running) and the time of the judgment (i.e. an *ex post* approach), whereas the Court of Appeal assessed damage as at the time of injury on an *ex ante* basis and so did not award damages for lost profits for the period between the time of injury and the date of judgment.

The German court in *Max Boegl* appears to have indicated that evidence provided by the claimants on the measure of damage calculated by reference to a hypothetical market price was not sufficient. The court thus seems to have imposed a high evidentiary standard as to the calculation of damages. In order to help ease the claimant's evidentiary burden as to quantification of damages, the current draft of the 7th amendment in Germany provides that the profits made by the infringer from the infringement can be taken into account in assessing the damages due to the claimant.

As to the Italian cases, in *Telsystem/SIP-Telecom* the court stated the principle that the loss of opportunity to enter the market amounted to harm that should be compensated and left the calculation of damages to experts at a later hearing. The French courts dispose of a similar mechanism, leaving the quantification of damages to a later stage once liability is established. This happened in *Mors/ Labinal,* where quantification was referred by the Cour d'Appel to a later hearing of that court, and the defendants were ordered to pay a provisional amount of damages in the interim. The English Court of Appeal in *Crehan* indicated that its assessment of quantum of damages was ‘provisional’ and said that it would if necessary hear further submissions from the parties on the issue. It also indicated that it would hear any further submissions of the parties as to the level of interest and tax on damages at a later hearing.

Passing on

The question of whether an antitrust defendant can argue as a defence that the claimant did not suffer loss on the grounds that he passed on the illegal overcharge to the next purchaser is an important one for the structure of private antitrust enforcement. There does not appear to be any case law directly on this point from any European jurisdiction in relation to actions for breach of EC competition law. In Germany, an earlier draft of the 7th amendment had provided explicitly for the exclu-

([1]) Para 157 of the judgment.

([2]) Paras 591 and 596 of the judgment.

sion of the passing on defence, (1) but this is not included in the most recent draft, on the grounds that under current law the passing on defence would be excluded by the courts.

V – The road ahead

The Commission is currently looking at the conditions under which private parties can bring actions before the national courts of the Member States for breach of the Community competition rules. It is commonly stated that in the US private action accounts for around 90% of competition enforcement, whereas as noted above, in Europe to date there have been very few successful actions in this field.

The objective of the exercise is to seek to encourage the enforcement of the Community rules on competition by means of private actions before the courts of the Member States. Work undertaken in relation to private enforcement of Community competition law should be seen in the context of making the reforms brought about by Regulation 1/2003 effective in practice, and as an important further step in the promotion and enforcement of the competition rules throughout the Community. As stated above, private enforcement of the Community competition rules would act as an additional deterrent to anticompetitive behaviour, as well as compensating the victim for losses suffered.

Research is required to establish the nature and extent of the potential obstacles to private enforcement of the competition rules in the Community. At the end of 2003, the Commission commissioned a study to assist it with this work. (2) An interim report of the study was given to the Commission in March and the final report should be available to it this summer. Based on the results of the study and its own work, the Commission will, in the second half of 2004, commence work on the drafting of a Green Paper with a view to identifying potential ways forward.

(1) Draft dated 17 December 2003.
(2) Open procedure COMP/2003/A1/22.

Competition and the water sector

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A debate has developed in recent years in several Member States (including the UK, France, Germany and Portugal) and in the European Parliament on how best to organise the water sector and introduce more transparency and competition. The European Commission should have a voice in such a discussion given that EC competition and internal market rules have an important impact on the water sector. This article looks at the reasons for the growing interest in the water sector, the obstacles to competition, and what the EC rules can do to address these problems.

Interest in the water sector

The water sector has attracted attention recently for both economic and competition reasons.

From an economic point of view water is an important sector of the economy where there are growing competitive pressures. First, the water sector is reported to have an annual turnover in the EU of about € 80 billion, which is more than the turnover of the gas sector. Secondly, the Water Framework Directive adopted in 2000 introduced economic concepts into the environmental legislation by requiring Member States to produce economic analyses of water use from 2004 and to introduce the principle of full cost recovery from 2010. Thirdly, higher environmental standards have increased the cost of water services, and this is likely to continue as existing rules enter into force and standards are increased. Fourthly, infrastructure will require significant investments, particularly in the new Member States, which are likely to come largely from the private sector given the pressures on public expenditure.

From a competition point of view our attention has also been drawn to the water sector. First, an increasing number of antitrust, State aid and merger cases in the water sector have been brought to our attention. Secondly, horizontal issues such as Services of General Economic Interest (SGEIs) and public procurement rules, including on Public Private Partnerships (PPPs), have been widely discussed and have direct implications for the water sector. Thirdly, other organisations, such as the OECD, have taken an interest in the water sector.

DG Competition commissioned an independent study into competition in the water sector in the EU and the final report is available on DG Competition's website. Since then more information has been gathered via the Member States, operators and consumers. In 2003 the Commission Communication on Internal Market Strategy Priorities 2003-2006 announced that the Commission services would look into the water sector and could publish a Working Paper in 2004, and this was repeated in the White Paper on Services of General Interest of May 2004.

Structure of the water sector

From a competition point of view, the most important characteristics of the water sector are:

- water distribution (ie the local transport of water to the final customer) and waste water collection (ie the local collection of waste water from the final customer) are normally natural monopolies at least for domestic customers;
- the fixed costs linked to water distribution and waste water collection represent up to 70 percent of the total supply costs for domestic customers, and this is largely a sunk cost;
- water is difficult and expensive to transport, with transport costs per 100km representing about 50 percent of the wholesale cost of water (compared to 5 percent for electricity and 2.5 percent for gas);
- water and waste water operators are almost always vertically integrated, although there is a growing use of public private partnerships (PPPs) which might change this;
- given the health and environmental needs for high standards in the water sector, national, regional and local authorities have traditionally imposed public service obligations on water operators and granted them exclusive rights as compensation;
- water is provided under the control of local authorities in almost all countries (the UK is an exception) which often only cover a relatively small area.

Two conclusions can be drawn immediately. First, liberalisation of the water sector would be unlikely to result in the same benefits as in other network industries because a large proportion of the cost of supply of residential customers is incurred by the distribution network (which would remain a monopoly) and there is little scope for supply from distant sources. Secondly, third party access (TPA) to the network — which was used to introduce competition in other network industries — raises concerns about quality standards and liability if these standards are not met. As the health and environmental consequences of unsafe water and waste water can be very serious, the adoption of general rules on TPA would be controversial. The issue of TPA should therefore be examined case by case. Nevertheless it will be interesting to follow market developments in England and Wales which have introduced compulsory TPA to the water networks for the supply of industrial customers following the adoption of the Water Act 2003.

Competition problems in the water sector in the EU

Wholesale markets, in particular supply to commercial consumers

Although water distribution and waste water collection for domestic purposes are generally considered to be natural monopolies, the supply of water and waste water services is not. For example, large water consumers could in theory be supplied (a) by the local operator; (b) by a neighbouring operator (either via specific pipeline for the site or via third party access to an existing pipeline); (c) through self-supply of water (eg water abstraction rights for raw water from a river or aquifer and possibly own treatment of this raw water); or (d) by a neighbouring water consumer carrying out its own water services (see c above) and with spare capacity.

The question is therefore whether there are legal obstacles to competition. The main threat to competition at the wholesale market, including supply to industrial and commercial consumers, seem to be **anti-competitive state measures** (ie state and local measures which cannot be justified by Article 86(2)). Examples include exclusive rights whose scope or duration is greater than justified; national legislation that permits water operators to share markets (eg Germany seems to allow agreements not to poach customers from each other); and a discriminatory allocation of water abstraction rights, often for indefinite periods.

In addition, **vertical restrictions** arising from exclusive long term supply dealings may be harmful. Examples could include long-term exclusive contracts between an independent treatment plant (possibly constructed under a PPP) and a water operator. **Horizontal restrictions** between operators may also be harmful and contrary to EC law even where national law allows them.

Market for the supply to households

Unlike the market for supply to industrial consumers where the quantities can be large enough to justify constructing new pipes, direct water to water competition in the household market would require third party access to the networks and so is unlikely to develop significantly in the near future. The main competitive pressure for domestic consumers therefore comes from competition for the market (ie competition to operate a local monopoly). The main barriers to competition in this market seem to be the lack of transparency when services are provided in-house by the owner of the network (normally the local authority) and problems with public tendering when the owner outsources the exclusive right to operate the network.

Water is subject to national and EC competition rules

The EC competition rules apply to all undertakings where there is an effect on trade between Member States.

The ECJ has consistently held that the concept of undertaking covers any entity engaged in an economic activity, and any activity consisting of offering goods and services on a given market is an economic activity. On this basis it seems that the provision of water and waste water services would be considered to be an economic activity, except possibly for domestic consumers in Ireland where the local authorities pay for water through taxation. This is despite recital 1 of the Water Framework Directive which states 'water is not a commercial product like any other but, rather, a heritage which must be protected, defended and treated as such', as this refers to water in nature rather than to the provision of water services.

There can be an effect on trade in the water sector (a) if the water consumer is sited close to a border and so could be supplied from a neighbouring Member State, (b) if the water consumer uses the water services as an input into goods that are then traded, (c) where the water operator is dominant on a substantial part of the European Community (eg supplies large cities or regions), (d) when there is a cumulative effect from a number of smaller networks, or (e) when a contract or concession is outsourced and an operator in another Member State might be interested in it. Normally if there is no effect on trade and the EC competition rules do not apply then the national competition rules will apply.

It is common for water operators to be entrusted by the relevant authority with public service obligations (eg universal service) and to receive in compensation exclusive rights, which remove them from the scope of the competition rules. But in accordance with Article 86(2), the exclusive rights must be proportionate to the service of general economic interest.

Application of the competition rules can help to address these problems

As noted above, liberalisation is probably not the best approach at this stage, but it is possible to encourage transparency and competition within the current structure of the market. This is in line with the views of the European Parliament which called in its resolution on the Green Paper on Services of General Interest for modernisation not liberalisation of the water sector. To encourage competition two important issues must be addressed.

The first is to limit the scope and duration of the exclusive rights granted to local monopolies to the minimum necessary to allow them to provide the public service obligations with which they are entrusted. The application of the competition rules, and in particular Article 86, is essential to achieve this. As public service obligations generally only cover domestic and not industrial purposes, the same should apply to the scope of any special or exclusive rights (see Corbeau (Case C-320/91)). So industrial users should be allowed to choose the most economically advantageous water and waste water services. Similarly, the exclusive right should not cover ancillary services (eg laying pipes or reading meters) which could be done by third parties without compromising the economic equilibrium of the provision of the service of general economic interest. When an exclusive right is granted linked to a specific investment (eg the construction of a treatment plant) its duration should also be limited to the minimum necessary not to compromise the economic equilibrium of the project.

The second is to ensure that there is a competitive market whenever an authority decides to outsource water activities. The competition rules could have a role to play here but this is primarily a question of the application of the public procurement directives and the related rules coming directly from the EC Treaty (eg non-discrimination, equal treatment, transparency). There is also a need for greater clarity of the term ‘outsourcing’, and the ECJ is examining the line between outsourcing and in-house contracts in three pending cases. More transparency in the market (eg via benchmarking) could also help competition.

Conclusion

Even if ‘liberalisation’ does not seem to be appropriate in the water sector at this stage, there is scope to improve competition and transparency in the sector. The most important issues to address to improve competition in the sector are first to reduce the exclusive rights, which are widespread in the sector, to the minimum necessary and secondly to improve the functioning of the outsourcing market. Both issues will be addressed in the Working Paper foreseen in the Internal Market Strategy and the White Paper on Services of General Interest, and could also be addressed by competition or internal market cases if appropriate.

Access to gas pipelines: lessons learnt from the Marathon case

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1. Introduction

Access to gas pipelines is an essential prerequisite for the successful liberalisation of the European gas markets. If new suppliers do not obtain access to existing gas pipelines, the possibility for gas consumers to switch to a new supplier will remain theoretical ([1]). It is therefore not surprising that the Commission pays particular attention to any obstacles to an effective Third Party Access regime.

The Commission has two instruments to ensure Third Party Access to gas pipelines. There is on the one hand sector-specific legislation based on internal market directives (Directive 2003/55/EC ([2]) and Directive 98/30/EC ([3])). The sector-specific legislation, which requires implementation into national law, provides for a Third Party Access regime including provisions on unbundling and an active role of a gas regulator. There is on the other hand European competition law, which obliges dominant operators to grant third parties access to their pipelines, either on the basis of the essential facilities doctrine or by relying on the principle of non-discrimination (once a dominant operator granted access to its pipelines, it has to offer the same service to other market participants) ([4]).

When making use of the second instrument (i.e. competition law), the Commission in principle has two possibilities to support the liberalisation process and the creation of an effective Third Party Access regime: it can either establish important precedents by formal decisions, on which market participants can rely in future, or it can informally settle cases with the companies, which allegedly infringed European competition law, in return for the companies improving their Third Party Access regime.

2. The Marathon case

The Marathon case, which was finally concluded on 30 April 2004, provides an excellent example of how the Commission's enforcement of competition law through settlements can support the liberalisation process.

The underlying facts of the Marathon case date back to the early nineties, when the Norwegian gas producer Marathon — a subsidiary of an American oil company — requested access to the pipelines of five continental European gas companies, namely the three German companies Ruhrgas, BEB (a joint venture between ExxonMobil and Shell) and Thyssengas (today a full subsidiary of RWE), the Dutch gas company Gasunie (owned by the Dutch State, ExxonMobil and Shell) and the French company Gaz de France. These companies refused arguing that they themselves wanted to buy Marathon's uncommitted gas. After some further attempts to obtain access Marathon decided to sell the gas to the European gas companies.

A few years later — following the termination by Marathon of its gas supply contract with these companies — the situation repeated itself. Marathon once again requested access to the gas pipelines of the European companies. They refused again on the ground that the contract was not terminated in a valid manner. Marathon therefore continued to sell the gas to the European gas companies.

Following the second attempt to obtain access to pipelines, Marathon eventually lodged a complaint with the European Commission arguing that the behaviour of the parties had amounted to a violation of European competition law. The complaint

([1]) See the Third Benchmarking Report on the implementation of the internal electricity and gas market commission; Commission staff working paper, 1.3.2004. Available at: http://europa.eu.int/comm/energy/gas/benchmarking/index_en.htm.

([2]) OJ L 176 of 15.7.2003, p. 57.

([3]) OJ L 204 of 27.7.1998, p. 1.

([4]) Cf. Commission notice on the application of competition rules in the telecommunications sector, OJ C 265 of 22.8.1998, §85.

alleged not only that the companies concerned unreasonably refused access individually, which would be a potential abuse of their dominant position in violation of Article 82 EC, but also that they colluded to refuse access to Marathon in violation of Article 81 EC. At the same time as filing a complaint with the Commission, Marathon and two of the companies involved entered into an arbitration proceeding, in which Marathon requested damages. When the arbitration case was concluded with an out of court settlement, Marathon withdrew its complaint. However the Commission took the view that it would be in the Community interest to pursue the matter on an ex officio basis. In this respect it considered that the Marathon case might be suited for a settlement: the alleged infringement dated back some years but repetitions could not be excluded if the Commission had taken a lenient approach, in the meantime the first gas directive had been adopted (i.e., there was no need to establish a precedent on access to pipelines in a formal decision) and commitments to improve the Third Party Access regime would probably be more beneficial for European gas consumers than a prohibition decision. The Commission therefore offered the companies the option to settle the case, which would allow them to maintain their legal position.

All the companies concerned eventually opted for the settlement route. Thyssengas was the first company to avail itself of this offer, followed by Gasunie ([1]), BEB ([2]), and recently also Ruhrgas and Gaz de France ([3]). The details of the respective settlements can be found on the websites of the companies concerned. It is however worth describing the approach followed by the Commission in settling cases informally under Regulation 17/62 ([4]).

In order to prepare the settlement discussions the Commission first identified the areas in which an improvement of the respective Third Party Access regime would be particularly desirable. It did so after conducting a market survey with market participants in the Member States concerned as well as potential entrants into these markets. In this respect the Commission established that progress was particularly needed with regard to transparency; treatment of access requests; congestion management; balancing; and access regime (entry-exit). All these areas were also identified later on as key areas in the so-called Madrid Guidelines ([5]), developed by the forum of European regulatory authorities, the European gas industry and the European Commission. However, contrary to the Madrid Guidelines, which apply across Europe, the Commission was prepared to adapt the commitments to the specificities of each of the gas transport markets concerned. At the same time the Commission kept in mind that common standards across Europe will facilitate cross-border transports and supplies.

During the subsequent negotiation process the Commission took into account the manner in which the companies had contributed to the alleged infringement and the measures they had taken in the meantime to create a Third Party Access regime. In this respect the Commission cooperated closely with the respective national authorities (including independent regulators where they exist). The Commission also showed significant flexibility with respect to the time when the companies wanted to carry out the discussions. However when it came to the substance the Commission was of the view that a company that opted for the settlement route later than the others should not benefit from the fact that in the meantime the market had developed further. As a consequence, the threshold for acceptable commitments became stricter over time.

Once a provisional agreement on the commitments was reached with the companies the Commission carried out a market test with market participants and associations representing the interests of gas consumers or trading companies. Their comments were taken into account before the Commission finally accepted the commitments. In return the Commission closed the case for the company concerned under the condition that the commitments would be respected.

([1]) IP/03/547, 16.4.2003.

([2]) IP/03/1129, 29.7.2003.

([3]) IP/04/573, 30.4.2004.

([4]) The new Regulation 1/2003 of 16 December 2002 (OJ L 1 of 4.1.2003) on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty and repealing Regulation 17/62, entered into force on 1 May 2004. It provides for a possibility to adopt formal commitments decisions pursuant to its Article 9.

([5]) http://europa.eu.int/comm/energy/gas/madrid/index_en.htm.

The commitments, which run for approximately four years from their signature, will be constantly monitored. As the Commission decided that it would not monitor the commitments itself, the companies and the Commission agreed on a trustee, which carries out the monitoring tasks and reports to the Commission once a year. The experience with these reports is quite satisfactory so far. The positive reactions of market participants also show that the commitments assisted in creating better functioning gas transmission markets, even if significant further efforts are still needed.

3. Conclusion

The Marathon case shows how the Commission makes effective use of competition law in order to improve the Third Party Access regimes in Europe. Combined with the efforts relating to the gas supply markets (see in particular cases ENI/Gazprom, Dong/DUC, GFU) [1] the Commission has also demonstrated its commitment to the successful liberalisation of the European gas sector, which is beneficial for the competitiveness of the European industry as a whole.

(1) Cf. Lindroos/Schnichels/Svane, Liberalisation of European Gas Markets – Commission settles GFU case with Norwegian gas producers; Competition Policy Newsletter 2002, n° 3, p. 50.; Schnichels/Valli, Vertical and horizontal restraints in the European gas sector – lessons learnt from the DONC/DUC case; Policy Newsletter 2003, n°2, p. 60.; Nyssens/Cultrera/Schnichels, The territorial restrictions case in the gas sector: a state of play; Competition Policy Newsletter 2004, n° 1, p. 48.

Commission adopts Decision in the Microsoft case

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1. Introduction

On March 24 2004, the Commission concluded its Microsoft investigation by way of a formal Decision. This brought to an end proceedings which had lasted just over five years. The Commission found that Microsoft had abused its dominant position in PC operating systems by (i) refusing to provide interoperability information necessary for competitors to be able to effectively compete in the work group server operating system market; and (ii) tying its Windows Media Player with Windows.

2. Procedure

The case originated with a complaint in December 1998 from Sun Microsystems, which alleged that Microsoft, with its Windows product, enjoyed a dominant position in PC operating systems, and that it had abused this dominant position by reserving to itself information that certain software products for network computing, called work group server operating systems, needed to interoperate fully with Windows. Following an investigation into this complaint, the Commission issued a Statement of Objections on 1 August 2000 which focussed on the interoperability issues in Sun's complaint.

In parallel, in February 2000, the Commission had launched an *ex officio* investigation into Microsoft's Windows 2000 generation of PC and server products, as well as Microsoft's incorporation of Windows Media Player into its PC operating system product. On 30 August 2001, the two procedures were joined with the sending of a second Statement of Objections to Microsoft. On 6 August 2003, following an extensive market enquiry, the Commission issued a third Statement of Objections, focussing on both issues of interoperability and tying. An Oral Hearing was held on 12-14 November 2003.

3. Microsoft's dominance

The common point of departure for both of Microsoft's abuses was its overwhelmingly dominant position in PC operating systems, the software that runs PCs. Microsoft's current market share in this market, with its Windows product, is between 90 and 95%, and it has enjoyed the same high market shares for many years. In its response to the third Statement of Objections, Microsoft recognised its dominance in this market.

The Decision highlighted that the key to Microsoft's enduring dominance were the network effects relating to the applications that run on Windows. Applications that are written to Windows will not run on other operating systems. The main benefits that consumers derive from a given PC operating system relate to the number and variety of applications that they can run on it. Similarly, software developers who write applications value operating system platforms that enable them to reach the greatest number of users. There is therefore a self-reinforcing dynamic, because the higher the number of users of a given operating system platform, the greater the number of applications that applications developers write for that platform and *vice versa.*

Due to the ubiquity that Microsoft has achieved on the PC operating system market, virtually all commercial applications are written first and foremost to the Windows platform. There is therefore a very strong network effect which protects Microsoft's position. This is called the *'applications barrier to entry'*.

4. Microsoft's abuses

4.1. Interoperability

The Decision identifies a relevant market for work group server operating systems. These are operating systems which are designed and marketed to deliver collectively to PC users the core tasks of file and print sharing and group and user administration within a corporate/administrative network. As such, interoperability with PCs is a necessary attribute of these products. The Commission also found that these operating systems are generally installed on cheaper servers.

As regards demand side substitutability, these operating systems fulfil a different demand to other operating systems such as: (i) higher-level operating systems, which support mission/business-critical applications; or (ii) 'edge' server operating systems, such as firewall or web server operating systems. As regards supply side substitutability, although different server operating systems within a given product range are generally built on a common 'code base', each server operating system within this product range needs to be optimised according to the tasks that it is designed to fulfil, and this requires a specific development and testing process. This process involves significant time and costs. Supply side substitutability from other markets does not therefore represent an appreciable competitive constraint in the market for work group server operating systems. The Decision also identifies significant barriers to entry in the work group server operating system market, in particular due to the presence of network effects in that market.

Sun supplied evidence that it had requested technical information on how Windows work group servers interoperate with Windows PCs in order to adapt its own work group server operating system offering to compete with Microsoft's, and that it had not been provided that information. Microsoft acknowledged during the course of the investigation that it was not prepared to provide the information requested by Sun to Sun or any other work group server operating system vendor. Indeed, many work group server operating system vendors confirmed to the Commission that they had difficulties in building products compatible with the architecture of Windows work group networks (PCs + work group servers). The Commission therefore concluded that Microsoft had engaged in a general pattern of conduct of withholding interoperability information from its competitors. The Commission also identified that similar information had been previously provided to the industry at large — through disclosure to AT&T — and that with Windows 2000, Microsoft disrupted this previous level of supply.

It must be underlined that the information at issue consists of the rules of connection between software elements in an IT network. The legally relevant refusal is not a refusal to supply the Windows source code, which constitutes the core of Microsoft's products. Microsoft is able to document the information at issue in the form of interface specifications and thereby supply this information without having to disclose source code.

It is also noteworthy that the relevant information relates to the organisation of Windows work group networks, which is based on an architecture of interrelated PC-to-server and server-to-server connections: for full interoperability with the PC to be achieved in this context, server-to-server connections are indispensable. As a result, the refusal, although it involves both client-to-server and server-to-server connections that relate to the interoperation within Windows work group networks, is in its essence a denial of compatibility with Windows PCs to competing work group server operating systems.

Although undertakings are as a rule free to choose their business partners, it is established case-law that a refusal to supply may in certain circumstances constitute an abuse of a dominant position, unless it is objectively justified. In the present case, the Commission has identified the following exceptional circumstances of Microsoft's refusal.

First and foremost, Microsoft's refusal risks eliminating competition in the work group server operating system market. This is borne out by the evolution of Microsoft's market power in that market, where the Decision establishes that Microsoft has actually already attained a dominant position and that its market shares continue to grow. The Commission collected a very significant amount of customer evidence showing that it is the 'interoperability advantage' that Microsoft reserves to its product *via* its refusal to supply interoperability information that drives customers towards Microsoft's work group server operating system products. This is confirmed by customer data provided by Microsoft itself. The Decision establishes that the interoperability information is indispensable to be able to viably compete in the work group server operating system market. In particular, the Commission extensively analysed actual and potential substitutes to the interoperability information which Microsoft had argued were effective, and concluded that they were technically or commercially unrealistic. It is also noteworthy that, due to the presence of significant barriers to entry in the work group server operating system market, an elimination of competition would be difficult to reverse.

Second, Microsoft's refusal limits technical development in the impacted market to the prejudice of consumers. If competitors had access to the refused interoperability information, they would be able to provide new and enhanced products to the consumer. Market evidence shows that consumers value product characteristics such as security and reliability, although those characteristics are relegated to a secondary position due to Microsoft's interoperability advantage. Microsoft's refusal thereby indirectly harms consumers.

Microsoft's justification was that the information at stake was protected by intellectual property rights. The Commission did not take a position on the validity of Microsoft's general intellectual property claims, which could in any case only be ascertained on a case by case basis when Microsoft has prepared the relevant specifications.

An undertaking's interest in exercising its intellectual property rights cannot as such constitute an objective justification when exceptional circumstances such as the ones identified above are established. However, the Commission did not a *limine* reject Microsoft's proffered justification, and addressed the impact on Microsoft's incentives to innovate of an obligation to supply in this case. First, the Commission concluded that an order to supply the relevant information could not lead to the cloning of Microsoft's product, not least because the interoperability information relates to interface specifications as opposed to source code. Second, the Commission took account of the fact that disclosure of interoperability information was commonplace in the industry. Third, the Commission drew inspiration from the *IBM* undertaking and from the 1991 Software Directive, ([1]) which strikes a balance between interoperability and copyright in restricting in specific circumstances the exercise of copyright over software (including exercise by non-dominant undertakings) in favour of interoperability, thereby stressing the importance of interoperability in the software industry in order to enhance competition and innovation.

In view of those exceptional circumstances, the Commission concluded that Microsoft's behaviour amounted to an abuse of a dominant position.

4.2. Tying

The Decision expounds that tying prohibited under Article 82 of the Treaty requires the presence of the following elements: (i) the undertaking concerned is dominant in the tying product market; (ii) the tying and tied goods are two separate products; (iii) the undertaking concerned affords consumers no choice to source the tying product without the tied product; and (iv) tying forecloses competition. In addition, it needs to be examined whether there is any objective justification for the tying.

The Commission concluded that PC operating systems and media players are separate products. This is because: (i) although Microsoft has been tying its media player with Windows for some time, there remains today separate consumer demand for stand-alone media players, distinguishable from demand for PC operating systems; (ii) a number of vendors develop and supply media players on a stand-alone basis; and (iii) Microsoft itself develops and distributes versions of its Windows Media Player for other PC operating systems.

The Commission also concluded that Microsoft afforded consumers no choice to obtain Windows without Windows Media Player; Windows Media Player is always present on a Windows PC. Even though the icon can be hidden, the product itself cannot be removed and the code remains instantly accessible on a user's PC (this is important for the subsequent harm to competition analysis). The issue of whether or not consumers are obliged to use Windows Media Player with Windows was different to the question of whether they are obliged to obtain Windows Media Player with Windows. The question of usage of Windows Media Player as opposed to other media players was nevertheless of key importance when the Commission considered the issue of whether tying harmed competition.

On this point, the Commission took into account the fact that users can and do also obtain other media players (mainly over the Internet) and that these media players are often free. The Commission therefore undertook a detailed analysis of the impact of Microsoft's behaviour, which included extensive questionnaires to a range of content providers, software developers and content owners.

The Decision outlined that the tying of Windows Media Player to Windows afforded Microsoft unmatched ubiquity on PCs worldwide, because Windows Media Player instantly shares the ubiquity of Windows in newly-shipped PCs. The Commission's analysis of the relevant evidence highlighted that other distribution means (e.g. downloading over the Internet, bundling with other software or hardware, agreements with OEMs and the retail channel) are second best. This guarantees content providers and software developers that if they use Microsoft's technology, they will be able to reach almost all PC users worldwide. Furthermore, the Commission's market enquiry showed that supporting several technologies generates significant additional costs. As such, Windows Media Player's ubiquitous presence induces content providers and software developers to rely on Windows Media technology.

([1]) Council Directive 91/250/EEC of 14 May 1991 on the legal protection of computer programs.

Due to the fact that applications and content are largely specific to the proprietary infrastructure used, customers will in turn prefer using Windows Media Player, since a wider array of complementary software and content will be available for that product.

This self-reinforcing mechanism seriously undermines the competitive process in the media player market to the detriment of innovation and the consumer, and has spill-over effects on competition in other markets. For instance, it strengthens Microsoft's position on media encoding and management software (often server-side). If Microsoft came to control the media player market, then its proprietary technology could constitute a significant barrier to market entry, not only to the media player market but also to related markets in which streaming media technologies are used (e.g. handheld devices).

The Commission's analysis was supported by market data, as well as by surveys commissioned by Microsoft itself. These figures showed a clear trend in favour of usage of Windows Media Player and Windows Media formats, to the detriment of competitors. Microsoft's argument that its success was the result of competition on the merits was not supported by the available evidence, which did not indicate a clear-cut lead of Windows Media Player in terms of product quality.

Microsoft attempted to objectively justify its conduct by putting forward a number of efficiency considerations related to distribution, and to the protection of the coherence of Windows, which according to Microsoft, outweighed any anti-competitive effects from tying. The Commission concluded that any such efficiencies could be achieved without resorting to tying. As for Microsoft's argument that tying Windows Media Player would be efficient as it provided a focal point for developers of complementary and compatible content and software, this is not a legitimate argument under Community competition law as it distorts competition on the merits.

In light of the above, the Commission concluded that Microsoft's tying of Windows Media Player with Windows violated Article 82, and in particular paragraph (d).

5. Remedies and fines

5.1. Interoperability

The Decision orders Microsoft to disclose the information that it has refused to supply and allow its use for the development of compatible products. The disclosure order is limited to interface specifications (not source code), and to ensuring interoperability with the essential features that define a typical work group network. It applies not only to Sun but to any undertaking that has an interest in developing products that constitute a competitive constraint to Microsoft's product in the work group server operating system market.

The conditions under which Microsoft makes these disclosures must be reasonable and non-discriminatory. Microsoft is allowed to require a reasonable and non-discriminatory remuneration for the production of the documentation, as well as for specific intellectual property rights that the Decision might prevent it from fully enforcing against beneficiaries of the order to supply (provided that Microsoft can establish that these specific intellectual property rights are valid in the European Economic Area).

5.2. Tying

The Decision orders Microsoft to provide a version of Windows which does not include Windows Media Player. PC manufacturers and consumers are thus left the choice to obtain Windows with the media player of their — not Microsoft's — choice. To maintain competitive markets so that innovations succeed or fail on the merits is an important objective of this remedy order. This will be beneficial to consumers. It is important to note that consumers have the benefit of PC manufacturers acting as their "purchasing agents" in relation to media player vendors. Consumers will not be forced to do that job themselves by rummaging through the web.

It is worth noting that the Commission does not prevent Microsoft from also offering a bundled version of Windows including Windows Media Player. However, the Decision makes clear that Microsoft must not circumvent the decision by engaging in technical or economic tying.

5.3. Monitoring regime

In order to enable the Commission to efficiently oversee Microsoft's compliance with the Decision, a monitoring regime is foreseen by the Decision. Microsoft is required to submit a proposal to that effect, including provisions for the establishment of a monitoring trustee. The Decision outlines what the Commission considers to be the necessary tasks that the trustee should be able to carry out. In essence, these are tasks that will assist the

Commission in enforcing the decision on an ongoing basis, and in the face of Microsoft's products developing and changing.

As regards interoperability, the monitoring trustee's responsibility should, in particular, involve assessing whether the information made available by Microsoft is complete and accurate, whether the terms under which Microsoft makes the specifications available and allows their use are reasonable and non-discriminatory, and whether the ongoing disclosures are made in a timely manner.

As regards tying, the trustee's responsibility should, in particular, be to advise the Commission whether substantiated complaints by third parties about Microsoft's compliance with the Decision are well-founded from a technical point of view.

5.4. Fines

In view of the above abuses, the Commission imposed a fine of € 497.196 million. The fine represents 1.62% of Microsoft's annual worldwide turnover. ([1]) Microsoft's infringement was considered very serious on the basis of the nature of the infringement, its impact on the market, and the size of the relevant geographic market. The initial starting amount of the fine was set at € 165.732 million. In view of Microsoft's size and resources, in order to ensure a sufficient deterrent effect, this was multiplied by a factor of 2. The starting amount was therefore € 331.464 million. This amount was increased by 50% in order to take into account the 5 years and 5 months duration of the infringement. In view of the absence of both aggravating and attenuating factors, the final amount of the fine was therefore at € 497.196 million.

([1]) EUR € 30,700.336 million.

The Clearstream decision: the application of Article 82 to securities clearing and settlement

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On 2 June 2004 the Commission adopted a decision finding that Clearstream Banking AG and its parent company Clearstream International SA violated Article 82 by refusing to supply certain clearing and settlement services to one of its customers (Euroclear Bank SA), and by applying discriminatory prices to that same customer.

1. Clearing, settlement and custody

Securities clearing and settlement are necessary steps for a securities trade to be completed. In the decision, *clearing* is referred to as the process that ensures that the buyer and the seller have agreed on an identical transaction and that the seller is selling securities which it is entitled to sell. *Settlement* is the transfer of securities from the seller to the buyer and the transfer of funds from the buyer to the seller, as well as the relevant annotations in securities accounts.

In addition to the steps necessary to complete a securities transaction, securities also need to be safekept. The terms *safekeeping* and *custody* are used interchangeably to refer to the actual depositing with the entity that holds a security in physical or electronic form. This is also referred to as the 'primary deposit' or 'final custody'. As opposed to final custodians, intermediaries perform services in relation to securities but do not hold securities in final custody.

2. Central Securities Depositories, International Central Securities Depositories and other intermediaries

Providers of clearing and settlement services may be Central Securities Depositories (CSDs), International Central Securities Depositories (ICSDs) or other intermediaries such as banks.

A CSD is an entity which holds and administers securities and enables securities transactions to be processed through book entry. In its home country, it provides processing services for trades of those securities that have been deposited with it (which it holds in final custody), and in this function the CSD is referred to as the 'issuer CSD' and is not an intermediary. A CSD can also offer processing services as an intermediary in cross-border clearing and settlement, where the primary deposit of securities is in another country.

Clearstream Banking AG is Germany's only *Wertpapiersammelbank* (CSD).

An ICSD is an organisation whose core business is clearing and settling securities — traditionally Eurobonds — in an international (non-domestic) environment. There are at present two ICSDs in the EU: Euroclear Bank, based in Belgium, and Clearstream Banking Luxembourg (CBL), a subsidiary of Clearstream International SA and a sister company to Clearstream Banking AG. An ICSD can also provide other services such as intermediary services for equities.

Intermediaries such as banks may also provide clearing and settlement services to their clients.

3. The relevant market

The relevant market in this case is the provision by the issuer CSD (Clearstream Banking AG) to CSDs in other Member States and to ICSDs of 'primary' clearing and settlement services for securities issued according to German law.

While, as explained above, clearing and settlement may generally be carried out by CSDs, ICSDs or other intermediaries such as banks, only final custodians may perform 'primary' clearing and settlement for the securities actually deposited in final custody. In the present case, all securities issued under German law and kept in collective safe custody — the only significant form of custody in Germany today for traded securities — are deposited with Clearstream Banking AG, and only this company can conduct the primary clearing and settlement related to these securities. Primary clearing and settlement therefore occurs when there is a change in the position of a securities account held with the issuer CSD (CBF for securities issued according to German law).

In contrast, secondary clearing and settlement is performed downstream by intermediaries in their own books. Secondary clearing and settlement encompasses both mirror operations through which intermediaries reflect the result of primary clearing and settlement in the accounts of their customers and annotations in account following internalised transactions. Internalisation takes place where the intermediary is able to settle the transaction in its own books because both the buyer and seller happen to hold accounts with that intermediary.

In the present case, it became apparent that the particular services that Clearstream provided to CSDs and ICSDs cannot be compared to the standard services provided to what Clearstream called 'non-CSD customers' (banks), who are supplied on the basis of Clearstream Banking AG's General Terms and Conditions.

An issue that the Commission examined in detail is whether clearing and settlement by intermediaries could be a substitute to the primary clearing and settlement performed by Clearstream Banking AG.

It is important to underline that, for market definition purposes, the Commission must not examine the needs of the intermediaries' clients, but rather the specific needs of the category of clients who require the product or service, that is, in the present case, the needs of financial intermediaries like Euroclear Bank, who desire to provide economically significant, efficient and competitive secondary clearing and settlement services to their own clients. For this category of customers, the Commission took the view that:

— indirect access to the issuer CSD — Clearstream Banking AG in the present case — through an intermediary is not a substitutable alternative for direct access (given that the use of an intermediary results in poorer deadlines, greater risk and complexity, additional costs and potential conflict of interests ([1]));

— no intermediary is able to internalise all transactions with all potential counterparties for all securities safekept in the issuer CSD and therefore access to the issuer CSD is a requirement. The present case precisely relates to a situation where an intermediary (Euroclear Bank) required primary clearing and settlement services from the issuer CSD and could not obtain substitutable services either in-house or from another intermediary;

— the issuer CSD is not constrained by the prices applied by intermediaries when primary clearing and settlement is needed. During the time that Euroclear Bank sought unsuccessfully to obtain price reductions for primary clearing and settlement services directly from Clearstream Banking AG and cease using a local agent as an intermediary, the prices applied by that local agent did not constrain Clearstream in its discussions with Euroclear Bank.

4. Dominance

Clearstream Banking AG is dominant in the relevant market since it is the only CSD where securities issued under German law and kept in collective safe custody are deposited. It is thus the only entity able to perform primary clearing and settlement for these securities. The position of Clearstream Banking AG is not constrained by any actual competition in the market. New entry is unrealistic in the foreseeable future.

5. The abuse

The decision identifies two types of abuse:

a) Refusing to supply primary clearing and settlement services for registered shares and discriminating against Euroclear Bank in relation to the provision of those services

The refusal to supply took the form of denying access to CASCADE RS ([2]). Without this access Euroclear Bank could not receive the clearing and settlement services of registered shares on the CASCADE platform whereas it could continue to receive this service for other transactions. The qualification of Clearstream's behaviour as refusal to supply follows from the combination of a number of factors: Clearstream Banking AG is an unavoidable trading partner, Euroclear Bank could not duplicate the services that it was requesting, and the refusal to supply had the effect of impairing Euroclear Bank's ability to provide a

([1]) The use of a local agent bank as an intermediary may create conflicts of interest, as the intermediary may be an actual or potential competitor in the downstream market and is informed of the operations of the customer against which it is competing or might start competing in the downstream market.

([2]) CBF provides services via an IT platform referred to as CASCADE. CASCADE RS is the CASCADE subsystem that serves the purpose of inputting information in relation to registered shares.

comprehensive and innovative pan-European service in the downstream market for cross-border clearing and settlement of EU securities. In addition, one of the effects of the growing importance of registered shares in Germany ([1]) was a reduction in the services provided to Euroclear Bank, an existing customer of Clearstream, and Clearstream breached Euroclear Bank's legitimate expectations that it would be supplied by Clearstream with primary clearing and settlement services within a reasonable time.

There is also discrimination because the dilatory behaviour vis-à-vis Euroclear Bank contrasts with the reasonable delay within which other comparable customers were supplied: Euroclear Bank asked for access to CASCADE RS on 3 August 1999 and only obtained access on 19 November 2001, while CSDs that requested access to CASCADE RS were granted access either almost immediately or in a maximum of one month, and the other ICSD (Clearstream Banking Luxembourg) received access within four months. The Commission considered that the infringement ran between 3 December 1999 ([2]) and 19 November 2001.

b) *Applying discriminatory prices for primary clearing and settlement services* ([3])

Between 1 January 1997 and 1 January 2002, Clearstream charged a higher per transaction price to Euroclear Bank than to CSDs outside Germany. In addition, Euroclear Bank, unlike CSDs, also paid an annual fee covering partly settlement services.

The decision considers that Clearstream discriminated against Euroclear Bank in violation of Article 82 because the content of the primary clearing and settlement services for cross-border transactions provided by Clearstream to CSDs and to ICSDs is equivalent, and because there is no objective justification for the difference in prices. To reach this conclusion, the Commission examined in detail the information regarding services and costs that Clearstream provided in reply to the Commission's requests for information.

6. The need to clarify the legal situation and provide guidance, and the non-imposition of fines

The Clearstream decision was adopted when the infringements had already ceased. The Commission found it necessary to adopt a decision for a number of reasons, including the need to clarify the legal situation and provide guidance, both to Clearstream and to other undertakings active in clearing and settlement, at a moment when the industry is consolidating within the EU.

The Commission however decided not to impose fines. Among other factors, the Commission took into account that:

— there is no Community decisional practice or case law relating to the complex area of clearing and settlement services; the decision analyses for the first time the clearing and settlement processes in the context of market definition, as well as other sector-specific issues such as internalisation, and this analysis has a direct bearing on the legal analysis of the case;

— clearing and settlement services in the EU are evolving, in particular as regards cross-border transactions. Different institutions and fora have been for some time discussing issues connected with the functions of the various actors in the industry. The scope for internalisation, the role of CSDs and ICSDs and their relationship with large custodian banks are matters being actively debated and that are connected to the subject matter of the Clearstream decision.

([1]) Registered shares are the most widely internationally traded German shares and therefore likely to be included in transactions of an ICSD's clientele.

([2]) The initial four-month period between 3 August and 3 December 1999 can be considered as a reasonable period within which Clearstream would not be refusing to supply. To ascertain what a reasonable maximum period for Clearstream Banking AG to provide direct access to CASCADE RS would be, the Commission took into account internal companies' plans in the present case and comparative data originating from various customers.

([3]) It should be noted that this concerns the pricing for all transactions processed on CASCADE for Eurocler Bank and is not restricted to registered shares, unlike in the case of the previous abuse.

Market analyses under the New Regulatory Framework for electronic communications: context and principles behind the Commission's first veto decision

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1. Introduction

On 20 February 2004 the Commission took a decision requiring the Finnish Communications Regulatory Authority ***(Ficora)*** to withdraw its draft regulatory measures concerning the markets for publicly available international telephone services provided at a fixed location in Finland. This was the first time the Commission exercised its so-called 'veto power' under Article 7 of the Directive on a common regulatory framework for electronic communications networks and services ***(Framework Directive).***

This decision is an important step in the implementation of the New Regulatory Framework ***(NRF)*** as it provides clarifications on some of the tasks which National Regulatory Authorities ***(NRAs)*** need to carry out, as well as on some pivotal principles of market analysis under the NRF.

2. Market analysis under the NRF ([1])

Under the NRF, NRAs must carry out an analysis of the relevant markets identified by the Commission as markets susceptible to ex ante regulation in the electronic communications sector ([2]). On the basis of their market analysis, NRAs must determine whether a relevant market is effectively competitive. Where a market is considered not to be effectively competitive as a result of an undertaking or undertakings having significant market power (SMP) on that market, NRAs must impose one or more obligations on this (these) undertaking(s), or 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.

Under the NRF, markets must be defined and SMP must be assessed using the same methodologies as under competition law. In this context, NRAs must conduct a forward looking, structural evaluation of the relevant market, based on existing market conditions. NRAs should 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.

Although NRAs are accorded discretionary powers correlative to the complex character of the economic, factual and legal situations, these powers remain subject to the procedure provided for in Article 7 of the Framework Directive. As a consequence, where the NRA intends to — inter alia — take a draft measure which aims at deciding whether or not to designate an undertaking as having SMP, it must make this draft measure accessible to the Commission, in case it would affect trade between Member States. If the Commission has serious doubts as to the compatibility of the draft measure with Community law, it may issue a 'serious doubts letter' requiring that the draft measure be not adopted for two months. If the Commission's concerns are not alleviated within this period, it can take a decision requiring the NRA to withdraw the draft measure ('veto decision'). This decision must be accompanied by a detailed and objective analysis of why the Commission considers that the draft measure should not be adopted together with specific proposals for amending it.

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(1) For a general review of the New Framework and the 'Article 7 consultation mechanism' see R. Krüger, L. Di Mauro. 'The Article 7 consultation mechanism: managing the consolidation of the internal market for electronic communications', (2003) 3 *Competition Policy Newsletter* 33.

(2) In the Commission Recommendation 2003/311/EC of 11 February 2003 on relevant product and services markets within the electronic communications sector susceptible for ex ante regulation in accordance with 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 ***(Recommendation on relevant markets),*** OJ L 114,of 8.5.2003, p. 45.

3. The case of international calls markets in Finland

3.1. The draft measures notified

The draft measures notified by Ficora concerned the Finnish markets for (retail) publicly available international telephone services provided at a fixed location for residential customers and for non-residential customers ***(international calls markets).*** ([1])

Ficora's market analyses concluded that there were no SMP operators in either of the two defined markets. In both cases, Ficora based its findings on three factors: (i) the fact that there are several (app. 10) providers of international calls, (ii) the fact that there are low barriers to entry, and (iii) the fact that subscribers may easily acquire international calls services from operators other than the undertaking providing the subscriber connection. As a consequence, Ficora stated that, despite the high market shares of TeliaSonera (i.e. about 55% of the residential market and about 50% of the non-residential market), the latter did not have SMP in either of the two markets.

3.2. The Commission's decision

Following a review of Ficora's market analyses, the Commission had serious doubts as to the compatibility of the draft measure with Community law. As these doubts had not been alleviated within the period of two months following the serious doubts letter, the Commission issued a veto decision.

3.2.1. The reasons for the veto decision

The information that the Commission received in the notification and as a result of several requests for information did not warrant the conclusion that Ficora had undertaken the assessment in accordance with Articles 14 and 16 of the Framework Directive, which specifically refer to the notion of SMP and the task of the NRA to determine whether or not there is a dominant operator on the market. The draft measure was in particular incompatible with Article 8(2)(b) of the Framework Directive (obliging NRAs to promote competition in particular by ensuring that there is no distortion or restriction of competition) read in conjunction with Articles 10 and 82 of the EC Treaty.

The Commission's view was based on two main reasons: first, Ficora did not provide sufficient evidence to support the finding whether or not TeliaSonera had SMP on the markets; and second, Ficora did not properly consider existing remedies when conducting an SMP assessment.

3.2.1.1. Lack of evidence to support the finding of the absence of SMP

The Commission found that Ficora did not analyse in a sufficient degree the extent to which TeliaSonera is in a position to behave to an appreciable extent independently of its competitors, customers and ultimately its consumers on the relevant markets.

Ficora provided only limited information, such as current market shares, and failed to present market data related to other factors. Under the NRF, when assessing the degree of effective competition in a relevant market NRAs need to take into consideration a number of indicators and base their analysis on the principles of competition law. While information on market shares alone was at the centre of the ONP framework, the previous regulatory regime in the EU, NRAs must today inform their view on the extent to which competition is effective by reference to several factors which may be relevant to the assessment of market power, for example, information on changes in market shares and prices, profitability or the relationship between price and costs. The change of perspective could not be more radical.

Ficora, on the other hand, did not rely but on a very few elements to reach its conclusion. Ficora somewhat recognised the limited extent of its findings when, although finding that TeliaSonera does not have SMP on the relevant markets, it also stated in its notifications that TeliaSonera holds such market power that affords it the possibility to restrict competition.

3.2.1.2. Lack of consideration of existing remedies

However an even more relevant concern for the Commission was that it was not clear how Ficora reached the conclusion that barriers to entry to the market for publicly available international telephony services provided at fixed locations are low. In fact, one of the reasons why this market had been identified by the Commission as a market suitable for ex ante regulation is the presumption that high barriers to entry exist in the absence of

([1]) Markets 5 and 6 of the Recommendation on relevant markets.

any regulation. All of Ficora's claims, that barriers to entry into these markets are low, that end users have access to more than one undertaking providing international telephone services, and that some degree of competition has developed, as well as the resulting conclusion of a lack of SMP, seem to rely entirely on existing regulation, such as carrier selection, carrier pre-selection, or, at earlier stages of the liberalisation process, the obligation to interconnect and to provide access.

3.2.2. The principles behind the veto decision

3.2.2.1. Taking into account existing regulation

Ficora's market analysis exposed a potential weakness of the framework *lato sensu.* Market conditions in regulated markets are not only a function of the competitive process, but also, and at earlier stages of regulatory action mainly, a function of the nature and intensity of obligations put in place to support the development of the competitive process. There are essentially two types of effects that regulation can have from the point of view of market analyses. First, regulatory obligations may modify substitutability patterns, hence providing grounds for market definitions which would appear different from those which would be observed in the absence of regulation. Second, regulatory obligations may modify the competitive conditions in the market, which would lead to conclusions on the degree to which competition in the market is effective that are different from those which would be reached in the absence of regulation. Both effects, of course, may be present at the same time, which in general makes the task of assessing effective competition in regulated markets more complex than it is the case for non-regulated markets.

In other words, Ficora's notification exposed the risks linked to ***circularity*** of the line of reasoning followed in market analyses. The circularity stems from the fact that competitive conditions in regulated markets are not exogenous to NRAs' regulatory decisions, but strictly depend on the way such decisions affect them. However, NRAs' choices also depend on an assessment of market conditions which in turn partly depends on previous regulatory decisions. Hence the risk exists that the conclusions of market analyses are based on a flawed starting point in respect of the 'true' market conditions.

In principle, the two types of effect mentioned above can be avoided, in all those markets where the effect of regulatory action is felt, by conducting market analyses which implicitly or explicitly compare the current market situation to the market situation absent regulation. Since the danger of using a circular approach often arises when considering the relationship between wholesale and retail markets, and since any assessment of market power needs to be based on a correctly defined market to be meaningful, it is essential that a correct starting point is used and that the interdependence between regulation and competitive conditions is properly considered. This exercise may appear to be rather speculative, but in practice a few relatively simple rules can be followed.

For what regards market definition of retail markets for which there is no regulatory intervention at the wholesale level, the effects of regulation can be safely assumed not to exist, hence market definition is straightforward. However, for retail markets which rely on any type of regulation at the wholesale level, market definition needs to be first carried out as if no regulation were in place. The retail market definition will then inform a correct market definition at the wholesale level, which in turn will give NRAs the possibility to carry out a meaningful assessment of market power at the wholesale level. This two-stage approach can be referred to as a **'green-field'** approach and has two purposes: first, it ensures that the correct starting point is identified for the analysis of the wholesale market. Second, it ensures that the subsequent assessment of the degree of effective competition at the retail level is based on a correctly defined wholesale market.

For what relates to the assessment of market power in a wholesale market, if a 'green-field' approach has been followed the assessment of the degree of effective competition at the wholesale level will be straightforward. If competition is not effective, NRAs will then impose obligations at the wholesale level. This is not only likely, but also supposed, to have an effect at the retail level. Such effect will be felt in a number of ways, not least through observing a greater degree of retail competition. When assessing market power in the retail market, it is correct for NRAs to recognise the greater degree of competition. However, it is also crucial that they recognise that such competition relies on regulatory intervention at the wholesale level.

The most obvious risks linked to circularity arise in those instances where regulatory intervention takes place in a market and the assessment of market power in the same market fails to take account of the effects of such intervention. If a market analysis reached the conclusion that a market is effectively competitive, but failed to relate this conclusion to regulatory intervention on the same market, the outcome would be that the NRA would not be able anymore to intervene on that market. This would obviously lead to the paradoxical outcome that regulation would be withdrawn when the main reason why competition was observed may well have been regulatory intervention. Withdrawing regulation in such context would very likely imply that market conditions would revert to a non-competitive outcome.

3.2.2.2 Hazardous vicious circles: Ignoring existing regulation and finding effective competition

Ficora's market analysis provided a very good example of the risks associated with an improper consideration of the regulatory context. Ficora concluded that the markets for international calls were effectively competitive merely by referring to one indicator of market power (market shares), which on its own, in the absence of exceptional circumstances, could have probably been evidence of a dominant position according to established case-law under EC competition rules. All other indicators provided seemed to depend on regulatory intervention, and in particular on the presence of an indirect access remedy (such as carrier selection or pre-selection).

The finding of lack of SMP on its own would perhaps not have been as problematic as it was considered to be when coupled with an improper consideration of the consequences of regulatory intervention. However, when both these aspects are taken into account, the risk that the conclusions reached are flawed is particularly high. It is absolutely clear that the impact of regulatory intervention on the market needs to be taken into account.

4. Conclusion

The key principle that the veto decision establishes is that when carrying out market analyses NRAs need to assess whether effective competition is or is not entirely or primarily a result of regulation in place, and whether the status of competition in the defined market is likely to be different in the absence of such regulation. In other words, consideration should be given to what the outcome of the market analysis would be likely to be in the absence of such obligations. The mirror image of this principle also applies: market analysis should provide justification for existing regulatory obligations which are imposed on undertakings in the same or other closely related markets, and which may have a substantial competitive effect on the markets analysed.

Incidentally, this is the reason why the view that in order to impose regulation on a wholesale market, a NRA would be required not only to find dominance in that wholesale market but also to show the lack of effective competition in the relevant downstream retail market(s), is substantially flawed. Such approach, which could be defined as a ‘double dominance test’, would imply the impossibility of taking sensible regulatory decisions on the part of NRAs. The reason for this is that retail markets may well be found to be effectively competitive only as a result of regulation at the wholesale level. If NRAs failed to recognise the causal link between regulatory obligations and their consequences in terms of development of effective competition, either in the same or in closely related markets, they would end up removing the determinants of such development and cause the market to revert to a non-competitive state.

It is also important to point out that the Commission, by requesting Ficora to withdraw its draft measure, did not aim at prejudicing the outcome of a further market analysis to be carried out by Ficora. In other words, the fact that the vetoed draft measure did not designate TeliaSonera as having SMP on the relevant markets in no way indicates that the Commission is of the opinion that TeliaSonera should be designated as having SMP. In fact, the Commission's veto decision is based on criticism of the methodology Ficora applied in the course of its market analyses, and as a result of which no outcome of the market analyses — whatever it may be in terms of SMP designation — would be appropriately justified. Therefore, in its veto decision the Commission proposed to Ficora to undertake, in accordance with the Guidelines on market analysis, a thorough and complete analysis of the economic characteristics of the relevant markets before coming to a conclusion as to the existence of significant market power.

Commission exempts vertical restraints in the Nordic pay-TV Sector: Telenor/Canal+/Canal Digital

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Introduction

After a fundamental restructuring of the Spanish and Italian pay-TV markets, also the Nordic pay-TV sector has undergone major changes in recent times, albeit in a different manner. While in Spain and Italy two 'mergers to monopoly', subsequent to the economic crisis of pay-TV, led to strong market consolidation and the ending of the hitherto duopolistic structures of these pay-TV markets, ([1]) consumers continue to benefit from tight competition between the two major pay-TV operators present in the Nordic region, i.e. Canal+ Nordic on the one hand and the Modern Times Group ('MTG') with its Nordic satellite broadcasting platform Viasat on the other. However, also in the Nordic countries the allocation of roles held by the operators involved has fundamentally changed, mainly triggered by the successive retreat of the Vivendi Universal/Canal+ group, the former parent of Canal+ Nordic, from its Nordic pay-TV business.

The first step in this retreat was a 'demerger' through Vivendi's/Canal+' divestiture from the Nordic Direct-To-Home ('DTH') satellite pay-TV distribution platform Canal Digital in 2001. Canal+ fully transferred its 50% shareholding in the platform to its co-owner, the Telenor group, with which it had hitherto jointly run Canal Digital. ([2]) The second and latest step was Vivendi's sale of its shares in Canal+ Nordic to capital investment firms Baker Capital and Nordic Capital in autumn 2003. ([3]) However, apart from the shift of control and ownership this transaction has not brought about any appreciable changes to the functioning of the Nordic pay-TV markets, nor to the Commission's respective competition assessment in the case discussed in this article.

In parallel with Vivendi/Canal+' divestiture from Canal Digital in 2001, Canal+ and Telenor entered into long-term bilateral exclusivity and co-operation agreements regarding the DTH satellite distribution of Canal+ Nordic's premium pay-TV and pay-per-view channels ([4]) in the Nordic region. In a nutshell, these arrangements aimed at guaranteeing the continuity of the service and the economic advantages previously derived from Canal Digital's vertical integration with Canal+ Nordic, hitherto its main supplier of pay-TV premium content. Moreover, these arrangements were designed to guarantee that both Canal+ Nordic and Canal Digital remain competitive in the premium pay-TV distribution segment, in particular *vis-à-vis* the second pay-TV operator in the Nordic region, MTG/Viasat, who operates on a vertically integrated basis and is active in both the production and the wholesale and retail (satellite and cable) distribution of pay-TV premium programmes.

While Canal+' sale of its 50% shareholding in Canal Digital to Telenor constituted a merger under the relevant Nordic merger laws and was cleared by the Finnish, the Swedish and the Norwegian competition authorities, Telenor notified the distribution and co-operation arrangements to the European Commission for clearance under Article 81 of the Treaty and Article 53 of the EEA Agreement ([5]) in late 2001. The notification also included the sale agreement between Canal+ and Telenor because it contained various clauses complementing the distribution agreements which had not been subject to the merger clearance by the Nordic competition authorities. Therefore, the Commission had to assess the distribution and co-operation arrangements contained in both the sale and the distribution agreements in the light of Article 81 of the Treaty and Article 53 of the EEA Agreement.

([1]) Cf. Commission decisions in Cases COMP/M.2845 – Sogecable/Canalsatélite/Vià Digital of 14.8.2002 (referral to the Spanish competition authorities) and COMP/M.2876 – Newscorp/Telepiù of 2.4.2003 (clearance with conditions). See on this in particular Miguel Mendes Pereira, Recent consolidation in the European pay-TV sector, Competition Policy Newsletter, No. 2, 2003, p. 29.

([2]) Cf. *http://press.telenor.com/PR/200107/826950_5.html.*

([3]) Cf. *http://www.bakercapital.com/press/pdf/09-09-03.pdf.*

([4]) 'Premium' denotes highly valued pay-TV services on top of the basic TV offering that are mainly comprised of recently released movies and top sports events, for which viewers have to pay an additional fee.

([5]) The decision refers to the application of both Article 81 of the Treaty and Article 53 of the EEA Agreement. In the following, it will nonetheless be referred to Article 81 of the Treaty only.

On 29 December 2003, the Commission adopted a positive decision exempting — and partly granting negative clearance to — the various exclusivity, non-compete and co-operation arrangements contained in the notified agreements between the Telenor group including Canal Digital on the one hand and Canal+/Canal+ Nordic on the other. (1)

EU competition policy implications of the decision

From the perspective of EU competition policy and in particular antitrust enforcement on the basis of Article 81 of the Treaty, the decision is of major importance in various respects:

First, the decision makes it clear that the Commission considers 'demerger' transactions of the kind at issue, i.e. the separation of previously vertically integrated companies, as principally falling within the scope of Article 81(1) of the Treaty in so far as they are coupled with vertical and horizontal restraints agreed between economically distinct undertakings. In fact, Canal+' divestiture from Canal Digital and its full acquisition by Telenor led to the creation of a situation typical of the application of Article 81 of the Treaty to the TV broadcasting sector, namely to the conclusion of vertical agreements between an independent upstream supplier of (pay-) TV content, Canal+ Nordic, and an independent downstream distributor of that content, Telenor/Canal Digital. In that context, the Commission is called upon to prevent long-term foreclosure of the upstream and downstream pay-TV markets, in particular, at the expense of potential entrants, *a fortiori* if these markets are highly concentrated. In its competition assessment the Commission furthermore undertakes a prospective analysis as to the likely evolution of competition in the relevant markets on the basis of a set of facts that would have existed in the absence of the restrictions agreed between the parties.

Secondly, the decision, for the very first time in the (pay-) TV broadcasting sector, explicitly draws on the principles laid down in the Guidelines on Vertical Restraints issued by the Commission in October 2000. (2) In applying these principles to the various vertical restraints at issue — notably the arrangements governing Canal Digital's exclusive right to distribute via satellite Canal+ Nordic's pay-TV premium channels and the related non-compete obligations of Telenor/Canal Digital — the decision gives additional guidance in respect of the application of Article 81(1) and the fulfilment of the exemption conditions under Article 81(3) of the Treaty in that specific area, in which only a few Commission precedents have existed so far. (3)

Thirdly, the decision further develops the Commission's policy in aiming to reduce both the scope and the duration of exclusivity and non-compete arrangements for the distribution of content, in so far as they restrict competition, in accordance with its previous antitrust and merger practice, notably in cases *UEFA Champions League* (4) and *Newscorp/Telepiù.* (5)

Finally, it is worth mentioning that the Commission endeavoured to reduce the agreed restrictions to the core business at issue, namely premium pay-TV satellite distribution. Therefore, all restrictions alien to this core business and not necessary to sustain the efficiencies generated by the restrictions in the pay-TV segment, notably the extension of the parties' co-operation to new media, could not be accepted in order to avoid foreclosure of emerging new media markets.

The administrative procedure

The notification

Telenor had notified the following agreements to the Commission on 16 November 2001:

- A sale and purchase agreement between Canal+ and Telenor relating to Canal+' sale of its 50% shareholding in Canal Digital to Telenor;
- A distribution agreement regarding the DTH satellite distribution of Canal+ Nordic's pay-TV premium content channels through Canal Digital;
- An agreement for the supply of PPV/NVOD (6) channels by Canal+ Nordic to Canal Digital.

(1) The full public version of the decision is posted on the DG Competition Website under: http://europa.eu.int/comm/competition/antitrust/cases/decisions/38287/en.pdf.

(2) Commission Notice – Guidelines on Vertical Restraints (2000/C 291/01), OJ C 291 of 13.10.2000, p. 1.

(3) See notably Decision 1999/242/EC in Case No IV/36.237 – TPS, OJ L 90 of 2.4.1999, p. 6 and Decision 1999/781/EC in Case IV/36.539 – British Interactive Broadcasting/Open, OJ L 312 of 6.12.1999, p. 1.

(4) Decision 2003/778/EC in Cases COMP/C.2-37.398 – Joint selling of the commercial rights to the UEFA Champions League, OJ L 291 of 8.11.2003, p. 25.

(5) Decision in Case COMP/M.2876 – Newscorp/Telepiù of 2.4.2003; cf. also Miguel Mendes Pereira, footnote 1, p. 56.

(6) PPV being the acronym for pay-per-view and NVOD for near-video-on-demand.

The agreements, as initially notified, contained essentially the following arrangements relevant to the Commission's competition assessment:

Exclusive distribution of premium pay-TV channels

The distribution arrangement initially provided for Telenor's exclusive right to distribute Canal+ Nordic's pay-TV premium content channels through Canal Digital while Canal+ renounces to own or operate a competing DTH/SMATV ([1]) distribution platform in the Nordic region during ten years. However, the exclusivity does not affect distribution of Canal+ Nordic's pay-TV premium content channels through third CATV ([2]) operators in the Nordic region.

Premium pay-TV channel non-compete obligations

Under the various non-compete arrangements, Telenor initially committed *vis-à-vis* Canal+ Nordic neither to own or operate a pay-TV premium content channel for DTH/SMATV distribution nor to distribute pay-TV premium content channels of competing suppliers via DTH, SMATV and certain smaller cable networks in the Nordic region for a period of ten years. However, the non-compete obligation does not affect distribution of third suppliers' pay-TV premium content channels via CATV networks owned or controlled by Telenor.

The non-compete arrangement was coupled with a mechanism for joint acquisition of certain content by the parties valid during the same period. In addition, the parties had agreed on a range of clauses affecting neighbouring markets including clauses on co-operation in new media markets and a non-compete obligation requiring Canal+ Nordic to use exclusively satellite transponder services offered by Telenor.

Exclusive distribution of PPV/NVOD channels and non-compete obligations

According to the PPV/NVOD distribution arrangements, Canal+ Nordic granted Canal Digital the exclusive right (and obligation) to distribute its PPV/NVOD movie channels through DTH/SMATV, smaller cable networks and Telenor's CATV networks in the Nordic region for a period of five years.

The exclusivity was combined with a non-compete arrangement under which Canal Digital could supply additional PPV/NVOD channels and services from third suppliers under certain circumstances only and after having observed a negotiation procedure with Canal+ Nordic.

Amendments to the notification

On 21 June 2002, Telenor submitted to the Commission a settlement agreement reached with Canal+ on 13 June 2002 regarding the interpretation of certain terms and conditions of the notified agreements and informed it about their closing. ([3])

After the Commission had raised preliminary competition concerns, the parties proposed to reduce substantially both the duration and the scope of the relevant clauses in the notified agreements and to eliminate some of them altogether. They agreed in particular to:

- reduce the duration of the pay-TV channel distribution exclusivity to a maximum of four years;
- reduce the scope of the exclusivity by narrowing the definition of DTH/SMATV distribution that previously included distribution to cable networks with a certain larger size;
- reduce the duration of the pay-TV and PPV/NVOD channel non-compete and joint acquisition arrangements to a maximum of three years;
- reduce the scope of the joint acquisition arrangement to premium content for pay-TV;
- reduce the duration of the satellite transponder non-compete obligation to a maximum of five years;
- eliminate bilateral rights of first refusal regarding the acquisition and marketing of premium content and new channels via new media platforms.

On the basis of these commitments, the Commission on 26 June 2003 published a notice pursuant

([1]) SMATV is the acronym for "satellite mastered antenna television". It denotes a network distributing TV signals received through a joint satellite dish to households located in one or more adjacent buildings, primarily serving urban and suburban multiple dwelling units.

([2]) CATV denotes large cable networks with a great number of households connected and providing their own technical services for the reception of TV channels.

([3]) Cf. http://www.canaldigital.com/press.asp?article=COM-32.dat.

to Article 19(3) of Regulation No 17 in the Official Journal summarising the notified agreements and their proposed amendments and inviting third parties to submit their observations. (1) The notice prompted reactions from three interested third parties, which however did not result in the Commission to change its preliminary favourable position.

The relevant markets

The decision delineates the following affected markets:

Retail distribution of pay-TV and PPV/NVOD services

The first markets defined are those for DTH satellite, cable and terrestrial retail distribution of pay-TV and PPV/NVOD services to households equipped with DTH satellite or terrestrial antenna and those connected to SMATV, small cable and CATV networks, in which Canal Digital is active as the most important Nordic DTH satellite TV distributor. The decision discusses in detail the criteria for determining whether the retail distribution of pay-TV services via DTH satellite, cable and digital terrestrial networks, respectively constitute separate markets or a single market in the Nordic region. (2) Without reaching a definitive conclusion in this respect, the decision argues that there exists a strong trend towards the emergence of a single pay-TV retail market in the Nordic countries regardless of the transmission mode. The Commission has further found indications that the retail of PPV/NVOD services constitutes a market distinct from pay-TV channel retail distribution in the Nordic region. Geographically and in line with the consistent approach by the Commission, the relevant retail pay-TV and PPV/NVOD markets were delineated on a national basis.

Wholesale supply of pay-TV premium content channels and PPV/NVOD film channels

The decision further assesses the market for the wholesale supply of pay-TV premium content channels and PPV/NVOD film channels to multi-channel TV distribution platforms, such as DTH satellite TV distributors, Digital Terrestrial Television ('DTT') networks and CATV networks, in which Canal+ Nordic is active as the most important Nordic pay-TV channel supplier. The Commission considers that there are strong indications that an overall wholesale market comprising all of these distribution platforms exists. The decision finds this market to be of a Nordic-wide dimension.

Wholesale supply of premium film and sports rights and other audio-visual content rights for pay-TV programming

The decision moreover addresses the markets for the wholesale supply of premium film and sports rights and other audio-visual content rights for pay-TV programming, in which Canal+ Nordic is active as one of the most important buyers in the Nordic region. The decision finds that the supply of premium films and that of sport broadcasting rights for pay-TV constitute distinct markets with a possible sub-segmentation of these markets in line with the Commission's previous practice. These markets are also found to be Nordic-wide.

New media markets

The emerging wholesale and retail markets for the distribution of content via new media platforms are only briefly addressed as the parties undertook to eliminate the relevant clauses governing their co-operation in that regard.

Supply of satellite transponder capacity for TV broadcasting

Finally, the decision delineates the market for the supply of satellite transponder capacity for TV broadcasting, in which Telenor is active as an important Nordic supplier. The Commission considers this market — based on the Nordic satellite 'footprint' — to be Nordic-wide.

(1) OJ C 149 of 26.6.2003, p. 16.

(2) See also Decision 2001/98/EC in Case IV/M.1439 – Telia/Telenor, OJ L 40 of 9.2.2001, p. 1, paras. 267 et seq.; Decision 1999/781/EC in Case IV/36.539 – British Interactive Broadcasting/Open, OJ L 312, 6.12.1999, p. 1, para. 26; Decision 1999/242/EC in Case No IV/36.237 – TPS, OJ L 90, 2.4.1999, p. 6, paras. 29 et seq.

Assessment under Article 81(1) of the Treaty and Article 53(1) of the EEA agreement

The notified agreements in their amended form gave rise to competition concerns in respect of three sets of arrangements:

- First, the arrangement establishing exclusive DTH satellite distribution of Canal+ Nordic's pay-TV channels through Canal Digital;
- Secondly, the non-compete and co-operation arrangements having the purpose of shielding the DTH satellite distribution of Canal+ Nordic's pay-TV and PPV/NVOD channels by Canal Digital from competition emanating from both third pay-TV channel suppliers and the Telenor group itself;
- Thirdly, the non-compete arrangement regarding the supply of satellite transponder services.

According to the courts' case law and the Commission's policy reflected in the Guidelines on Vertical Restraints, also in the TV broadcasting sector the restriction of the commercial freedom of one or more of the parties to an agreement is not sufficient in itself to conclude that the prohibition of Article 81(1) of the Treaty applies. Rather account is to be taken of the actual conditions in which the agreement functions, in particular the economic context in which the undertakings operate, the products or services covered by the agreement and the actual structure of the market concerned. ([1]) The decision therefore takes account of the market positions of the operators present — i.e. the suppliers, their competitors and the buyers — including their countervailing power as well as the existence and the weight of barriers to entry in order to appraise possible foreclosure effects in both the upstream and downstream markets, which may result from either the substance or the duration — or a combination of the two — of the exclusivity and non-compete arrangements. ([2])

The decision finds that the notified agreements as amended appreciably restrict competition and are therefore caught by the prohibition in Article 81(1) of the Treaty. The only exception is the PPV/NVOD film exclusivity. The exclusivity is not capable of creating foreclosure essentially because the content input used for PPV distribution, i.e. premium films, is generally marketed on a non-exclusive basis. Therefore, the decision grants the PPV/NVOD film exclusivity clause negative clearance.

Exclusive distribution of premium pay-TV channels

The decision finds that the exclusive supply of Canal+ Nordic's pay-TV channels to Canal Digital restricts competition appreciably. It raises already high barriers to entry in the Nordic DTH segment and prevents potential entrants from accessing an important input for their business during four years. In that context, *inter alia,* the high market shares of the parties to the exclusive arrangement on both the supply and demand sides have been taken into account. The prohibition on Canal+ Nordic to run a DTH platform competing with that of Canal Digital is subordinate to the exclusivity and does not create additional restrictive effects.

Premium pay-TV and PPV/NVOD channel non-compete obligations

The pay-TV and PPV/NVOD non-compete obligations of Canal Digital and Telenor *vis-à-vis* Canal+ Nordic restrict competition appreciably. They render it more difficult for potential entrants on the supply-side, i.e. pay-TV and PPV channel suppliers, to access a DTH platform for the purpose of redistribution of their channels in the Nordic region during three years. Moreover, attempts by Telenor to create an own pay-TV brand are stifled during the same period of time. These negative vertical effects are strengthened by the prohibition on Telenor to acquire premium movie rights in competition with Canal+ Nordic and a complex mechanism of co-operation and joint bidding for premium content rights established between the parties. In addition, this mechanism also restricts competition at the horizontal level between Canal+ Nordic as an actual buyer of premium content in the Nordic region and Canal Digital/Telenor as an at least potential buyer.

Satellite transponder non-compete obligation

The satellite transponder non-compete obligation appreciably restricts competition. It prevents Canal+ Nordic during five years from leasing transponder capacity from third satellite suppliers. It thereby sensibly raises already very high barriers

([1]) Cf. in particular, CFI, Case T-112/99 *M6 and others v. Commission* [2001] ECR 1057, para. 76.

([2]) Cf. Guidelines on Vertical Restraints (2000/C 291/01), OJ C 291 of 13.10.2000, p.1, paras. 121 et seq.

to entry to the Nordic market for the supply of satellite capacity because third party providers (potential entrants) cannot supply their services to Canal+ Nordic as an attractive Nordic pay-TV broadcaster with a large subscriber base.

Assessment under Article 81(3) of the Treaty and Article 53(3) of the EEA Agreement

The Block Exemption Regulation on Vertical Restraints ([1]) did not apply to the present case, essentially because of the involvement of copyright licensing for broadcasting purposes ([2]) and the relatively strong market positions of the parties to the notified agreements. Therefore, an individual exemption was necessary.

Improvement in production or distribution and/or promoting technical or economic progress

The pay-TV channel exclusivity generates a range of efficiencies. It notably protects Canal Digital/ Telenor's market-specific investment into its DTH pay-TV operations by preventing actual and potential DTH competitors from 'free-riding' ([3]) on Canal Digital's promotion and branding efforts in the satellite distribution of Canal+ Nordic's premium channels. Moreover, Canal Digital's exclusive status promotes distinctive branding and penetration of pay-TV channels including enhanced digitalisation in response to competition from the second important DTH pay-TV provider in the Nordic region, MTG/Viasat. Finally, the exclusive supply guarantee helps avoid a typical 'hold-up' problem ([4]) on Telenor's side and, conversely, provides an important economic incentive for Canal Digital/Telenor to continue investing in their DTH pay-TV operations.

The pay-TV and PPV/NVOD channel non-compete obligations entail efficiency gains by guaranteeing that Canal Digital continuously concentrates its efforts on promoting Canal+ Nordic's pay-TV premium brand via DTH rather than distributing third party channels or engaging in the creation of an own premium pay-TV service. As a further consequence, inter-brand competition via DTH between Canal+ Nordic/Canal Digital on the one hand and MTG/Viasat on the other is stimulated. Moreover, the guarantee of an "exclusive DTH outlet" is an important economic pre-condition and incentive for Canal+ Nordic to continue investing in costly premium content acquisition and the creation of attractive pay-TV/PPV/NVOD brands designed to match the "Nordic taste". The film acquisition prohibition on Telenor and the co-operation and joint bidding arrangement between the parties help secure these efficiencies.

The satellite transponder non-compete obligation generates efficiencies in that it protects Telenor's investment in Nordic satellite capacity designed to carry the DTH pay-TV channels jointly marketed by Canal+ Nordic and Canal Digital.

Fair share of the benefit to consumers

The efficiencies generated by the restrictions provide the consumers with a fair share of the benefit at least in the short and mid-term. It secures that a certain level of inter-brand competition and consumer choice is maintained in the Nordic pay-TV sector. Moreover, as a result of this competitive process, it creates specific consumer advantages derived from digitalisation, such as the introduction of enhanced digital TV services and of new decoder technology at low cost. MTG/ Viasat's and Canal Digital's marketing strategies in recent times to offer their digital premium pay-TV services jointly with heavily subsidised reception equipment are evidence of this evolution.

Indispensability of the restrictions

The restrictions addressed are both in their substance and in their duration indispensable to guarantee the above efficiencies. The pay-TV channel exclusivity is indispensable during four years in particular to enable Canal Digital/Telenor to recoup market-specific investment in its DTH pay-TV business. Conversely, the pay-TV and PPV/NVOD channel non-compete obligations including the film acquisition prohibition and the co-operation and joint bidding arrangements are indispensable during three years to protect Canal+ Nordic's market specific investment into its pay-TV operations. However, protection beyond that period is not justified because of the weighty long-term negative vertical and horizontal effects on

(1) Commission Regulation (EC) 2790/1999 of 22.12.1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336 of 29.12.1999, p. 21.

(2) Guidelines on Vertical Restraints (2000/C 291/01), OJ C 291 of 13.10.2000, p. 1, para. 32.

(3) Ibidem, para. 116(1).

(4) Ibidem, para. 116(4).

competition flowing from the non-compete arrangements. Finally, the satellite transponder non-compete obligation is indispensable during five years with a view to its function to secure the efficiencies generated through the pay-TV channel distribution exclusivity and the parallel exemption of a bilateral satellite transponder exclusivity between NSAB and MTG/Viasat for five years. [1]

No elimination of competition

Because of the maintenance of a reasonable degree of competition in all of the affected markets, in particular, through the presence of third strong players, such as vertically integrated MTG group and satellite provider NSAB, there is no elimination of competition.

Conclusion

The decision therefore concluded that the requirements of Article 81(3) of the Treaty and Article 53(3) of the EEA agreement are all fulfilled in order to grant the notified agreements an exemption to the extent as set out above. The exemption will last five years and take effect on 21 June 2002, the date on which Telenor notified to the Commission that closing of the notified agreements had occurred.

Finally, apart from its operational conclusions with respect to the various restrictive clauses contained in the notified agreements, the decision implicitly raises a number of important issues which may possibly require further consideration in the context of future cases. This includes in particular the pricing behaviour of TV programme suppliers in co-operation with multichannel TV distribution platforms *vis-à-vis* end-consumers including their bundling strategies in respect of TV channel packaging as well as potential foreclosure effects created by long-term premium film licensing contracts between film production studios and pay-TV broadcasters.

(1) Comfort letter of 6.12.2001 in Case COMP/C-2/38.016 – NSAB/MTG (IP/01/Nordiska, 17.12.2001).

Using the instrument of sector-wide inquiries: inquiry into content for 3G services

Alain CRAWFORD and Panayotis ADAMOPOULOS, Directorate-General Competition, unit C-2

1. The importance of a proactive approach in the antitrust field, especially regarding emerging markets

DG Competition has launched a comprehensive rethinking of the use of its instruments. This has been spread across the different fields of competition law, with the new Merger Regulation, the new anti-trust Regulation 1/2003 and current changes regarding State Aid.

This more proactive approach has in particular prompted the move towards increased decentralization in the antitrust field, as implemented by Regulation 1/2003. As well as reducing unnecessary administrative burdens that fall on companies, such changes in operating procedures allow the Commission to free resources that can be devoted to key competition issues.

In the antitrust field, one of the main goals is to react as early as possible to competition problems. This is to make sure that economic activity is not impeded by anticompetitive restraints. Despite providing for effective action by stopping abuses and finding offenders, dealing with such restraints on a case-by-case basis only does not allow the Commission to influence emerging anticompetitive strategies optimally. In a rapidly changing economic environment, early tracking of new anticompetitive behaviour is a necessary addition to case work as it provides early guidance to economic operators in an efficient manner.

Targeting anticompetitive behaviour in emerging markets is a clear priority for two main reasons. First, new markets are of key importance for the development of European economies. Their unhindered growth is an essential condition for Europe's ability to stand its grounds in increasingly international markets. Building a knowledge-based society, as set out in the Lisbon strategy, depends heavily on the vigour of competition and innovation. The second reason is that particular threats to competition may affect the emergence of new markets. Indeed, in many cases, innovation builds up as a challenge to existing technologies and/or processes. As such, it pits new players against established firms. Such configurations obviously create incentives for the incumbents to try to block or curtail the emerging dynamics in the market place in order to defend their entrenched position at the expense of the innovators.

It is also very important to provide guidance to emerging markets. This may be done through a regulatory framework in cases where market power or technical restraints call for heightened scrutiny. However, in other contexts, guidance will serve to help the operators construct their strategies with increased legal certainty and make sure that strategies develop in ways that do not obstruct competition.

2. Sector inquiries as an important instrument in a proactive approach

Regulation 1/2003 has given renewed importance to 'sector inquiries' as a key tool in antitrust policy and enforcement ([1]). Indeed, article 17 of Regulation 1/2003 provides that *'Where the trend of trade between Member States, the rigidity of prices or other circumstances suggest that competition may be restricted or distorted within the common market, the Commission may conduct its inquiry into a particular sector of the economy or into a particular type of agreements across various sectors'*. To that end, *'in the course of that inquiry, the Commission may request the undertakings or associations of undertakings concerned to supply the information necessary for giving effect to*

([1]) Sector Inquiries (Article 12 of Regulation 17) have been used relatively rarely in the past. However, they made a re-appearance with the launch of three Sector Inquiries in the telecommunications sector in 1999 / 2000. The Commission decided on 27 July 1999 to open inquiries into the telecommunications sector relating to: the provision and pricing of leased lines; mobile roaming services; and the provision of access to and use of the residential local loop. See also Commission press release of 22 October 1999, IP/99/786, Commission launches first phase of sectoral inquiry into telecommunications : leased line tariffs.

Articles 81 and 82 of the Treaty and may carry out any inspections necessary for that purpose.' ([1])

Furthermore, *'the Commission may invite comments from interested parties* ([2])*'*. Sector inquiries help to fuel debate over a particular market, for instance with a view to harmonizing approaches across sectors and among authorities. Indeed, sector inquiries are set to play a key role in policy making. In addition to wide consultation, sector inquiries are an essential way of approaching not only a particular case, but also to investigate the workings of a particular sector. Data collection undertaken in a sector inquiry covers the legal environment as well as business strategies, contracts, technical elements, and financial conditions. Such a comprehensive view is a key step in defining which competition law principles should apply to a given sector.

Sector inquiries also serve to provide guidance to market operators allowing them to operate with increased legal certainty. Indeed, article 17 of Regulation 1/2003 allows for the publication of a report on the results of an inquiry and to hold hearings on it.

3. The competition risks regarding the provision of sport content over 3G networks has prompted the launching of the first sector inquiry in the new framework

With the general objective of keeping media markets open, the Commission is intent on ensuring that access to key inputs in content markets is not unduly restricted. Indeed, certain content plays a crucial role in the media sector today, and is a 'must-have' element to build up an attractive offer. Major sports rights belong to this category. This includes rights relating to both international and national top football, because football carries very powerful branding abilities and is a key-subscription driver in many countries.

There are undoubtedly efficiencies incurred by strong and stable relationships between content providers and distributors, in particular to ensure that some players do not free-ride on the promotional investments made by others. But problems are raised when operators secure exclusivity over very long periods of time and on a large scope, or alternatively, when rights are bundled to be sold on an exclusive basis by sports organizations. More generally, the restricted access to premium content contributes to media concentration and creates the risk of higher prices, less choice for the consumers and reduced levels of innovation.

The Commission has consistently strived to uphold the principles of contestable access to 'premium content' in the media sector, while also taking into account the particular economics of each situation. In the merger field, with its recent NewsCorp / Telepiu ([3]) decision, the Commission has for instance, imposed strict conditions to keep relevant media markets open for potential entrants and competition. In the antitrust area, the Commission has looked at a number of football leagues in Europe, notably the UEFA Champions League, where a formal decision was adopted in July 2003, ([4]) the German Bundesliga ([5]) and English Premier League cases ([6]).

The sector of New Media / 3rd Generation Mobile Telecommunications networks has specific characteristics which render the importance of key sports rights crucial, for several reasons:

— popular audiovisual content will be crucial in the uptake of the new 3G services as consumers will need to invest in new mobile handsets;

— they are well suited to the technical conditions of mobile devices, through the display of highlights video clips directly streamed by the operators;

— sports rights for sports played during the whole season constitute a recurring source of programming from which operators can build attractive offers; and

([1]) Article 17 of Regulation 1/2003.

([2]) Ibid.

([3]) Case No COMP/M.2876 -NEWSCORP/ TELEPIU – Art. 8(2) with conditions & obligations – 2.4.2003 - press release IP/03/478.

([4]) Commission Decision of 23 July 2003 relating to a proceeding pursuant to Article 81 of the EC Treaty and Article 53 of the EEA Agreement (COMP/C.2-37.398 – Joint selling of the commercial rights of the UEFA Champions League), 8.11.2003, OJ L 291/25.

([5]) Commission press release of 24/07/2003, IP/03/1106, New marketing system for Bundesliga broadcasting rights. COMP/37.214 – DFB, 30.10.2003, Art. 19(3) notice, OJ C 261, 30.10.2003, p. 13-15.

([6]) Commission press release of 16/12/2003, IP/03/1748, Commission reaches provisional agreement with FA Premier League and BSkyB over football rights.

— consumers are willing to pay substantial amounts to be able to follow games that are played when they are not in a position to watch them live.

Furthermore, the Commission has identified several types of conduct by established players that restrict access to key sports content for new media operators, especially in the 3G sector. Indeed, current operators have an interest in limiting the development of other platforms which might in the future represent competition for their content, or indeed might hinder their ability to monopolize certain key content. In that respect, three main types of behaviours have been identified:

— Refusal to supply sport content to New Media / 3G network operators by content owners. This may be the result of content providers and/or distributors seeking to extract as much value as possible from given rights through a policy of maximum exclusivity that will thus range across platforms to include UMTS.

— Restrictions such as bundling TV rights with New Media / 3G rights and embargoes favouring TV rights over New Media rights. This serves to secure the value of TV rights that today achieve the highest prices, to the expense of alternative means of distribution. Many different provisions may seek to achieve this goal, for example the bundling of TV and new media rights. For a long time, it was standard practise for TV operators to acquire all the rights even for platforms and /or means of distributions they did not operate. Such practices clearly render new media rights unavailable, at the expense of the development of new platforms. Embargoes, which mean that the most valuable live content is reserved for television, lead to similar effects.

— Purchase of New Media / 3G content on a broad and exclusive basis. Rather than leverage by traditional media, this refers to the risks of major 3G service providers acquiring sweeping exclusivity over content in a bid to squeeze their competitors out of the market.

4. Outlook

The sector inquiry into the provision of sports content over third generation mobile networks was launched in January 2004 by the Commission ([1]). The first stage of implementation of the Inquiry is now fully under way. Information requests have been sent to concerned undertakings and authorities through a first wave of questionnaires. The questionnaires targeted UMTS / 3G operators, rights holders, clubs as well as federations, sports agencies, television channels, Mobile Content Aggregators and other relevant players. Data will be collected and analysed extensively, and completed by a further in-depth questionnaire.

In the second half of 2004, the launch of another sector inquiry into content provision via the Internet is planned. Recent developments in video on demand for example, have shown that there is currently intense demand in that field being hindered, however, by the actions of established TV operators to protect their position to the detriment of new technologies and new players.

([1]) Commission press release of 30.1.2004, IP/04/134, Commission launches sector inquiry into the sale of sports rights to Internet and 3G mobile operators.

New developments in the aviation sector

Consolidation and competition: recent competition cases

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Following the completion of the Internal Market in air transport in 1997, the European aviation sector is going through a period of rapid change. However, while liberalization of the Internal Market has been accomplished, air traffic with third countries is still heavily restricted. The so-called Chicago System establishes a rigid and fragmented international framework based on national bilateralism. Moreover, until very recently, the European Commission did not have the enforcement powers to apply effectively its anti-trust rules on such markets (see below). The system of bilateralism prevented consolidation in the industry, as merging entities faced the risk of losing traffic rights for services to third countries. The Open Skies judgements of the European Court ([1]) are likely to change this situation, as it declared nationality clauses in agreements between Member States and the US to be illegal ([2]). Member States cannot any longer designate only the national flag carrier to fly to third countries.

The liberalization process has already triggered a process of consolidation and restructuring in the European aviation sector. Larger airlines have reacted by establishing hub-and-spoke systems, concentrating traffic on their respective hubs. This allows them to improve capacity utilization due to better feeder services, and to reduce cost by bundling airport services. Furthermore, they aim to extend their respective networks through alliance agreements. The recent Open Skies judgement has now paved as well for European mergers. The recent Air France / KLM merger is a first step in this direction.

The Commission has recently taken three decisions in the aviation sector, as presented below. In two alliance cases it granted an exemption for six years for agreements between British Airways and Iberia ([3]) and between Air France and Alitalia ([4]) pursuant to Regulation 3975/87 ([5]). In February 2004, the Commission also cleared, based on Article 6(2) of Council Regulation (EEC) No 4064/89, the merger between Air France and KLM which will create the largest airline group in Europe ([6]). These three decisions were taken subject to a number of commitments which are binding on the Parties.

Even if each case must be assessed on its own merits and every situation tends to be different, the remedies proposed in those three cases are similar. Their main objective is to lower barriers to entry to allow new competing services to be operated on markets where the agreement would have eliminated competition. In the last few years, the Commission has been adjusting its remedy approach towards making actual entry of new competitors more likely.

([1]) Judgement of 5 November 2002 in the cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98 against the United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria and Germany.

([2]) The nationality clauses is bilateral agreements concluded between some Member States and the US provide that the US may withhold or revoke operating permission from a carrier if it is not substantially owned and effectively controlled by either state or its nationals.

([3]) See IP/03/1703 of 10 December 2003 (case COMP/D2/38479, BA/Iberia/GB Airways). GB Airways is a British Airways franchisee. The exemption is granted until 12 September 2009.

([4]) See Commission Decision of 7 April 2004 relating to a proceeding under Article 81 of the EC Treaty. A public version of this decision in English, French and German (only the English text is authentic) is available for information on DG COMP's website at http://europa.eu.int/comm/competition/index_en.html (case COMP/D2/38284 Air France/Alitalia). Also see IP/04/AirFrance of 7 April 2004. The exemption is granted until 11 November 2007.

([5]) Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector, OJ L 374 of 31.12.1987, p. 1. Regulation as last amended by Regulation (EC) No 1/2003 (OJ L 1 of 4.1.2003, p. 1).

([6]) See Commission Decision of 11 February 2004 declaring a concentration to be compatible with the common market (case n° IV/M.3280 Air France/KLM) according to Council Regulation (EEC) N° 4064/89).

Market definition

In line with its well established policy in the air transport sector, as supported by case law (1), in all three cases the Commission applied its point-of-origin / point-of-destination pair (O&D) approach. According to that approach, every combination of point-of-origin and point-of-destination should be considered to be a separate market from the customer's point of view. Network carriers operating the above-mentioned hub-and-spoke system, however, consider that the O&D approach fails to capture the nature and the extent of competition which now occurs on a network basis.

The issue of network competition is addressed explicitly in these decisions. The Commission acknowledges that, from the business model of network carriers, network competition is relevant from a supply side perspective (2). However, from the demand side, arguably the network approach is of little relevance to the individual consumer. If confronted with high prices due to a monopoly on a particular O&D pair, a passenger may find little comfort in the fact that airlines compete worldwide in the development of their respective networks. Even in the case of corporate customers, who negotiate discounts with airlines and receive typically a bulk of services, the market investigations did not confirm that this customer group has a particular concern with a possible effect on network competition. Finally, network carriers represent only one, if important, part of the industry. Low cost point-to-point operators and many regional carriers instead tend to agree with the O&D approach (3).

Airport substitutability

In certain cases passengers may have the choice between different airports. If the catchment areas overlap sufficiently such airports may be considered to be substitutable on a given city pair. For instance, the results of the market test in the BA / Iberia alliance case confirm that, for journeys between Spain and London, all London airports are part of the market for price-sensitive passengers. However, as regards time-sensitive passengers the results are less clear-cut, i.e. a majority of Heathrow/Gatwick business passengers would not accept to switch over airports in Luton and Stansted for flights between London and Spain. Likely, in Air France/Alitalia it was concluded that Beauvais-Tille is not substitutable to Paris-Orly and Paris-Charles de Gaulle for time-sensitive passengers.

The issue of airport substitutability is also important with regard to slot related remedies. In that case, the principles of proportionality and effectiveness of the remedy have to be taken into account. In principle, if airports are considered to be substitutable from the demand side, the alliance partners may have the choice in which airport they wish to offer slots to new entrants. However, at the same time the offered remedy has to be effective. If potential entrants can demonstrate that, due to a different level of cost or their already existing operations, they can only operate from a specific airport, this choice may be restricted. In that case the principle of proportionality requires that the restrictions imposed on the parties do not go further than what is necessary to address the competition concerns. This can only be judged on a case by case basis.

For instance, in the Air France / Alitalia decision, the Commission considered that, from the demand side for point-to-point traffic, the Paris airports Charles de Gaulle (CDG) and Orly are substitutable. However, in order to ensure the effectiveness of the remedies proposed and applying the principle of proportionality, it was agreed with the parties that, under certain conditions (4) slots should be surrendered at Orly to competitors which already offer services on the affected routes out of this airport. This would allow to strengthen already existing competitors on the affected city pairs. By way of contrast, in

(1) See Judgments of the Court of justice in Case 66/86 Ahmed Saeed Flugreisen of 11.4.1989, [1989] ECR 803 and of the Court of First Instance in Case 2/93 Air France/Commission (TAT) of 19.5.1994, [1994] ECR 323.

(2) When defining a relevant product market, the Commission first considers demand substitution. The competitive constraint arising from supply side substitutability is normally only considered in the market definition when it has an immediate and effective impact on the relevant product market (see Commission Notice on the definition of the relevant market for the purposes of Community Competition law, OJ C 372).

(3) The market investigations conducted by the Commission in the three cases have furthermore confirmed the traditional distinction between 'time-sensitive' and 'non-time-sensitive' customers used in previous cases. See for example Commission Decision 2001/716/EC in Case COMP.D.2 37.444 - SAS Maersk Air and Case COMP.D.2 37.386 – Sun-Air versus SAS and Maersk Air (OJ L 265, 5.10.2001, p. 15) and Commission's Decision 2002/746/EC in Case COMP/37.730 – AuA/LH (OJ L 242, 10.9.2002, p. 25.).

(4) In Air France/Alitalia, a competitor is entitled to obtain slots at Orly if it already operates flights on an affected route out of Orly and if it has all its scheduled flights serving Paris operated out of this airport.

the Air France / KLM decision, at the time of the merger, no competitors operated on the affected city pairs. In order to allow for effective entry, the parties agreed that entrants could choose at which Paris airport to pick up the slots, without any conditions attached.

Affected markets

As pointed out above, the lack of effective enforcement powers implied that the analysis of competitive impact of the two alliance agreements was limited to intra EU traffic. By way of contrast, the Air France / KLM merger was investigated under the merger regulation which allows the Commission to look also at traffic between the Community and third countries.

In its investigation of the alliance between Air France and Alitalia the Commission concluded that the co-operation eliminates competition on seven O&D pairs ([1]). Similarly, in the case of BA/ Iberia five routes between London and Spain ([2]) were affected. In its assessment, as well as with regard to the remedies, the Commission took into account that on many of these routes the parties already face competition ([3]).

However, the existing competitors do not currently offer a service sufficient to compete efficiently against the parties' scheduled services, in particular to attract time- sensitive passengers. Those passengers would notably require a higher number of daily frequencies to consider switching from the alliance partners to these competitors ([4]). In its investigation of the Air France / KLM merger, the Commission took into account the existing agreement between Air France and Alitalia. It concluded that, irrespective of the actual relationship between KLM and Alitalia, the merger would eliminate any incentive to compete between the merged entity and Alitalia. For that reason the merger eliminates competition between KLM and Air France on the Dutch-French bundle of city pairs as well as between the merged entity and Alitalia on all city pairs between The Netherlands and Italy. As a result, it was concluded that the merger would affect nine intra-European routes ([5]). As regards intercontinental traffic the Commission accepted the parties' submission that, under certain conditions, indirect flights offer a competitive service to direct ones. However, it found that such indirect competition can be significantly hampered by government intervention. This applies in particular to price regulation for indirect services ([6]). It concluded that the merger eliminates competition on five intercontinental routes ([7]).

Commitments

With a view to address the Commission's concerns, the parties offered a large number of commitments ([8]). In the case of the two alliance agreements, the main purpose of such commitments has been to strengthen already existing competitors. Due to the lack of available slots at airports, these competitors were not in a position to increase their operations and to offer a viable service in particular to time-sensitive customers. The main remedy therefore has been that the parties offer additional slots to such competitors.

As some of these routes are attractive to new entrants, it cannot be excluded that demand for slots will exceed the total number of slots offered by the parties. Some priority rules therefore had to be established. The Commission considers that it is more effective to add frequencies to an existing service than to start a new service from scratch on a particular city pair. In addition, in terms of competition, it is considered that a competitor offering a package of flights per day will have more chance to compete efficiently against the parties than

([1]) Paris-Milan, Paris-Rome, Paris-Venice, Paris-Florence, Paris-Bologna, Paris-Naples and Milan-Lyon. On the latter route, due to competitive constraints from other transport modes (road transport), this does not apply to non-time sensitive customers.

([2]) Madrid, Barcelona, Bilbao, Valencia and Seville.

([3]) Several competitors operate or have initiated competing services since the date of the notification on several routes between France and Italy (Paris-Rome, Paris-Milan, Paris-Venice and Paris-Naples) and the UK and Spain (London-Madrid, London-Barcelona, London-Bilbao) respectively.

([4]) Either the number of daily frequencies offered by the competitors is too low to provide sufficient ticket and departure flexibility for business passengers or the competitors are offering services out of secondary airports - like many low cost carriers - prolonging total travel time to a level that is not accepted by most business passengers.

([5]) Routes between Amsterdam and Paris, Lyon, Marseille, Toulouse, Bordeaux, Rome, Milan, Venice and Bologna.

([6]) Some Member States still have legislation enabling them to oppose the fares offered by the indirect service provider(s) [e.g. BA operating Paris-London-Atlanta] when the latter undercuts the fares of the direct service provider(s) [e.g. Air France operating Paris-Atlanta].

([7]) Amsterdam – New York, Atlanta and Lagos, as well as Paris – Detroit and Lagos.

([8]) Apart from the slot related commitments discussed here, depending on the case, commitments also comprise issues like frequency freeze, block-space, Frequent-Flyer, inter-lining and inter-modal agreements, as well as price regulation.

several competitors each offering only a limited number of flights. If demand exceeds supply of additional slots, preference is therefore given to competitors who are already established on a particular city pair. Similar considerations also apply for the slot release under the commitments of the Air France / KLM merger.

To some extent, commitments offered under the merger exceed those offered in the alliance cases. This reflects the different market situations and takes into account that the clearance of the merger is given for an unlimited period of time whereas the exemption decision is delivered for only six years. As a result, for instance, in the case of the merger the surrender of slots is for an unlimited duration, compared with six years for the alliances. Moreover, in the case of the merger, the slot release becomes a slot divestiture. In order to take into account concerns raised with regard to hub dominance, slots released by the parties and which are not any longer used by an entrant on a particular city pair will eventually go back into the slot pool of the airport. As there exist particular competition concerns, an innovative approach was chosen for the city pair Amsterdam - Paris. In order to make entry more attractive, under certain conditions an entrant could even obtain the grandfather rights for the slots offered by the parties.

With regard to long-haul services to third countries ([1]), the Commission's entire analysis hinges on the assumption that indirect flights would offer competitive constraints for direct ones. As this is put into doubt by the above-mentioned price regulation, a crucial condition for clearing the merger are the French and Dutch governments' declarations that they will refrain from any intervention into the price setting of indirect services on a large number of long-haul city pairs. Moreover, the Commission obtained assurances from the respective governments that they would give traffic rights to other carriers wishing to stop over in Amsterdam or Paris en route to the United States or other non-EU destinations.

([1]) Note that in both alliances cases the Commission has not taken a decision as regards EU-third country routes.

New enforcement tools to tackle long haul routes: finally the King got a throne

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On 26 February 2004 the Council adopted Regulation (EC) N° 411/2004 ([1]) amending two existing regulations in the air transport sector ([2]) and Regulation (EC) No 1/2003. ([3]) In spite of the very technical provisions contained in this Regulation, the essence of it is that Regulation (EC) No 1/2003 will apply also to air transport between the European Community and third countries (or long haul routes) It further broadens the scope of the Council enabling block exemption Regulation allowing the Commission to issue block exemption Regulations on certain listed air transport activities affecting also the long haul routes.

Until the adoption of this Regulation the Commission acted like a *King without a throne* in the field of air transport to third countries. Although there was no doubt that the competition rules applied also to the long haul routes ([4]), the Commission lacked the effective enforcement powers in this field. Indeed, the assessment of international alliances such as *Star, Wings* and *Skyteam* obliged the Commission to separate procedurally the intra-Community routes from the third country routes, which led to an unsatisfactory patchwork scenario. This was further accentuated by the fact that the Merger Regulation does not make this difference and therefore, when assessing mergers in the air transport field such as the recent Air France/KLM merger, the Commission also assessed the impact of the merger on long haul routes.

Therefore, the application of Regulation (EC) 1/2003 to all air transport, irrespective of the routes involved, finally brings air transport under the general framework of competition enforcement.

The Regulation entered into force on 1 May 2004 together with the modernization package.

([1]) OJ No L 68, 6.3.2004. page 1. See also press release IP/04/272, available at the Competition DG's web-site.

([2]) Regulation (EEC) No 3975/87 laying down the procedure for the application of the EC competition rules in the air transport sector and Regulation (EEC) No 3976/87 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector.

([3]) For an extensive explanation of the Proposal and its background, see the article of Monique Negenman, "Commission proposes effective enforcement rules for air transport between the Community and third countries", Competition Policy Newsletter 2003, number 2, page 12.

([4]) *Nouvelles Frontières,* joint cases 209-213/84 [1986] ECR 1425.

Professional services: more competition, more competitiveness, more consumer orientation

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1. Introduction

Liberal professions are occupations requiring special training in the liberal arts or sciences. This sector is usually characterised by a high level of regulation, in the form of either State regulation or self-regulation by professional bodies. The work of the Commission so far has concentrated on a limited number of professions, namely lawyers, notaries, accountants, architects, engineers and pharmacists.

Professional services, meaning in this context services provided by liberal professions, have an important role to play in improving the competitiveness of the European economy. They are inputs for the economy and business, and their quality and competitiveness have substantial spill over effects. The Italian Antitrust Authority has estimated that in Italy an average of 6% of costs of exporting firms are due to professional services. Thus greater variety in prices and quality, as well as greater innovation in professional services could go a long way in improving the competitiveness of European enterprises and fostering GDP growth in the EU. For these reasons the modernization of professional services should be seen as part of the Lisbon agenda.

Professional services are also important because of their direct impact on consumers. For the foreseeable future competition for professional services will continue to take place mainly at the local level. Greater choice in the range of services available and in prices empowers users to choose the combination of price and quality which better suits their needs.

2. Commission action in the field of competition for professional services

In order to obtain a better understanding of the regulation of liberal professions and its effects the Commission undertook a substantial stocktaking exercise in 2002 and 2003.

In March 2003, the Commission published an independent study on the professions carried out by the Institute of Higher Studies in Vienna ([1]). The study underlines the wide disparities in levels of regulation across the EU, with countries such as Italy, Austria and Germany maintaining very high levels of regulation, while Ireland, the UK, Denmark and the Netherlands have considerably more liberal regimes. It also reveals links between excessive regulation and economic inefficiency.

At the same time, the Commission published an invitation for interested parties to comment on regulation in the professions. The exercise attracted around 250 responses from across the EU, mainly from professionals but also from consumers. An overview of the nearly 250 responses received, as well as of the rules and regulations existing in the 15 Member States was made available on the internet ([2]). The stocktaking exercise was closed by a Conference on the Regulation of Professional Services held on 28 October 2003 in Brussels. The Conference brought together 260 representatives of the professions, their clients, consumer organisations, competition authorities, policy makers as well as the academic world.

The stocktaking exercise allowed the Commission to evaluate the market failures existing in these sectors and the answers brought to them in different regulatory regimes. The various parties concerned also brought new elements to the debate, such as the diverse cultural sensitivities and the need to empower consumers.

During and after the stocktaking exercise the Commission co-operated closely with other competition authorities. On several occasions the regulation of professional services was discussed in meetings with Directors General and experts of

([1]) 'Economic Impact of regulation in the field of liberal professions in different EU Member States', Ian Paterson, Marcel Fink, Anthony Ogus, Institute for Advanced Studies, Vienna, January 2003.

([2]) Full details of the activity of the Commission in this field (the Commission report, the study, transcripts and recordings of the speeches at the Conference) are accessible at: http://europa.eu.int/comm/competition/liberalization/conference/libprofconference.htm.

National Competition Authorities. In parallel, the Commission carried out traditional casework. Ten years after its first decision condemning the fixed tariffs for professional services — in that case those provided by Italian customs agents (1) — the Commission is disappointed to see that minimum price levels still persist. This is why on 24 June 2004 it took a decision against the Belgian Architects' Association in which it concluded that the Association's recommended minimum fee scale constitutes a violation of EU competition rules. It also imposed a fine of €100 000. (2)

National Competition Authorities have dealt with notifications for clearance or exemption under national competition law or complaints against the conduct of professional bodies. The most common cases have been against price-fixing by professional associations, although action against discriminatory conditions of access to the profession, boycotting practices and advertising restrictions has also been taken. Five National Competition Authorities (Denmark, Ireland, Netherlands, Finland, UK) have set up a general programme of action to bring reform to this sector, in particular to forbid price-fixing arrangements or recommended tariffs.

3. Commission report on competition in professional services

On 9 February 2004 the Commission adopted a report on competition in professional services. (3) The main purpose of this report is to set out the Commission's thinking on the scope to reform or modernise specific professional rules.

In this report the five main categories of potentially restrictive regulation in the EU professions are identified: (i) price fixing, (ii) recommended prices, (iii) advertising regulations, (iv) entry requirements and reserved rights, and (v) regulations governing business structure and multi-disciplinary practices.

On the one hand, the report concludes that a significant body of empirical research shows the negative effects that excessive or outdated restrictive regulations may have for consumers. Indeed, such regulations may eliminate or limit competition between service providers and thus reduce the incentives for professionals to work cost-efficiently, to lower prices, to increase quality or to offer innovative services.

On the other hand, the report acknowledges that there are essentially three reasons why some regulation of professional services can be necessary: first, asymmetry of information between customers and service providers, as a defining feature of professional services is that they require practitioners to display a high level of technical knowledge which consumers may not have; second, externalities, as these services might have an impact on third parties; and third, certain professional services are deemed to produce 'public goods' that are of value for society in general. Proponents of restrictive regulations argue therefore that such regulations are designed to maintain the quality of professional services and to protect consumers from malpractice.

While the Commission acknowledges that some regulation in this sector is justified, it believes that in some cases more pro-competitive mechanisms can and should be used instead of certain traditional restrictive rules.

As far as the application of EC competition rules is concerned, the report distinguishes between the potential liability of professional bodies and that of the Member States.

When a professional body regulates the economic behaviour of its members, the regulations it adopts are decisions of associations of undertakings in the meaning of Article 81 EC. However, regulations which are objectively necessary to guarantee the proper practice of the profession, as organised in the Member State concerned, fall outside the scope of the prohibition contained in that Article. (4)

State regulation which imposes or favours anti-competitive conduct or reinforces its effects, infringes Articles 3(1)(g), 10(2) and 81 EC. Where a State delegates its policy-making power to a professional association without sufficient safeguards, that is without clearly indicating the public interest objectives to be respected, without retaining the power to take the decisions of last resort and without controlling the implementation, the Member State can also be held liable for any resulting infringement.

(1) 93/438/EEC: Commission Decision of 30 June 1993 relating to a proceeding pursuant to Article 85 of the EEC Treaty (IV/33.407 – CNSD) OJ L 203, 13.8.1993 p. 27.

(2) Commission Decision of 24 June 2004 relating to a proceeding pursuant to Article 81 of the EC-Treaty (COMP/D3/38549 – Orde van Architecten), C(2004)2180 final.

(3) Communication COM(2004) 83 final of the Commission of 9 February 2004, 'Report on Competition in Professional Services'.

(4) Judgment of the Court of Justice of 19 February 2002, case C-309/99, *Wouters,* ECR I-1577.

Ultimately, in the Commission's view, in all scrutiny of professional regulation a proportionality test should be applied. Rules must be objectively necessary to attain a clearly articulated and legitimate public interest objective and they must be the mechanism least restrictive of competition to achieve that objective. Such rules serve the interests of users and of the professionals alike.

The Commission Report invites all involved to make a joint effort to reform or eliminate those rules which are unjustified. Regulatory authorities in the Member States and professional bodies are invited to review existing rules taking into consideration whether those rules are necessary for the public interest, whether they are proportionate and whether they are justified. The Commission also intends to explore together with these actors the need to put in place mechanisms which are pro-competitive and lead to greater transparency in order to strengthen consumer empowerment.

From an enforcement perspective it is clear that since May 2004 the national competition authorities and the national courts have a more prominent role to play in assessing the legality of rules and regulations in the professions. To the extent that competition restrictions have their centre of gravity in one Member State, administrative enforcement of the EC competition rules in the liberal professions will then mainly be the task of the relevant National Competition Authority. The Commission will however also continue to carry out casework where appropriate. A coherent application of Articles 81 and 82 will be guaranteed through co-ordination in the European Competition Network of competition authorities.

The Commission will report in 2005 on progress in eliminating restrictive and unjustified rules.

4. The way forward: Competition advocacy

Following the indications in the report, DG Competition has invited the European professional bodies of lawyers, notaries, accountants, tax consultants, architects, and pharmacists to bilateral meetings to discuss the justification of existing professional rules. These meetings enable the Commission to clarify which restrictions appear to be excessive and might need to be eliminated or justified. They provide an opportunity for the European professional bodies to explain their understanding of the public interest objectives in their domain and to come to an agreement with the Commission on more pro-competitive mechanisms to achieve those objectives. The European professional bodies should then relay the Commission's concerns to the relevant national professional organisations.

More generally, DG Competition has also embarked in a dissemination process by keeping an open door for professional organisations that want to discuss directly with the Commission services. National Competition Authorities are encouraged to do the same, in particular when those requesting meetings are national organisations.

Experience of past modernisation efforts in the field of professional services in some Member States shows that a simple elimination of anti-competitive mechanisms may not be enough to bring about more competition to this sector. Consequently DG Competition and DG Health and Consumer Protection of the Commission are liaising with consumer organisations to learn their view on the restrictions the Commission has identified and on the ways the professions could best be organised and take account of the interests of the consumers.

It has been agreed that there is a need for pro-competitive accompanying mechanisms which increase transparency and enhance consumer empowerment. Such mechanisms could include, for instance, active monitoring by consumer associations, collection and publication of survey based historical data by independent organisations or public announcements of the abolition of tariffs.

The Commission Report has raised the debate in various member States and has already led some professional bodies to reconsider the existing regulation and to improve the information supply to the users.

In some Member States there is also some movement in the legislative field. In the UK an ongoing independent review of legal services aims to consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient and independent legal sector. This review also aims to recommend a framework which will be no more restrictive or burdensome than is clearly justified ([1]). In Germany, the government has proposed to eliminate a provision granting exclusivity for legal advice to professional lawyers, which is one of the most restrictive in Europe. In Italy, the various proposals on reform of liberal professions pending

([1]) See *http://www.legal-services-review.org.uk/content/consult/review.htm.*

at the Parliament have been consolidated in a single text, which is currently under examination.

These developments concern also the new Member States. Indeed, the National Competition Authorities of some of these States have been particularly active in this sector. The Commission is currently proceeding with fact-finding concerning the rules and regulations affecting liberal professions in the new Member States.

Merger control: Main developments 1 January to 30 April 2004

Recent cases — Introductory remarks

In this period, the Commission received 67 notifications — the same number as in the corresponding period last year but representing a slight decrease (4 %) over the previous four-month period. Between 1 January and 30 April the Commission adopted 57 final decisions representing a substantial decrease compared to the previous 4 -month period. There were 52 unconditional clearance decisions taken pursuant to Art. 6 (1) (b) and 4 conditional clearance decisions taken pursuant to Art. 6 (2). Of the 52 unconditional clearances, 28 were adopted in accordance with the simplified procedure. There were no prohibitions (pursuant to Art. 8(3)) during this period. However the Commission completed one Phase II investigation. Three notifications were withdrawn in this period. The most important decisions adopted during the period are summarised in the articles below and in the article relating to the KLM/Air France decision in the aviation section reproduced above.

INA/AIG/SNFA

François-Xavier ROUXEL, Geraldine EMBERGER and Oliver KOCH, Directorate-General Competition, Merger Network (1)

The proposed acquisition of the French precision bearing manufacturer SNFA by Europe's leading bearing producer INA, jointly with the insurance group AIG, is an illustrative example for the impact of competition enforcement even in cases where no final decision is taken. INA/AIG withdrew their notification in January 2004 after the Commission had issued a Statement of Objections, raising concerns that the proposed operation would have led to the creation of a dominant player in Europe.

I. Introduction

The acquisition of SNFA had originally been notified to several national competition authorities by INA (acting without AIG). However, the deal was abandoned in 2002, after the German authority had signalled serious doubts as to the compatibility with its competition regime. The transaction met the thresholds of the EC Merger Regulation only after the American insurance company AIG had stepped in as a joint acquirer.

INA is a Germany-based manufacturer of a wide range of bearings. SNFA is a French company specialising in precision bearings.

II. The relevant product markets

1. *Precision vs. standard bearings*

The products concerned by this transaction were so-called 'precision bearings'. While most of us might be familiar with bearings used in bicycles, rollerblades or cars, precision bearings (2) differ significantly from those bearings. They are typically used in applications that require a very high degree of accuracy and durability and can be found in a variety of 'high tech' products, such as machine tools, aircraft engines, high precision drills — or even in Formula 1 racing cars. The production of precision bearings is far more complex than the production of standard bearings and involves different machines and materials. Accordingly, precision and standard bearings do not belong to the same market.

2. *Machine tool precision bearings*

The most common application for precision bearings are machine tools. Modern machines for metal or wood processing rely very much on the quality of their bearings. As a result, these machines use almost exclusively bearings that fulfil specific accuracy standards (3).

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(1) The authors thank Paul Malric-Smith and the other members of the INA/SNFA case team, namely Csilla Bartok and Cecilia Nilsson-Bottka.

(2) Also referred to as 'special bearings' or 'high precision bearings'.

(3) Today, precision bearings for machine tool have to comply with ISO tolerance classes P4 or better (P2).

Precision bearings can also be found in aerospace applications (engines and transmissions for aircrafts and helicopters). However, the market investigation carried out by the Commission showed that the market characteristics for aerospace bearings are manifestly different from machine tool precision bearings ([1]).

Finally, a minor part of precision bearings is used in other 'specialty' applications (e.g. dental drills, molecular pumps, hard drives etc.). According to the market investigation, these bearings are neither substitutable with machine tool bearings from the demand nor from the supply side ([2]).

3. *Machine tool Angular Contact Ball Bearings (ACBBs)*

The majority of precision bearings used in machine tools are so called 'angular contact ball bearings' (ACBBs, see below).

Angular Contact Ball Bearing (ACBB)

Although another type of precision bearing is also used in machine tools (cylindrical roller bearings — CRBs), the Commissions' market investigation has shown that machine tool ACBBs form a separate market from machine tool CRBs ([3]). As SNFA is not active in the production of CRBs, the market for CRBs was not analysed further.

4. *Machine tool ACBBs sold to OEM/OES*

Bearing manufacturers sell their machine tool ACBBs to two groups of customers: spindle or machine tool manufacturers (‘OES/OEM ([4])’) and dealers who mainly serve the replacement market. In line with its previous decision practice, the Commission considered sales to OES/OEM and to the aftermarket as distinct product markets ([5]).

Based on this product market delineation, the Commissions' assessment was focussed on the product market for *precision machine tool ACBBs sold to OEM/OES* ([6]).

III. The relevant geographic market ([7])

Defining the geographic scope of the machine tool bearings market was at the heart of the Commission's investigation. INA/FAG maintained it was world-wide in scope due to the absence of regulatory and administrative trade barriers, the low impact of transport costs and, finally, the fact that both INA/FAG and SNFA as well as their major competitors sell their products not only in Western Europe but also in Asia and in the USA.

The initial working hypothesis adopted by the Commission was based on a Western European market (EU 15 plus CH ([8])). This approach was chosen with a view to the strong differences between the market positions of INA and SNFA and their competitors in the different world regions, which seem to be much stronger in those areas, where these companies have production facilities. Differences were also observed with regard to the average European price level for certain precision bearings, which turned out to be significantly lower than in the US and higher than in some parts of Asia.

In order to verify the accuracy of its working hypothesis, the Commission went on to examine the situation of demand and supply side, assessing the ability and readiness of suppliers and customers of spindle bearings to provide/purchase these products from regions outside Western Europe.

([1]) E.g., unlike machine tool bearings, aerospace bearings do not have to fulfil ISO P4/P2 standards. They are tailor-made for each application and require a documentation of every single step of the production process.

([2]) Most specialty bearings differ significantly as regards sizes, types and production know-how.

([3]) Switching production between ACBBs and CRBs on a given production line is practically excluded. Also from the customers' point of view, ACBBs and CRBs are not interchangeable.

([4]) OES = Original Equipment Supplier; OEM = Original Equipment Manufacturers.

([5]) See Comp/M.2608-INA/FAG, par. 13; Comp/M.3011-Timken/Torrington, par. 11. Price differentials and different purchase patterns between these two groups as well as a significantly different level of pre-sales service involved sales to OES/OEM justified their separate assessment.

([6]) The remaining product markets (e.g. aerospace bearings or precision bearings sold to dealers) raised no serious competition concerns.

([7]) Please note that the following arguments only relate to the OEM/OES market.

([8]) Switzerland was included given that many manufacturers present in the EEA are also producing precision bearings for the Swiss market and given that there are no significant tariff or non-tariff barriers for precision bearings between the EEA and Switzerland.

ACBBs form the heart of the machine tool spindle. Their accurate functioning is indispensable for a smooth manufacturing process. The great majority of machine tool manufacturers thus co-operate with their suppliers throughout the purchasing process to select solutions to adapt the selected basic bearing model to their specific needs. This situation together with the delivery conditions for replacement bearings (1), are the reason why precision bearing customers -unlike buyers of standard bearings- require European production plants and technical support on site. Suppliers relying on imports hold only *de minimis* sales. Any switch to suppliers lacking European production facilities would mean additional risks for the customers, who usually rely on brand image as a proxy for competency and reliability in designing and testing precision bearing solutions. Compared to the risks, the potential benefits of such a switch seem to be rather unattractive considering the modest share (1-3%) precision bearings represent in the overall cost of a machine tool, and, considering also the small volumes purchased by European customers, who are mostly small and medium-sized enterprises (SMEs). This situation is mirrored by the low level of imports which in 2002 were found to only account for 3% of European consumption. It was thus concluded that Western European customers of machine tool bearings would not be in a position to divert their orders to companies located elsewhere in the short term and at a negligible cost (2).

Notwithstanding its negative conclusions on demand side substitution the Commission nevertheless examined whether suppliers from outside Western Europe would be able to meet any potential additional demand (3). The investigation, however, showed that this was not the case. Due to the need for suppliers to closely cooperate with their customers in the development of specific bearing solutions, successful entry is linked to a European presence in terms of production, R&D and technical support centres. Entry is thus marked by considerable hurdles in terms of cost and time, requiring from the entrant to take strategic business decisions to make substantial investments (4). Additional demand could therefore not be met in the short term and in an effective manner.

In conclusion, the above-explained considerations led the Commission to define a Western European market for precision ACBBs sold to machine tool OES/OEMs.

IV. Assessment

At first glance, the market for ACBBs seems to be relatively unimportant if one considers sales volume (5). However, the market investigation showed that the product at stake is of great importance for the mainly small and medium-sized machine tool producers in Europe, which heavily depend on the supply of high quality precision bearings. The Commission investigated thoroughly the effects of the proposed transaction on the competitive structure of this market.

The investigation carried out by the Commission revealed that each party to the concentration held a market share in the range of 25%-30%, conferring the merged entity a 50% to 60% market share, while the second and third largest players, hold less than 10% market share each.

The merging parties also appeared as the two strongest competitors in many respects. To assess more qualitative features, the Commission gathered the contact details of customers accounting for 90% of the main players' customer base, and asked these customers to rank each supplier according to seven criteria: ‘Quality, reliability’, ‘performances of the bearings’, ‘breadth of ACBB portfolio’, ‘price level’, ‘innovation/technology’, ‘reactivity/flexibility/delivery terms’ and ‘technical support/expertise’ (6). The customers were also requested to rank the criteria depending on their respective importance.

83% of the respondents ranked ‘Quality/reliability’ as the most important criterion. In second position, 44% mentioned ‘Performances’. ‘Price level’ came only as the third most important criterion, illustrating the low sensitivity to prices of the

(1) Machine tool OEM/OES source one fourth of all failed precision bearings from their manufacturers, who must be able to supply them within a very short time limit.

(2) See par. 29 of the Commission’s Notice on market definition (OJ C 273 of 9.12.1997).

(3) See par. 20 of the Commission’s Notice on market definition (OJ C 273 of 9.12.1997).

(4) This situation becomes even more evident if one considers that – except from two transatlantic acquisitions – no entry by foreign players had been witnessed over the past 10 years.

(5) The total volume of sales of machine tool ACBBs sold to OES/OEM in the EEA does not exceed EUR 100 Mio

(6) These criteria where those mentioned by customer the most often when asked about the strengths and weaknesses of the various players.

customers. Indeed, while the cost of ACBBs in a machine tool is small (1%-3%), a failing bearing can have disastrous consequences on the whole production line.

This survey outlined that the two merging parties were considered by customers as the two strongest competitors with respect many criteria: reliability, performance, innovation, support, portfolio breadth, etc, far before the following players.

These numerical results were corroborated by several pieces of evidence. As regards technology and innovation, for instance, it turned out that the customers with the most sophisticated needs were predominantly supplied by the two merging companies. Even competitors sourced ACBBs from the merging parties to build high-technology machine tool spindles.

The Commission also sought to compare the ACBB portfolios of the main players. Given that several thousands of ACBB variants are produced, the Commission agreed with the parties and competitors on a common methodology to compare portfolios. This showed that SNFA had the second largest portfolio behind INA/FAG and that certain ACBBs were produced only by the two merging parties. The merging parties thereby would hold a significant competitive advantage in particular vis-à-vis the customers which source several hundreds of different ACBB variants each year.

In addition, the Commission did not single out elements that may have been able to constrain the merged entity: (i) the parties had only a very limited part of their customer bases in common. Therefore, post-merger melt-off effects would have been almost insignificant. (ii) Customers and competitors reported that the players which were the best placed to compete with the parties would have not been in a position to defeat price increases.

In the light of these elements, the Commission issued a statement of objections in which it concluded that the proposed transaction would lead to the creation of a dominant position in the West-European market for precision ACBBs sold to OES/OEM.

Further to the issuance of this statement, the merging parties decided to abandon their planned transaction. Indeed, appropriate remedies would have required divesting a large part of the merged entity, thereby removing most of the rationale of the deal.

An amended merger implementing regulation for a new merger regime

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A. Introduction

The adoption of a new Merger Regulation by the Council on 20 January 2004 (1), has made it necessary for the Commission to review the implementing measures which it had put in place under the old merger regime. In addition to new measures to reflect the changes made in the new Merger Regulation the Commission was able to avail of the opportunity to make other amendments with a view to improving the clarity of the text, as well as improving the efficiency and fairness of the process. The final text of the new Implementing Regulation was adopted, following a public consultation which ended on 11 March, by the Commission on 21 April 2004 and entered into force on 1 May 2004 (2) at the same time as the new Merger Regulation.

B. Implementing Regulation

New referral mechanism and new forms

The new Merger Regulation introduces the possibility for notifying parties to request at the pre-notification stage that a concentration be referred to or from the Commission. This request must be made in a reasoned submission which should be submitted prior to notification. With a view to simplifying and expediting the processing of these submissions a reasoned submission form (Form RS) has been introduced and annexed at Annex III of the Implementing Regulation (IR). This form sets out which information needs to be provided by the parties in order for their submission to be processed. Further details with regard to this new Form RS are to be found below. In addition the new IR introduces the possibility for parties to submit notifications using a special simplified or Short Form. The conditions under which such forms may be used are dealt with in further detail below.

The addition of 10 new Member States on 1 May 2004 has also made it necessary to require the notifying parties to provide a further 10 copies of each notification to be submitted to the Commission in order that the notification can be considered complete. This requirement to submit 35 copies was criticised by many respondents to the public consultation as constituting a major burden for merging parties and entailing unnecessarily high costs. The Commission is cognisant of the need to reduce burdens and costs on companies and it is intended to reduce this burden as soon as a technical solution becomes available which would allow for electronic notification. In the meantime it was felt that the requirement to provide electronic copies as well as paper copies — which was contained in the proposal which went to public consultation — actually increased the burden on companies. This requirement to provide an electronic copy was therefore dropped from the final text adopted by the Commission.

Time limits

The new IR also contains amendments to the provisions on the calculation of time- limits providing that these should be calculated, in line with the wording in Regulation 139/2004, on the basis of working days rather than months. The provisions on the calculation of the beginning and end of the various time periods have also been streamlined and simplified in accordance with the new wording. The new Article 7 provides that these shall begin on the working day following the event to which the relevant provision refers. Article 8 contains simplified rules for the calculation of the expiry of the various time-limits.

Thus Article 19 (1) provides that the deadline for the submission of commitments in Phase I should be 20 working days, and Article 19 (2) provides that the deadline for the submission of commitments in Phase II should be 65 working days from

(1) Council Regulation (EC) N° 139/2004 of 20 January 2004 on the control of concentrations between undertakings OJ L 24 of 29.1.2004, p. 1.

(2) Commission Regulation (EC) N° 802/2004 of 7 April 2004 implementing Council Regulation (EC) N° 139/2004 on the control of concentrations between undertakings OJ L 133 of 30.4.2004, p. 1.

the date of initiation of proceedings. In addition Article 19 provides that where the deadline for the adoption of an Article 8 (2) decision is extended at the request of the parties pursuant to Article 10 (3), the deadline for the submission of commitments should also be extended by the same number of working days. Thus for example where the 90 working day deadline is extended by 10 working days to 100 working days, then the deadline of 65 working days for the submission of commitments is extended to 75 working days.

Article 9 of the new IR introduces the possibility to suspend certain time-limits. First, the time-limit in Article 9 (4) of the new Merger Regulation may be suspended where the Commission has had to take a decision pursuant either to Article 11 (3) (having first made a direct request for the information) or Article 13 (4). Secondly, the time-limits in Articles 9 (4), 10 (1) and 10 (3) of the new Merger Regulation may be suspended where the Commission adopts a decision pursuant to Article 11 (3) without first making a direct request for information from the parties.

Right to be heard

The new IR contains new provisions on the right to be heard essentially expanding the category of natural or legal persons who have such rights to consumer associations in cases where the proposed concentration concerns products or services used by final consumers.

Confidential information

The new IR also introduces an obligation on persons who make known their views pursuant to Articles 12, 13 or 16 of this Regulation or who supply information pursuant to Article 11 of the new Merger Regulation to clearly identify any material which they consider to be confidential. Such persons should also provide an explanation as to why they consider the information to be confidential and should provide a separate non-confidential version by the date set by the Commission.

Notifying parties are also required, pursuant to Article 18 (3), to identify the business secrets or other confidential information in the documents or parts of documents which they have produced. They should also identify the undertakings with regard to which such documents are to be considered confidential. This requirement to identify confidential information also applies to any part of a statement of objections, case summary or a decision adopted by the Commission which in the view of the parties contains business secrets. As in the case of third parties, notifying parties are required to provide an explanation for their claim of confidentiality and to provide a non-confidential version of the relevant document.

Additional amendments

Article 3 contains two minor amendments: the fourth paragraph provides that the language of the original proceeding shall also be the language of 'any subsequent proceedings relating to the same concentration'. The aim of this measure is to ensure that any proceedings relating to one and the same concentration are dealt with in the same language. This would be the case, for example, where a matter has to be re-examined following a ruling of the Court of Justice, or where proceedings are brought pursuant to Article 14 ECMR, for submission of incorrect information in a notification.

Article 5 has been amended to clarify which information should be included in the category of information which 'must be communicated to the Commission without delay' after notification. The information which should be thus communicated includes not only, as at present, 'material changes in the facts contained in the notification', but also 'new information coming to light subsequent to the notification which the parties know or ought to know and which would have had to be notified if known at the time of notification'.

C. Revised Form CO

The Form CO has been amended to reflect changes in the new Merger Regulation and the Implementing Regulation and, at the same time, to focus on certain competition issues raised within the analytical framework of the new Commission Notice on the assessment of horizontal mergers (the new Merger Guidelines). The Introduction of Form CO further highlights the Commission's need to have comprehensive information about the proposed concentration up-front, due to the Merger Regulation's short legal deadlines. As before, notifying parties are encouraged to ask for a dispensation from providing information ('waiver') required by Form CO, where they consider that such information would not be necessary for the Commission's examination of the case.

A new section draws attention to the fact that a proposed concentration may be subject to Community and/or national rules governing the provision of certain information regarding the proposed transaction *vis-à-vis* the notifying parties' employees and their representatives (Introduction, Section 1.7).

The information requirements in Form CO have been modified to streamline the Commission's information-gathering procedures, while ensuring that the Commission obtains all necessary information to conduct investigations thoroughly and expeditiously. In order to improve the Commission's — and the public's — understanding of the nature of a proposed operation, notifying parties are now required to provide an executive summary of the proposed transaction suitable for publication, which must specify, for example, the markets in which the concentration will have an impact, and the strategic and economic rationale for the transaction (Section 1).

Section 3 now requires the notifying parties to specify the value of the proposed transaction. In Section 5, the questions on supporting documentation have been made more specific, so as to obtain more relevant documents.

Section 6 sets out the market definitions to be used in completing Form CO. As before, the Form requires information on horizontally 'affected markets' (where parties hold a combined market share of 15% or more) and vertically affected markets (where parties together hold 25% or more at either level). In addition, the Form now also seeks information on other markets in which the notified operation may have a significant impact, for example, because of potential entry issues, or because parties have strong positions in 'neighbouring' markets (Section 6.3). Information on this category of markets was already called for in the previous Form CO (in Sections 6.2 and 9.1). The new section strikes a balance between ensuring that the Commission is informed of such issues in relevant cases, while at the same time minimising the frequency with which this section needs to be completed. Thus, the category is now more focused than the broad category of conglomerate mergers referred to in the previous Form.

Section 7 has been modified to obtain more complete background information on competitors. First, notifying parties must now provide the required information on all competitors holding at least a 5% market share in an affected market, whereas the prior Form set the threshold at 10%, which tended to exclude important information on a number of competitors. Second, in view of the role of the 'HHI' concentration index in the new Merger Guidelines, companies are now required to compile information on the HHI levels in affected markets. It is not expected that this will place a greater burden on notifying parties, as the underlying market share data have been required in the previous Form as well. Automated functions in text editing programmes will enable users to automatically transform market shares into HHI indices.

Section 8, dealing with questions on general market conditions in affected markets, has been made somewhat more precise, reflecting points of emphasis in the new Merger Guidelines (for example, the role of product differentiation). In addition, more information is sought on foreseeable future market developments, for example, on the existence of 'pipeline products', plans to expand capacity, or plans to enter new product or geographic markets.

Further, in view of the increased role of efficiency analysis in merger control, Section 9 has added a question on efficiencies. As before, the parties must describe how the proposed concentration is likely to affect the interests of intermediate and ultimate consumers and the development of technical and economic progress. In addition, should the parties wish the Commission to consider from the outset whether efficiency gains generated by the concentration are likely to enhance the ability and incentive of the new entity to act pro-competitively for the benefit of consumers, they are requested to provide a detailed description of such efficiencies. (It should be noted that it remains possible for the parties to provide back-up information as to efficiency claims later in the procedure.)

Finally, questions in old Section 11 which dealt with ancillary restrictions have been removed, in line with the clarifications in the new Merger Regulation that the Commission will not normally deal with such issues. At the same time, the new Section 11, governing the certification of the completeness and accuracy of the notification, has been changed to require that it is the notifying party (or parties) who must declare that, to the best of his or her knowledge and belief, the information given in Form CO is true, correct, and complete, rather than a certification from the legal representatives as had previously been required.

D. Short Form CO

Short Form CO has been created for the notification of certain concentrations that are unlikely to raise competition concerns. In order to simplify the merger control system, it was decided to align Short Form CO as closely as possible with the Commission Notice on a simplified procedure

(OJ C 217, 29.07.2000, p. 32). This Notice is at the time of writing under revision, that is, to be made consistent with the Short Form CO.

As a general rule, the Short Form may be used for the purposes of notifying concentrations, where:

(a) in the case of a joint venture, the joint venture has no, or negligible, actual or foreseen activities within the territory of the European Economic Area (EEA). Such cases occur where the turnover of the joint venture and/or the turnover of the contributed activities is less than EUR 100 million in the EEA territory; and the total value of the assets transferred to the joint venture is less than EUR 100 million in the EEA territory (‘*de minimis* joint venture’);

(b) none of the parties to the concentration are engaged in business activities in the same relevant product and geographic market (no horizontal overlap), or in a market which is upstream or downstream of a market in which another party to the concentration is engaged (no vertical relationship);

(c) two or more of the parties to the concentration are engaged in business activities in the same relevant product and geographic market (horizontal relationships), provided that their combined market share is less than 15%; and/or one or more of the parties to the concentration are engaged in business activities in a product market which is upstream or downstream of a product market in which any other party to the concentration is engaged (vertical relationships), and provided that none of their individual or combined market shares at either level is 25% or more; or

(d) a party is to acquire sole control of an undertaking over which it already has joint control.

Point (d), dealing with the acquisition of sole control over an undertaking where joint control is currently exercised, has been added as a category of cases that would qualify for notification under the Short Form notification. Experience has shown that competition concerns are generally unlikely to arise in such situations. It is the intention to add this category of cases to the upcoming revision of the Commission Notice on a simplified procedure.

In line with the Notice on a simplified procedure, certain types of concentrations have been identified where a notification using the Short Form would not be appropriate, even though the formal conditions may be fulfilled. Such a situation may arise, where for instance it is difficult to define the relevant markets; where one party is a new entrant or an important patent holder; where it is not possible to adequately determine the parties' market shares; where there are high entry barriers, with a high degree of concentration or known competition problems; where an issue of coordination under Article 2(4) arises; and where at least two parties to the concentration are present in closely related neighbouring markets. Similarly, a full Form CO notification may be required in the case of a party acquiring sole control of a joint venture in which it currently holds joint control, where the acquiring party and the joint venture, together, have a strong market position, or the joint venture and the acquiring party have strong positions in vertically related markets.

Safeguards have been added to ensure that, in case it emerges that the concentration does not qualify for notification under the Short Form but has already been notified, the Commission may then require full or partial notification under Form CO. Such a situation may arise, where the conditions for using the Short Form are not met; where a full or partial notification under Form CO appears to be necessary for an adequate investigation of possible competition concerns; incorrect or misleading information has been submitted; and/or a Member State or a third party expresses substantiated competition concerns about the notified concentration. It should be emphasised that the responsibility to provide correct and complete information rests with the notifying parties. These and other issues relating to the appropriateness of using the Short Form notification should be dealt with during the pre-notification contacts.

As to the information required in the Short Form CO itself, this has been kept short while, at the same time, ensuring that all relevant information is submitted in order to allow the Commission to verify that the proposed concentration is appropriate for notification using the Short Form CO.

Short Form CO requires information on so-called ‘reportable markets’, which can be horizontal or vertical markets. Following the principle that is already in the Notice on a simplified procedure, it is spelled out in the Short Form CO that data on the basis of all plausible alternative market definitions must be provided.

The information required on the reportable markets is limited to the information concerning the total market size, the notifying parties' sales data and market shares. This information is limited to last year's financial data only. In the case of horizontal and vertical relationships, market shares of the three largest competitors must be provided. This basic information will allow the Commission to ensure that the concentration is one for which a

Short Form notification is appropriate. Furthermore, the section seeking information on possible cooperative effects under Article 2(4) has been retained in the Short Form CO.

Finally, in line with the full Form CO, a provision concerning the need to inform employees and their representatives has been added. Similarly, the notifying parties are asked to provide an executive summary of the concentration.

E. Form RS and the Draft Notice on case allocation

The new Form RS applies to Reasoned Submissions that are made at the pre-notification stage. The overall purpose of the new streamlined referral system is to put in place a more rational corrective mechanism for case allocation between the Commission and Member States based on the principle of subsidiarity, by ensuring that the authority or authorities best-placed to carry out a particular merger investigation should deal with the case. This system aims in particular at tackling the problem of 'multiple filings', that is, notification to various competition authorities within the EU, while preserving the major benefits of EC merger control, in particular, one-stop-shop, expediency, legal certainty and administrative efficiency. To this end, the rules governing the referral system in the new Merger Regulation (Articles 4(4), 4(5), 9 and 22) have been simplified and rendered more flexible. In particular, referrals from the Commission to Member States and vice versa can occur before a formal filing has been made in any EU jurisdiction, based on a procedure triggered by a reasoned submission by the parties.

For the purpose of pre-filing referrals under Article 4(4) or 4(5), merging parties are required to file a request by using Form RS (Reasoned Submission). The purpose of the Form is to enable the Commission and the Member States to establish whether a case is appropriate for referral. As no full competitive assessment is to be undertaken at this stage, the amount of information required in Form RS is less substantial than in Form CO.

In particular, in Sections 4 and 5 of Form RS, which deal with affected markets, the information required is confined to horizontal and vertical affected markets, figures are limited to the last financial year, and no contact details of competitors, suppliers and customers are required.

Specific attention should be given to Section 6 of Form RS, which has no equivalent in Form CO. This is the section of the form where the submitting parties should demonstrate both that the legal requirements for referral are fulfilled and the reasons why the case would benefit from a referral in either direction.

In view of the novelty of the some of the referral procedures set out in the new Merger Regulation, as well as Form RS, these amendments will be complemented by a new Commission Notice, a draft of which was published for public consultation on 28 April 2004. The draft Notice deals with principles, criteria and methodology upon which referral decisions should be based.

The draft Notice first spells out the guiding principles upon which the mechanism of reallocation of cases between the Commission and Member states is founded, namely subsidiarity, one-stop-shop and legal certainty. Subsidiarity implies that in principle jurisdiction should be re-attributed to the competition agency that is best-placed for dealing with a merger, having regard to the impact on competition of the case as well as the investigative tools and expertise available to the agency.

With respect to referrals from the Commission to one or more Member States, the draft Notice summarises the legal requirements for a referral under Article 4(4), that the transaction 'may significantly affect competition' within a distinct market in a Member State. In essence the requesting parties should demonstrate that the transaction is liable to have a potential impact on competition on a distinct market in a Member State, which may prove to be significant, thus deserving close scrutiny. Such indications may be no more than preliminary in nature, and would be without prejudice to the outcome of the investigation (for example, the existence of affected markets in the sense of Form CO would generally be considered sufficient to justify a request).

As mentioned earlier, the parties have the exclusive right of initiative at this pre-filing stage. The request must be based on a Reasoned Submission and must be agreed to by both the Commission and the National Competition Authority(ies) ('NCA') concerned, within short deadlines, thereby excluding situations of deadlock. The draft Notice provides that, in considering whether or not to refer a case, the Commission is to ascertain that the recipient NCAs will be in a position to properly scrutinise the case and effectively restore competition, having regard in particular to resources, investigative and enforcement powers, and past record of enforcement of competition rules.

Moreover, in the draft Notice the Commission foresees that the best candidates for referral from the Commission to Member States will be cases which are likely to affect competition in markets that have a national or narrower-than-national scope, and which effects are likely to be confined to, or have their main economic impact in, a single Member State.

As regards referrals to the Commission under Article 4(5), the only legal requirement is that the case must be reviewable by at least 3 Member States. The draft Notice elaborates on the procedural elements, which include that competent Member States have 15 working days to review the parties' Reasoned Submission, and unless none of them object, the concentration acquires a Community dimension and must be notified accordingly. If any competent Member State objects within that time period, however, no referral is made. Failure by a Member State concerned to react within the above deadline is tantamount to approval.

In essence, the above system is governed by a ‘unanimity rule’, which has the advantage of removing the risk of fragmentation as a result of partial referrals requested by only some of the Member States competent to review a case. This rule also underlies the importance for the parties of correctly identifying in the Reasoned Submission all Member States which are competent to review their case, as this will decide which Member States are able to block a requested referral. In order to ensure that such information is always available from the outset, Form RS includes a set of ‘tick boxes’ on the competence of each Member State, and a default assumption of competence for any Member state where the tick box has not been filled in.

The draft Notice identifies as the best candidates for referral to the Commission cases where the market/s in which there may be a potential impact on competition is/are wider than national in geographic scope, or where some of the potentially affected markets are wider than national, and the main economic impact of the concentration is connected to such markets; cases that give rise to potential competition concerns in a series of national or narrower than national markets located in a number of different countries in the EU, and in circumstances where coherent treatment (regarding the investigation but also regarding possible remedies) of the case would be desirable.

Finally, the draft Notice also provides guidance regarding the application of Articles 9 and 22 after a case has been notified to the Commission or Member States, as the case may be.

Air Liquide / Messer: addressing the changes brought about by the concentration in the industrial gases industry

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On 15 March 2004, the European Commission approved, subject to conditions, the acquisition by L'Air Liquide SA ('Air Liquide') of Messer Griesheim KGaA's ('Messer Group') activities in Germany, the UK and the US ('Messer'). The Commission was concerned that the merged entity would have become dominant on the European market for tonnage gases and jointly dominant with Linde in the German markets for bulk and cylinder gases.

The Commission's concerns were removed following Air Liquide undertaking to sell two pipeline networks, tonnage plants and bulk and cylinder businesses covering a large part of Germany.

This case illustrates how quantitative tools may allow a thorough assessment of the impact of a concentration and of proposed divestitures, within the short deadlines of first phase investigations, when remedies and market data are provided at an early stage.

I. Introduction

a. The notified operation

Air Liquide and the Messer Group are both active worldwide in the production and distribution of industrial and medical gases and the services associated with these products. They supply industrial gases to various industries including iron, steel, refining, chemicals, glass electronics, paper pulp, food processing, health care and aerospace industries. Air Liquide is the world leader in the production and distribution of industrial gases.

The operation, signed on 19 January 2004 and notified on 30 January 2004, consisted in two interlinked operations: the acquisition by Air Liquide of the whole of the Messer Group's activities in Germany, the UK and the US, along with the acquisition of sole control of the remaining business by the Messer family.

b. The market definitions retained by the Commission

The products in this case are industrial and medical gases, such as gaseous or liquid oxygen, nitrogen or argon, which are extracted from the air and various other gases produced through chemical reactions, such as hydrogen, carbon dioxide, acetylene.

In this case, the Commission confirmed the product market definitions of previous decisions (2) in the sector. Given the lack of demand-side substitutability, each gas (e.g. oxygen, nitrogen, hydrogen, argon, carbon dioxide, acetylene, helium, each of the Electronic Specialty Gases ('ESG')) and each distribution format thereof (i.e. tonnage, bulk, cylinder) had to be considered as a distinct product market.

The tonnage business involves building and operating plants to produce gases (as opposed to liquefied gases) on a customer's site. The gas is supplied under long-term supply agreements, typically for fifteen years. The tonnage gases are oxygen and nitrogen (produced simultaneously by separation from air), hydrogen, carbon monoxide or a mixture of both (so-called 'syngas'). The tonnage gas customers usually have requirements in excess of 100 ton per day ('T/day') and include steel mills, refineries or the chemical industry.

Bulk deliveries are made for industrial customers with lower gas requirements, ranging from 0.1 T/day to 100 T/day. The gas is produced in a stand-alone plant or in a tonnage plant serving the tonnage customer ('piggy-back' solution). It is then liquefied and transported by road tankers to the customer's site where the liquid gas is stored before being used. The gases delivered in bulk are oxygen, nitrogen, argon, hydrogen and carbon dioxide.

Deliveries in cylinders are used when the quantities requested by the customers are small. Cylinders may be filled at and distributed from the

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(1) The authors thank the other members of the Air Liquide/Messer Targets case team, Sandra KIJEWSKI and Katharina KRAAK.

(2) Decisions in case COMP/M.1630-Air Liquide/BOC and COMP/M.1641-Linde/AGA.

production plant or cylinder filling centres. From these filling centres cylinders in various sizes are transported directly to the customer, or to depots which supply to retail customers. The gases distributed in cylinders are to a large extent the same as those delivered in bulk but also include helium, acetylene and the various ESGs used in the electronics industry.

As to the geographical scope of the markets, the Commission concluded that the markets for ESGs were EEA-wide and that those for bulk and cylinder gases were national although competition takes place at the local level ([1]). The Commission did not find any strong evidence pointing towards worldwide or quasi-worldwide markets for tonnage gases as suggested by the notifying party. In line with previous decisions, the relevant market for tonnage gases was found to be the EEA or the extended EEA including the ten Accession countries at most.

On the basis of these market definitions, the proposed operation would have given rise to the following affected markets: the European tonnage markets for oxygen, nitrogen), hydrogen, carbon monoxide and synthesis gas; the various markets for bulk and cylinder gases in Germany; and the European market for ESGs.

In order to address the competition concerns identified by the Commission, the notifying party submitted a set of divestitures at an early stage of the procedure ([2]). This early submission, together with the provision of relevant market data, made it possible for these remedies to be market-tested and subsequently modified to address the issues identified by the Commission following its investigation.

The final version of the commitments comprises divestitures the sales of which exceeded EUR 200 million in 2003.

II. Tonnage markets

a. Possible single dominance in the EEA markets for oxygen and nitrogen

Market shares and purchasing process

Both companies are in the tonnage markets. For the standard air gases (oxygen and nitrogen), Air Liquide/Messer would have had by far the highest market shares in the EEA (40-50% in each market). For Linde, the next largest supplier, market shares would have been only half of the combined entity's. Despite the contention that tonnage markets are bidding markets, the Commission took the view that the way in which tonnage contracts are currently awarded does not undermine the significance of market shares as a first proxy for market power. Market shares remained very stable over time and the tendering procedures sometimes used by tonnage customers were different from formal bidding process. In particular, even when suppliers made offers in response to requests for quotations (RFQs) significant modifications to these offers were made, in some cases, during subsequent negotiations.

Against this background, the question arose as to whether the merger would result in significant changes on the markets. The Commission's market investigation confirmed that, with EEA market shares of 5-10%, Messer was a second-tier player with much lower market shares than the first-tier players (i.e. Air Liquide, Linde, Air Products, Praxair, and to some extent BOC). Messer had limited presence outside Germany and lacked engineering capabilities. In addition, the data collected ([3]) by the Commission from all major players with regard to their past tonnage offers indicated that, outside its entrenched position in Germany, Messer had not exerted a strong competitive constraint on Air Liquide prior to the merger.

Messer's pipeline networks

The Commission found that a substantial change resulting from the merger concerned Messer's pipeline networks in Germany, where a significant part of EEA tonnage gas customers are located. Messer's activities in the tonnage business are concentrated in the Rhine-Ruhr and Saar regions, where it is the only industrial gas company to own pipeline networks delivering oxygen and nitrogen to industrial customers. The pipelines gave Messer a strategic position in these industrial basins where important clusters of customers for air gases are active, such as steel producers or chemical companies. The market investigation revealed that such infrastructures can give incumbents a structural advantage over rivals competing with on-site

([1]) Due to transport costs, bulk and cylinders can be delivered economically within a radius that does not exceed 100-150 km and 150-200 km respectively. However, market players' economic radii largely overlap one another, hence leading to a larger relevant market.

([2]) The first version was offered by the notifying party four working days after notification.

([3]) The Commission gathered information on all RFQs to which the main market players replied worldwide over the past five years.

plants when tonnage customers are located in the catchment area of the pipeline. Messer has thus been able to maintain its market share over the years thanks to its entrenched position in those German regions, despite competition from mainly Air Liquide and Linde.

The Commission considered that, following the proposed transaction, the competitive constraint that Air Liquide had exerted on Messer (Rhine-Ruhr) or was likely to exert in the near future (Saar) would have been definitively eliminated, and would have strengthened the merged entity's position in the EEA market. In the Rhine-Ruhr region, in the recent years, both Linde and Air Liquide had competed with Messer sometimes successfully, with offers from on-site plants. By contrast, other competitors had not been present or were present only to a much more limited extent. In the Saar/Lorraine region, 'pipeline-to-pipeline competition' between Messer's network in Saar and Air Liquide's in Lorraine was likely to intensify in the near future following the announcement of plant closures in Lorraine by one of Air Liquide's major customers. The plant closures would leave Air Liquide with unused capacity.

Given that Air Liquide already holds an entrenched position in other key regions of the EEA as a result of its pipeline networks, the Commission concluded that Air Liquide/Messer would have gained a significantly larger (and to some extent captive) customer base and thereby a dominant position in the EEA.

b. The proposed remedies

Description of the remedies

In the final set of remedies, the notifying party proposed to divest the whole of Messer's Saar pipeline network, the southern half ([1]) of Messer's Rhine-Ruhr pipeline network as well as Air Liquide's tonnage plants located in the neighbourhood of, or connected to, the divested pipelines.

Assessment of the remedies

The competition between Air Liquide and Messer in the tonnage market has predominantly occurred in the catchment area of Messer's pipeline networks in Germany, where the main suppliers exercising competitive pressure on Messer have been Linde and Air Liquide. By divesting a significant part of the tonnage activity in the Rhine/Ruhr area, the remedies prevent Air Liquide from adding to its already strong position in the EEA and restore the number of players effectively competing for tonnage contracts in this region.

In addition, the acquirer will have the ability not only to supply customers located in its pipeline catchment areas but also, by extending the one of the pipelines, to supply customers located in the northern part of the Rhine/Ruhr valley. The Commission's investigation confirmed that this extension was possible since the northern end of the divested pipeline is only 25km away from Air Liquide/Messer's customers. The remedies will therefore lead to 'pipeline-to-pipeline competition' that did not exist prior to the merger and, given the advantage that such infrastructure confers to the supplier, the competitive constraint exerted on Air Liquide/Messer is likely to be at least as effective as that exercised by Air Liquide pre-merger.

Similarly, the divestiture of the Saar pipeline will ensure that the competition existing prior to the merger in this industrial basin will be maintained.

III. Bulk and cylinders

a. Joint dominance in Germany

On the bulk and cylinder markets in Germany (for all gases except hydrogen and ESGs), the Commission considered that the proposed transaction was likely to lead to the creation of joint dominant position between Air Liquide/Messer and Linde.

Symmetric market structure and elimination of Air Liquide as an aggressive player

The proposed operation would have led to further concentration on the already highly concentrated German markets. Air Liquide/Messer and Linde would have held symmetric market positions, totalling together between 65% to 90% depending on the gas. In addition, on the cylinder markets where, as a result of the limited distance over which it is economic to transport cylinders, competition has a more local dimension, the strategic positions of the two main national players would have been almost perfectly symmetrical. Air Liquide/Messer would have been the leading player in the East and West with Linde, the main challenger. Conversely, Linde would have held a leading position in the North and South.

([1]) Air Liquide committed to divest the Southern (i.e. the Rhine) part of the Rhine/Ruhr pipeline network, which is [500-600]km long in total.

The existence of joint dominance before the merger between Messer Targets and Linde had been considered but rejected in a previous Commission decision [1], in particular because of the growth of Air Liquide. The Commission's market investigation confirmed that, in recent years, Air Liquide has been the most aggressive player on the bulk and cylinder markets and has represented a strong competitive constraint on Linde and the Messer Group. Consequently, the Commission took the view that Air Liquide played a disruptive role on the German markets and has been the main obstacle to the creation of collective dominant position.

Likelihood of joint dominance

The Commission considered that Air Liquide would cease to be an aggressive player in the German markets and its combination with one of the major incumbents would be likely to lead to coordinated effects. In that regard, both members of the duopoly would have had common incentives not to compete effectively, through customer sharing or market partitioning. In particular, Air Liquide's pre-merger incentive to increase its customer base through all possible means would be very different from Air Liquide/Messer's post-merger incentives. Evidence of past collusion on the same product markets but in another EEA country provided an important indication in this respect [2].

The Commission's market investigation further revealed that there was sufficient transparency, in particular (but not exclusively) with respect to customer allocation, to make monitoring effective. This transparency would have been greatly enhanced by the proposed transaction because of the reduced uncertainty on the main competitor's identity. Tacit coordination also appeared to be sustainable because for each of the players could make a credible threat of future retaliation in case of deviation. The Commission identified several means of effective retaliation and underlined that it could have taken place either on the same markets or in other product or geographic markets. Finally, several elements indicated that neither competitors nor customers would have had the ability and/or the incentive to significantly disrupt the stability of the duopoly.

Consequently, the Commission concluded that, in the absence of remedies, Air Liquide/Messer and Linde would have held jointly a dominant position.

b. The proposed remedies

Description of the remedies

The notifying party proposed to divest, as regards the bulk markets, four plants producing bulk gases and the customer base around each plant. As regards the cylinder markets, ten cylinder filling centres and service centres covering most parts of Germany would be divested. In addition, the party committed to divest all Messer's activities in ESGs.

Assessment at the national level

Depending on the market concerned, these divestitures remove entirely or to a large extent the overlap brought about by the transaction. Most importantly, the final version of the divestitures significantly disrupts the symmetry between Linde's and Messer's market positions, both in terms of markets shares and geographic positioning, and thereby removes the serious doubts as to the risk of the creation of joint dominance. In cylinders, for instance, the operation as modified by the proposed divestitures, will strengthen the merged entity in the regions where Linde is the leader ([30-40]% instead of [20-30]% in the North; [20-30]% instead of [10-20]% in the South) and reduce its market shares as compared with the notified operation in the areas where it would have been the leading player: [30-40]% instead of [50-60]% in the East and [30-40]% instead of [40-50]% in the West.

In addition to its geographic coverage, the final remedies ensure that the divested entity will have the critical mass to be a viable and competitive player. The market shares that will be divested will confer to the acquirer a position close to that of Air Liquide prior to the merger for most gases and, therefore, the ability to play a similar disruptive role.

Assessment at the local level

Given that competition takes place at a local level, the Commission also checked whether the transaction, as modified by the proposed remedies, would not lead to high concentrations in some local areas.

(1) Commission Decision M. 1641 – Linde/AGA.

(2) See Commission Decision of 24 July 2002 relating to a proceeding pursuant to Article 81 of the EC Treaty, Case COMP/E-3/36.700 – Industrial and medical gases, OJ L 84, 1.4.2003, p. 1.

Bulk gases can be transported economically within a 200km radius. As the production capacity of each liquid plant is in the public domain, the Commission asked the notifying party to consider each liquid plant serving the German bulk market as the centre of a hypothetical bulk ([1]) market of 200km radius and to calculate the hypothetical market share of each player in the area. These market shares were based on each player's level of bulk production ([2]) in the hypothetical 200km-radius market. Based on these market shares the level of concentration in each of these hypothetical local markets has been calculated using the Herfindahl Hirschman Index (HHI), prior to the merger ('initial'), after the merger as notified ('Combined') and finally, after the merger as modified, for each acquirer of the divested business (Air Products, Praxair or other competitors). This analysis shows that while the notified operation would have increased local HHIs by as much as 1000 significantly reducing competition, the local HHIs after the divestitures are similar to those pre-merger.

Contrary to liquid plants, no production capacity can easily be attributed to filling centres whose production varies greatly according to the number of shifts operated. For these products the Commission analysed the number of effective players remaining in each local area after the proposed operation. To this end, Germany was divided in 720 clusters of customers, based on the German zip codes. For each cluster, the number of effective players was established as the number of players operating a cylinder centre within 120km of the cluster. This being the distance over which cylinders can economically be transported.

The study led to the following results: without the remedies, the operation would have led to a reduction of the number of effective players from three to two in a number of zip code areas, mainly in the Eastern part of Germany. Similarly, there would have been a reduction from four to three players in a number of areas in the East, Centre and the North. The remedies restore the number of effective players in the vast majority of the zip codes. As a result, the proposed remedies ensure that competition be preserved locally at the pre-merger level.

IV. Conclusion

Due to the fact that it was possible to gather and analyse a large quantity of market data in a relatively short period of time, this case shows that quantitative tools enable the assessment of both the changes brought about by a notified merger and the appropriateness of proposed remedies to be carried out quickly and effectively. Relevant examples include the analysis of commercial offers by market players in response to RFQs as well as the extensive assessment, both at the national and local level, of the likely impact of the transaction, as notified and as subsequently modified by remedies.

These quantitative approaches were useful and complemented the more classical qualitative investigation carried out by the Commission. It should nevertheless be emphasised that such developments have been made possible by the notifying party's early submission of remedies and by the large quantity of information obtained by the Commission from both the merging parties and third parties. Under these circumstances, it has been possible to assess and address very different types of competition concerns within the time constraints of a first-phase procedure.

([1]) The notifying party submitted that is was not possible to carry out this study on LOX and LIN separately since, for a given total production capacity, the LOX/LIN ratio can be significantly modified. They nevertheless constitute distinct markets, as explained above, in particular in view of the absence of demand-side substitutability.

([2]) The actual sales could not be used as their geographical distribution was not available, particularly for competitors. These figures overestimate the concentration in the market since they do not take swaps into account (which allow a competitor to be present in an area without any local means of production).

Reform of procedural rules for state aid cases

Annette MATTHIAS-WERNER, Directorate-General Competition, SAC

The reform of the procedural rules implementing regulation 659/99 ([1]) inserts itself into the major reform project undertaken in the state aid area. This reform aims at important improvements in the co-operation with Member States, by encouraging greater dialogue and exchange of information, as well as by raising awareness of state aid issues among regional, local and national authorities and the national judiciary. At the same time, efforts will be undertaken to put state aid control in the context of the broader range of Community policies, in particular the economic reform agenda. Light, predictable and transparent procedures as well as more economically sound and robust criteria for the assessment of state aid measures should be the result of the reform process undertaken. The reform should also facilitate state aid control after enlargement and make it possible to deal with a possible substantial increase of state aid measures being notified.

On 24 March 2004 the European Commission has adopted a set of rules implementing and clarifying Reg. EC 659/99 ([2]) (hereinafter 'the procedural Regulation') which sets out the procedure to be followed in state aid cases. Based on art. 27 of this Regulation, the implementing provisions concern form and content of notifications and annual reports as well as other details of time-limits and their calculation, the establishment of the interest rate in cases of recovery of unlawfully granted aid.

One of the main purposes of the new procedural regulation is to streamline and simplify the procedures concerning notification and reporting by Member States while enhancing transparency and legal certainty. The objective is thus to free the process of examining state aid measures from unnecessary procedural burden, thereby facilitating rapid decisions, when feasible. Moreover, through the notification forms, Member States should be given clearer indications as to the type of information the Commission needs in order to properly assess the different aid measures. This is expected to accelerate the review process since it will avoid the need for the Commission to request supplementary information from the Member State concerned.

Adopted in 1999, the 'Procedural Regulation' already increased transparency and legal certainty in the field of state aid by codifying and clarifying procedural rules. The new regulation further develops these rules and thereby contributes to increased legal certainty and increased transparency, which seems to be even more important under the impression of enlargement. Through a new and compulsory notification form the Regulation aims at improving the efficiency of the Commission's assessment of planned state aid measures, as the forms contain a set of questions drafted along the lines of the existing frameworks and guidelines applicable to state aid measures. The answers to theses questions should ensure a sufficient level of information for the Commission to assess the notified aid measure.

Annex I of the Regulation, which sets out forms, is divided into three parts: a general information part, which should be completed for every case (Part I), a simplified notification form for the notification of the changes to authorized state aid measures mentioned in Art.4 (2).(Part II) The changes or alterations defined in Art. 4 (2), i.e. increases in the budget of the scheme exceeding 20 %; prolongation of an authorized scheme up to six years as well as the tightening of the criteria for the application of the scheme, a reduction of aid intensity or a reduction of eligible expenses benefit from a simplified notification form. The information contained in this form should allow the Commission to monitor existing aid requested by Art. 93(1) now Art. 88 (1) of the Treaty. Other alterations not falling within the scope of those mentioned in Art. 4 (2) are not likely to modify the Commissions original assessment and authorization and do therefore not need to be notified.

Some discussion had developed why the tightening of criteria needed to be notified, as tightening the criteria might reach the goal of a reduction of state aid as defined by several European Councils. The reason behind this requirement for notification is that even though tightening of the criteria might lead to an overall decrease in state aids, such a tightening might in individual cases change the character of the aid measure in question

([1]) Reg. EC 794/2004, OJ L 140 of 30.4.2004, p. 1.

([2]) Council Reg.(EC) No. 659/99 of 22 March 1999, OJ L 83 of 27.3.1999, p. 1.

and diminish the incentive character of the aid. The Commission has taken the position that the simplified notification procedure combined with its commitment to assess such a case within one month if possible, does not go beyond an acceptable burden in the interest of transparency and efficient monitoring.

Supplementary information sheets were drafted along the lines of existing guidelines and frameworks in order to give Member States precise indications on the information needed when notifying planned aid measure which might be covered by these frameworks or guidelines. The supplementary information sheets do not alter these texts in any way, but only translate theme into specific questions. This explains what might be seen as a certain limitation. The Commission did not intend to use this legislative process as an opportunity to widen the scope of or alter the guidelines or frameworks as some Member States might have hoped or misinterpreted.

Art. 3 specifies the mailing route from the Member State to the Commission and from the Commission to the Member State. The route via the Secretariat General will remain necessary as long as state aid control lies in the responsibility of several Directorates general of the Commission, i.e. DG Competition, Transport, Agriculture and Fisheries. Once the attribution has been made, all further correspondence will be exchanged between the notifying Member State and the Director General of the DG to which the case has been attributed.

The regulation further introduces rules for the transmission of notifications and thereby tries to remedy some shortcomings of the past. The compulsory electronic transmission of notifications is foreseen from 1January 2006. This relatively remote date has been set in order to allow Member States as well as the Commission to create safe technical conditions for such transmission. This regards as much the security of the transmission as such as the guarantee that the documents are treated as confidential and are not disclosed voluntarily or involuntarily to the public or accessible to unauthorized third parties. Clarification as to the acceptance of fax transmissions until that date are mentioned in Art. 3 (5) in order to avoid situations of the past, where notifications were sent by fax to whatever address within the Commission for reasons of keeping deadlines and time limits, but needed a considerable amount of time to arrive at the correct place where it could be dealt with.

Art. 5 gives some indications on how annual reports on existing aid should be structured and the annexes, the article refers to, give Member States indications on which information the Commission will need for a proper monitoring of existing aid. Specific annexes have been drafted for annual reports in the areas of agriculture and fisheries as specific provisions apply to these sectors. The date for transmission of annual reports has been advanced as compared to the earlier situation in order to allow the composition of the scoreboard and a meaningful analysis of the situation in time for the European Councils to reflect on and take some measures or make recommendations to Member States for an improvement of their policies in the state aid sector. In some areas, such as fiscal aid, he availability of exact figures will depend on the beneficiary's tax declaration, therefore the Commission will in justified cases content itself with estimates under the condition, that exact figures will be communicated at the latest the year later.

Art. 8 aims at clarifying certain rules for the calculation of time-limits and deadlines and fixes the minimum delay for the request of an extension of deadlines, as much as regards requests made by member States as by the Commission. The rules refer to Council Reg. (EEC, Euratom N° 1182/71 of 3 June 1971 ([1])), but add some clarifications for the state aid sector.

Recovery of illegal aid should be done in a way to re-establish the situation existing without the aid being illegally granted. (Art. 9) By repaying the aid, the beneficiary forfeits the unfair advantage which it enjoyed over its competitor on the market and the conditions of competition which existed prior to the aid are restored. In the Commission's communication of 8 may 2003, it is made clear that the effects of an unlawful aid are to provide funding to the beneficiary on similar conditions as a medium term non interest-bearing loan. Accordingly the Commission decided to apply compound interest in order to ensure full neutralization of the financial advantages resulting from the aid. It should be noted that this rule will be directly applicable, so that in a proceeding for recovery the national judge will have to apply compound interest as well.

([1]) OJ L 124 , 8.6.1971, p. 1

The Regulation fixes the method for calculating the interest rate to be applied in the cases of recovery of unlawful aid. To ensure equal treatment the advantage should be measured objectively from the moment when the aid is available. Starting from general financial practice it seems appropriate to fix the rate as an annual percentage rate fixed for 5 years. This approach is in line with the recent Commission Communication on the interest rates to be applied when aid granted unlawfully is being recovered. It provides for specific rules to be applied when no interbank swap rate or similar instruments for reference exist in the Member State concerned and leaves it to negotiations between the Commission and the Member State to fix the applicable rate. This latter possibility will certainly be of relevance for some of the new Member States.

Art. 12 calls for a review of the Regulation within four years of its entry into force, which gives the possibility to discuss its functioning and provide for improvements if necessary. It's annexes will be subject to constant modifications in line with the parallel legislative process of reviewing guidelines and frameworks or adopting new regulations applicable to state aid measures in particular sectors.

Enforcement of State aid control in the banking sector: Bankgesellschaft Berlin AG

Elke GRAEPER and Stefan MOSER, Directorate-General Competition, unit H-2

On 18 February 2004, following an extensive investigation, the Commission decided to approve the restructuring aid for the ailing group Bankgesellschaft Berlin AG worth almost € 10 billion. This amount included, first, the capital injection of roughly € 1.8 billion by the Land Berlin into BGB and, secondly, the provision of the guarantees to cover BGB's risks from the old real estate business with an economic value of € 6.1 billion (the theoretical maximum amount of nominally € 21.6 billion is based on legal provisions and supervisory rules but is unrealistic under pessimistic assumptions). Thirdly, it includes the repayment agreement between the Land Berlin and BGB of December 2002 regarding a potential recovery order up to € 1.8 billion following a Commission decision on the open procedure C48/ 2002 (the Landesbank Berlin capital transfer probe is still pending).

Bankgesellschaft Berlin AG (‘BGB’) is controlled by the Land Berlin owning roughly 81% of the shares. It is the holding company of the BGB group, which was formed in 1994 by the amalgamation of several credit institutions formerly controlled by the Land of Berlin; BGB also does business as a credit institution in its own right. In 2001 BGB had a group balance sheet total of about € 189 billion, and in 2002 about € 175 billion. This put it in tenth place among German banks in 2001 and in twelfth place in 2002. It employed 17 000 people in the year 2000, more than 15 000 in 2001, and about 13 000 in 2002. BGB' main business field comprise of retail banking (private customers and small and medium sized business clients), real estate financing, real estate services, capital market business and some smaller areas which are to be run down or drastically cut back such as the large corporate clients/international segment and the public sector segment (lending).

As a result of high risk real estate transactions such as rent guarantees given to fund investors, the bank in 2001 went into a serious crisis. In order to avoid immediate action by the banking supervisory authorities, the Land provided a capital injection of € 1.8 billion which the Commission in summer 2001 authorised as rescue aid on a provisional basis, pending the submission and approval of a restructuring plan. Due to the discovery of further risks, the Land in December 2001 had to intervene again and provided the bank with a so-called ‘risk shield’ *(Risikoabschirmung)* comprising credit, book value and other guarantees to cover risks mainly stemming from the real estate services business. These two measures, the capital increase and the guarantees of the risk shield formed the basis of the original restructuring plan submitted to the Commission in January 2002. Following a preliminary assessment the Commission had doubts as to the compatibility of the restructuring aid with the common market and opened the formal investigation procedure during which it also received comments from third parties.

The subsequent investigation under the *Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty* mainly focussed on two issues, the restoration of the long-term viability of the group and the so-called 'compensatory measures', i.e. measures to mitigate the distortive effect of the aid on competition. As described below, the analysis had to cover several highly complex issues. This included, for instance, the rather unique structure of the group involving the public bank subsidiary *Landesbank Berlin* (‘LBB’) and raising an old state aid issue and recovery risk for the group. The open LBB-procedure is similar even not the same as the WestLB case where the Court of First Instance issued a judgement in March 2003. In addition, the Commission had to take into account the forthcoming abolishment of the existing state guarantees (Anstaltslast & Gewährträgerhaftung) for LBB in the context of its viability assessment. Other issues complicating and extending the investigation included the Land's attempt to privatise BGB which finally failed in March 2003. The failed privatisation in combination with the — worse than forecasted — losses in the accounts for 2002 triggered the Commission's employment of independent experts in summer 2003. Following their report and further negotiation rounds in autumn 2003 the aid could finally be approved.

In exchange for obtaining the approval, Germany and the Land Berlin submitted several divestiture commitments. This included, for example, the hiving-off of the real estate services subsidiaries, which were the main cause for the crisis, the divestment of *Berliner Bank,* one of BGB's two retail brands, and the sale of the Land's shares in BGB including its other retail brand, *Berliner Sparkasse* by the end of 2007. The notified restructuring plan provided for a series of other measures such as the divestment of Berlin based Weberbank and the sale or closure of national and foreign branches and subsidiaries. Moreover, it is intended to divest the real estate financing subsidiary BerlinHyp, either separately or together with the rest of BGB.

The divestments, closures and other measures to reduce BGB's business volume will reduce BGB's balance sheet total from roughly € 189 billion in 2001 to about € 124 billion in 2006/2007 when the restructuring period and divestiture measures will be completed. This total reduction is not only adequate in view of the very high aid amount but also in line with the Commission's practice regarding restructuring aid for banks, for instance, the Commission decision in *Crédit Lyonnais.* ([1])

The divestment of *Berliner Bank* remained a contested issue between the Commission, Germany and the Land Berlin until the final stage of the investigation. However, in view of BGB's leading position in Berlin, the Commission had to insist on this measure in order to mitigate the distorting effect of the very high aid amount on competition in the field of retail banking in Berlin. Finally, an agreement on this point was reached just before Christmas 2004. Germany committed itself to the divestment of Berliner Bank as a further compensatory measure with a view to enabling the Commission to approve the aid. Germany accordingly undertakes to ensure that the group sells the 'Berliner Bank' division as an economic entity, including at least its trade name, all private, business/corporate and other customers associated with the business carried on under the trade name Berliner Bank, branch offices and front office staff, in a legally effective, open, transparent and non discriminatory procedure, by 1 October 2006 (closing by 1 February 2007). BGB's market share in the individual segments of the Berlin retail business will be reduced by roughly one third to one sixth as a result of the sale.

In that context the Commission took the view that not only the total of the reduction measures were decisive for the assessment, but also the quality of the measures with respect to its effect on competition. The so-called compensatory measures should not only or mainly 'compensate' competitors for the distortive effect of the aid but primarily competition itself and, thereby, focus on the interest of consumers. Therefore, point 37 of the guidelines for rescue and restructuring aid provides that an assessment of compensatory measures must take account of 'the relative importance of the firm on its market or markets'. The retail banking business (private and smaller corporate customers) of BGB was by far the most problematic from a competition point of view. Therefore, already in its decision initiating the procedure, the Commission expressed doubts about the appropriateness of the compensatory measures primarily on account of BGB's strong regional and local position on this market. With respect to consumer benefits, the Commission also refrained from insisting on compensatory measures such as the mere closure of branches or brands.

It was, however, not only the compensatory measures that made this case a difficult a complex one. The Commission also had to analyse the question of the long-term viability of BGB in conjunction with the forthcoming abolishment of the existing state guarantees (Anstaltslast & Gewährträgerhaftung). This question required an in-depth investigation and had to be re-entered with the help of external consultants when the first procedure to divest the Land's shares of BGB failed in March 2003. Finally, the Commission concluded that the restructuring measures already carried out and those planned for the future are reasonable, logical and fundamentally appropriate in order to enable BGB to restore its viability.

Moreover, the investigation had to take into account the rather unique structure of the group involving the subsidiary Landesbank Berlin (LBB). This raised an old state aid issue similar to the WestLB case where the Court of First Instance issued a judgement in March 2003. The repayment agreement between the Land Berlin and BGB regarding a potential recovery order following a Commission decision on the open LBB procedure is an appropriate but exceptional measure to cover this risk for the restructuring success of BGB. The agreement constitutes itself restructuring aid and created thus the need for additional compensatory measures to which Germany has finally committed itself, in particular with the divestment of Berliner Bank.

Finally, the Commission concluded that the aid measures are limited to the strict minimum needed to enable BGB's restructuring in the light of the existing financial resources of the bank and its shareholders. The Commission found in particular

([1]) OJ L 221 of 8.8.1998, p. 72.

that the risk shield does not provide funds to BGB's normal banking activities and that it is appropriately managed by a specialised Land-owned control agency to exclude any payments without legal obligation. In this context, the Commission also analysed the financial consequences of alternative scenarios, for instance, a scenario excluding the risk shield. It concluded that these alternatives would not reduce but probably increase the amount to be paid by tax payers due to the still existing state guarantees and the given particularities of the group structure.

Commission's negative decision on Gibraltar corporation tax reform: findings on regional and material selectivity

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Following the state aid investigation initiated by the Commission in the exempt and qualifying companies schemes, as well as the criticisms expressed in the context of the Code of Conduct for direct business taxation, the Gibraltar Government set up a new comprehensive tax system, which United Kingdom notified to the Commission in August 2002.

It is worth mentioning that it was the first time the Commission had to deal with a notification concerning a comprehensive tax system. It should also be underlined that the notified taxation system was quite innovative as far as its content is concerned as explained below.

The content of the Gibraltar tax reform

The reform aimed at replacing the classical corporate tax system (based on taxation of profit) which had been currently in force by a payroll tax and business property occupation tax (hereinafter 'BPOT'). All companies registered in Gibraltar would have to pay GBP 3000 per full time employee and additional 100% of their current tax on their real estate property. However, the reform foresaw that the total tax liability of a company would be capped at 15% of its profits. Originally, the tax had been capped at GBP 500 000 as well, but this feature was removed after the Commission had opened its formal investigation procedure. Two sectors would face a top-up tax. First, financial services were originally to be taxed at least at the rate of 8% on their profits. However, this was subsequently changed as a reaction to abandoning the GBP 500 000 cap to a rate that shall be fixed in the future between 4-6%. The top-up tax was credited to the payroll tax and to the BPOT and the cap of 15% applied to the total taxation (top-up, payroll and BPOT), so that a company's tax liability for its financial activities was at least 4 to 6% (for simplification let us further assume it would be 5%) and at most 15% of its profits from this activity. The second sector that incurred top-up tax were the utilities (water, sewage, electricity, gas, telecommunications, etc.), which are mostly not mobile and occupy a monopolistic position. They were taxed at a flat rate of 35%.

In October 2002 the Commission decided to open the formal investigation procedure foreseen in Article 88(2) EC Treaty because of its doubts concerning the compatibility of this scheme with the common market. [1] The doubts of the Commission concerned mainly two issues. Firstly, the Commission raised the issue of regional selectivity, as the whole scheme would, according to the Commission, grant an advantage to companies registered in Gibraltar in comparison with those in the UK. Secondly, it addressed the issue of material selectivity, mainly because:

— the requirement to make a profit before incurring any payroll and property tax liability would confer an advantage on unprofitable companies, and

— the 15% cap on liability to payroll and property taxes would confer an advantage on those companies to which it applied.

Other issues raised in the opening decision have been solved by subsequent adjustments made to the notified reform by the Government of Gibraltar.

During the investigation the Commission received comments from the UK and diverse interested parties: the Spanish Government, the Government of Gibraltar, the Åland Islands Executive and the Spanish Confederation of Business Organisations.

The Commission focused in its final negative decision adopted on 30 March 2004 [2] mainly on the assessment of the regional and the material selectivity of the measure.

Regional selectivity

In the UK companies are subject to a maximum 30% tax rate on their profit, while in Gibraltar the maximum rate following the introduction of the reform would be 15%. Therefore, the difference was considered as constituting a selective advantage because it is only available to companies regis-

(1) OJ C 300 of 4.12.2002, p. 2.
(2) C(2004)929fin of 30 March 2004, not yet published.

tered in Gibraltar. They also receive further advantages because capital gains are excluded from the calculation of profits, and a general first year allowance as well as a 33% allowance on plant and machinery in subsequent years were provided for, while in the UK capital gains are taxed, there is no generally applicable first year allowances and the capital allowance is 25% of the declining balance. The Commission did not consider the latter measures as general measures of purely technical nature according to point 13 first indent Notice, because they only apply to a limited territory. As mentioned in point 17 of the Notice, 'the Commission's decision-making practice so far shows that only measures whose scope extends to the entire territory of the State escape the specificity criterion laid down in Article 87(1)' and 'the Treaty itself qualifies as aid measures which are intended to promote the economic development of a region' ([1]).

The Commission rejected arguments that a measure is general because it applies to all firms under an autonomous tax jurisdiction. In order to assess the selectivity, first, the common system was determined and, second, the actual effects of the measure in question on the position of undertakings were compared to the effects of this common system.

The reference framework, to which the situation of the benefiting companies is to be compared, was found to be the economy of a member state. The Gibraltar taxation reform could indeed benefit certain firms, namely those resident in Gibraltar, as compared to others in the same reference framework, namely those resident in the UK. Stating that a measure established by a regional rather than central authority would be general would allow circumventing the rules applicable to state aid by the means of adapting the internal institutional order of the member states. This possibility would be contrary to the concept of state aid, which is an objective one ([2]) and includes all measures that satisfy the four criteria laid down in article 87(1) EC Treaty. Qualifying a measure as state aid cannot thus depend on the fact whether the central government enacted the measure or whether it was put into effect by an autonomous local authority. The application of state aid rules cannot depend on the institutional or constitutional arrangements within a member state, as it is a factor at its disposal. Otherwise the inequality of treatment would lead to distortions on the common market. ([3])

The UK line of reasoning that in absence of the tax measures in question, no tax would be applicable, was rejected as an argument of form; it shows that it is not possible to compare a given measure with conditions without this measure. Moreover, an abolition of a tax in a particular area of a member state would constitute state aid as well. The reform was therefore compared rather with conditions that apply generally in similar circumstances within the economy of a member state. That is in this case with the taxation of companies in the UK. The Commission concluded therefore that the Gibraltar Government tax reform was granting a selective advantage to the companies registered in Gibraltar as compared to those in the UK.

This decision does not question the autonomy of Gibraltar neither it prevents member states from an effective decentralisation of their taxation powers. It rather follows that lowering of tax burden in a particular area of a member state must comply with state aid rules. The Commission mentioned that higher taxation in one region does not, on the contrary, constitute aid as it does not give any advantage to the companies. In any case, member states and bodies to which fiscal powers have been devolved must respect EC law. Where tax powers have been devolved but central reference system remains, a reduction of the tax burden applicable to certain regions constitutes state aid and must be notified. It is then up to the Commission to assess whether it is compatible with common market, for example on the basis of the rules concerning regional aid.

([1]) See in particular Commission Decision 93/337/EEC of 10 May 1993 on tax concessions for investment in the Basque Country (OJ L 134 of 3.6.1993, p. 25).

([2]) For examples see Case T-158/99, Thermenhotel et al. v Commission, not yet published, paragraph 106; Case C-83/98, France v Ladbroke Racing and Commission [2000] ECR I-3271, paragraph 25; opinion of Mr Advocate General Jacobs to case C-126/01, paragraph 73.

([3]) According to the conclusions of Mr Advocate General Saggio in joined cases C-400/97, C-401/97 and C-402/97, paragraph 37 'the fact that the measures at issue were adopted by regional authorities with exclusive competence under national law is (...) merely a matter of form, which is not sufficient to justify the preferential treatment reserved to companies which fall under the provincial laws. If this were not the case, the State could easily avoid the application, in part of its own territory, of provisions of Community law on State aid simply by making changes to the internal allocation of competence on certain matters, thus raising the general nature, for that territory, of the measure in question'. See also *Carlos Tenreiro, Le système fiscal des Açores (Portugal),* Competition Policy Newsletter, 2003/1, p. 93-95.

Material selectivity

Requirement to make profit before incurring any payroll and property tax

The Commission found the just mentioned feature of the reform to be selective as it gives an advantage to companies that do not make profit. Companies incur no payroll tax and BPOT liability if they are not profitable, which is a criterion external to the system in that the tax base is the number of employees and the property tax. It is an additional element, which was not considered as general because it does not apply to all companies in the same way.

Further, the Commission did not accept the justification by the nature or general scheme of the system. It looked at the Gibraltar tax reform from two angles. First, as a pure payroll system, in which case the nature of the system is to pay tax for each employee independently of the profitability and it is perfectly within the nature of the system that unprofitable companies pay tax. And secondly, as a hybrid system that applies one or another tax base depending on the particular situation of a tax payer. In this case it is impossible to identify the nature and general scheme of the system. Consequently, this possible justification does not make sense as any given feature of a hybrid system would form a part of the nature of the scheme.

15% cap

The advantage of this feature consists in the tax that would have to be paid above of this threshold. The Commission underlined that it is *de facto* selective as it gives an advantage to firms that have relatively a lot of employees and property in respect to their profits. The effect of the measure was to limit the liability of the offshore sector (in particular qualifying companies) and to lower the tax rate for the on-shore companies (from former 35% to 15%). It was not qualified as a general measure following the reasoning in point 14 of this Notice because it did not reduce the tax burden related to labour for all firms. Neither was it accepted as a purely technical measure taken in order to introduce a progressivity of taxation per employee according to point 13 first indent of the Notice, since the cap was linked to a different criterion than used for delimiting the tax base. In order to be justifiable by the nature of the system, the progressivity would have to be introduced, for example by, differentiated tax amounts per employee depending on the number of employees. Moreover, the Commission denied that the measure would fall under general policy measures as mentioned in the point 13 second indent, as it does not reduce the tax burden related to production costs and is neither linked to the labour nor to the business property costs.

It was not justified by the nature and general scheme of the system. The Commission stated that the inherent logic of a payroll and business property occupation tax system is to incur higher tax when the company uses more labour and/or property. Labour market considerations are external to the logic of the payroll/BPOT system ([1]). They can hardly justify the cap.

Payroll tax and business property occupa-tion tax

In the opening of the procedure, the Commission had not explicitly addressed the payroll tax and BPOT per se as an element possibly constituting state aid. Nevertheless, an opening of the formal investigation procedure concerns a measure as a whole and not solely certain of its aspects. Furthermore, the comments that the Commission received from the UK and the interested parties related also to this point.

The Commission did not qualify the payroll tax and the BPOT in general as being materially selective. In its assessment, the Commission looked in the first place at the effects of these taxes in the particular circumstances of the Gibraltar economy. There operates an important number of offshore companies. These are mainly exempt companies, which often do not employ any or only one part-time employee and do not possess property in Gibraltar. The very general principle of corporation taxation is to collect revenue from companies. However, under the reform some companies receive an advantage to the extent that they effectively entirely escape the payroll tax and BPOT. The Commission found that this advantage is not effectively open to all companies in the sense of point 13 Notice. Furthermore, it is not a purely technical measure according to the first indent of point 13 Notice, as it does not provide for a technical adjustment, but it concerns the tax base itself. Furthermore, it was not qualified as a general economic policy measure in the sense of the second indent as it does not reduce any production costs but rather increases the costs of labour and real estate property.

([1]) Point 26 Notice.

A distinction was made between the payroll tax in Gibraltar and social security contributions in the usual taxation systems. Social security contributions represent a minor aspect of the taxation. They are usually paid on top of a profit tax, whereby the latter ensures a wide taxation of companies on the results of their activities. The primary logic of these contributions is to finance the security of employees; thus it follows from the nature of the system that they are directly linked to the employment.

Top-up tax

Spain argued in its observations that the top-up tax applicable to utility companies leads to granting a selective advantage to other sectors. The Commission answered that in general an exceptional burden placed on some companies would represent state aid only if it could be demonstrated that it causes a corresponding advantage for other enterprises than those, which bear the detriment. In the case of the Gibraltar corporation tax reform, it could not be proven that a higher taxation of the utilities sector would directly lead to lowering the tax burden for the remaining sectors. A higher taxation of a clear minority of companies does not amount to a general measure to which the taxation of the rest of the enterprises should be compared.

Combined effects on specific groups of companies

The Commission found the combination of the above-mentioned measures resulting into different levels of taxation for different kinds of companies as can be illustrated in the table below.

Table 1: Data available on Gibraltar companies

Type of companies	Tax rate %
All companies	0-15 or 35
Utilities	35
Other	0-15
— Companies with no income	—
— Companies with income	0-15
• Exempt	0 or 5 (1) (2)
* Financial services	5 (1) (2)
* Non-financial services	0 (1)
• Non-exempt	0-15
* No profit	—
* Profit making	0-15
— Financial services	5-15 (2)
— Non-financial services	0-15

(1) Assuming that exempt companies have no physical presence in Gibraltar and would therefore have no liability for payroll or business property occupation tax
(2) Assuming that the financial services top-up tax would be set at 5%

Even though the exact effective tax rate imposed on each company depends on its number of employees and premises occupied, this table shows that the taxation of certain welldefined groups of companies will be limited to lower levels than the generally applicable 15% upper limit. First, any companies independent of their present statute that do not make profit will not be taxed on the number of their employees neither on their business property. Second, offshore companies (the former exempt companies), which tend not to have any real presence in Gibraltar will face a 0% tax rate or, third, a 5% tax rate on their financial service activities.

The Commission concluded that the notified measure entails regional as well as material selectivity. The latter is due to several isolated aspects of the reform and to their combined effects.

State resources, affectation of trade and distortion of competition, compatibility

The UK argued that no state resources were foregone with respect to the regional advantage, as the UK taxation does not apply in Gibraltar. The Commission reiterated that the measure in question must be compared to the general system that normally applies to similar situations, which is the taxation in the UK at the rate of 30%. As the Government of Gibraltar taxes certain local enterprises at a lower level than the generally applicable, it renounces on its budgetary revenue. This is equivalent to a public expenditure (1) and, the Government of Gibraltar being a part of the state administration, imputable to the Member State.

Trade between member states and competition on the common market were found to be distorted as undertakings with cross-border activities have not been excluded from the scheme. Moreover, former exempt companies, which would benefit the most from this system, are by definition specialised in activities outside of the territory of Gibraltar.

None of the derogations provided for in Article 87(2) or Article 87(3) applies. The Commission therefore decided that the Gibraltar corporation tax reform constitutes a scheme of State aid that is incompatible with the common market. Thus, it cannot be implemented.

(1) Point 10 Notice.

Conclusion

In its decision the Commission confirmed the applicability of article 87(1) to benefits that are restricted only to a certain region of a member state. It followed its approach to regional selectivity as it was set out in the decision concerning Azores [1], according to which a measure does not escape the scrutiny under the state aid rules only because it was adopted by a fiscally autonomous authority, even though such a measure would be general within the autonomous territory.

Concerning material selectivity, the Commission stated firmly that a system, which in law appears to be general, is subject to the state aid discipline when in effect it grants benefits to particular firms or sectors of the economy.

[1] Commission Decision 2003/442/EC of 11 December 2002, OJ L 150 of 18.6.2003, p. 52.

More than 40% of aid intensity for investments in solar photovoltaic energy

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Introduction

On March 19, 2004 (OJ L 81, p. 72) the Commission's conditional positive decision closing the formal investigation procedure on case C 60/2002 was published. It concerned an aid scheme that Tuscany Region (Italy) had planned to implement for the reduction of the greenhouse gases emissions.

It approved, for the first time, an aid intensity going beyond 40% (75% in the case at hand), in favour of investments in renewable sources, and in particular in new photovoltaic installations. It can therefore constitute a useful precedent for other Member States where programmes intended to support solar energy are planned.

Description of the planned measure

In November 2001 Italy notified an aid scheme project, aiming at reducing the greenhouse gases emissions through (1) the promotion of renewable energy sources and (2) energy saving programmes.

Within the former, new biomass installations, preferably integrated with district-heating networks, new solar energy installations, new renewable energy installations (wind, solid biodegradable municipal waste and biogases ones) serving the needs of minor islands and, in particular, new photovoltaic plants were envisaged.

The expected overall environmental goals of the whole scheme, over the period 2002-2007, were: (1) a lower atmosphere pollution, engendered by greenhouse gases, corresponding to 700.000 tons CO_2; (2) a percentage of 3% of the global energy consumption, derived from renewable sources, attained, and (3) energy saving equal to 25.000 tons of oil.

Aid was envisaged to be provided in the form of non-refundable grants, with respect to investments in buildings, plants, equipments, directly linked expenditures for planning, work supervising and testing, and finally land, whether strictly necessary, up to a maximum percentage of 10% of total eligible costs. Undertakings of all sizes were intended to be recipients of the aid.

While aid intensities between 30 and 40% were envisaged with regard to all planned measures of the scheme, the increased intensity of 75% was proposed only towards new photovoltaic installations.

Public support to promote investments in solar energy installations

The Commission examined the notified aid measures in the light of the Community guidelines on State aid for environmental protection (hereinafter also referred to as 'the guidelines'), published in the OJ C 37 of 3.2.2001, p. 3.

Public support to promote investments in solar energy installations may be in principle provided, under the above mentioned guidelines, pursuant to Article 32, first paragraph, which stipulates that investments to promote renewable sources of energy are deemed equivalent to environmental investments undertaken in the absence of mandatory Community standards, on the grounds they represent one of the Community's environmental priorities ([1]) and one of the long term objectives that should be encouraged most.

This is why a basic rate of aid of 40%, which can be considered as already being relatively high, is allowed for investments in support of these forms of energy.

Solar energy complies with the definition laid down at Article 2(a) of the Directive 2001/77/EC ([2]), to which the guidelines explicitly refer, as far as renewable sources of energy are concerned ([3]).

([1]) See Council resolution of 8 June 1998 on renewable sources of energy, published in the OJ C198 of 24.6.1998, p. 1

([2]) 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, published on the OJ L 283 of 27.10.2001, p. 33.

([3]) See footnote 7 to point 6 of the environmental guidelines.

The enforcement of the third paragraph of the environmental guidelines

Furthermore, the third paragraph of point 32 of the guidelines allows the above mentioned threshold of 40% to be increased, up to a maximum of 100% of the eligible costs, to the extent that the necessity of the proposed intensity can be demonstrated by Member States.

This provision had not been applied thus far in respect of solar installations.

More in general, as regards all renewable energy sources, the provision at hand, so far, has only been applied in the Austrian Investment scheme for renewable heat production by biomass installations [1].

Assessment

In order to assess the necessity of the 75% aid intensity proposed by the Italian authorities in respect of new photovoltaic installations, the Commission calculated the investment cost per kW in respect of five installation layouts, supplied by Italy.

The average investment cost resulting was 7 934,40 €/kW, which is in line with the ENEA [2] data, submitted enclosed to the comments of the Italian authorities. In fact, according to the former, the investment costs per kW, related to photovoltaic installations, had to be set in a range between 7 746 and 8 263 €, particularly when referring to the production of electricity, linked to a distribution network.

The guidelines clarify, at point 37, fourth paragraph, that, for renewable energy, eligible costs are normally the extra costs borne by the firm compared with a conventional power plant with the same capacity in terms of the effective production of energy.

Accordingly, the Commission, in order to appreciate the necessity of the proposed aid intensity, compared the average extra costs of the only initial investment of photovoltaic installations to those ones of the other renewable energies (wind, minihydro power, biogases, geothermal, biomass) in addition to non-renewable (fossil sources).

It came out that, although the non assisted percentage of the extra costs was of 25% for the photovoltaic installations, instead of 60% for the other renewable energies, the average contribution of the beneficiary to the extra costs of the investment was supposed to amount to 1 892 €/kW, in the case of the photovoltaic energy, while it attained only 1 209 €/kW for the most expensive among the other renewable energies.

The resulting average contribution, net of any aid, of the recipients to the total investment costs, in absolute figure per kW installed, is therefore 2 330 € in the case of photovoltaic installations, compared to an amount of 1 647 € and 874 €, respectively referred to the most expensive and the cheaper among the other renewable sources, and finally of 438 € for conventional plants, producing grey energy.

The Commission also estimated the average pay back time of the investments concerned. In the case of photovoltaic energy, provided a rate of aid of 75% of the extra costs is allowed and on the basis of an actual production of 3,2kWh/day per 1kW of capacity installed, it should be 11 years.

On that basis, the Commission considered therefore the necessity of the rate of aid of 75% sufficiently proved, in the case of the sub-measure 'new photovoltaic installations', pursuant to point 32, third subparagraph of the guidelines.

A dynamic approach to the investment costs gap between photovoltaic and other renewables

The Commission highlighted that a yearly report, by the Italian authorities, on the execution of the scheme, was particularly necessary in the case at hand, in order to allow the monitoring, during the duration of the aid scheme, of the gap between the investment costs of the photovoltaic technology and those of the other renewable sources.

In such a way, where a risk of overcompensation of the specific installations, in respect of which the intensity of 75% has been authorised, should arise [3], a recommendation proposing appropriate measures might be issued by the Commission to Italy, pursuant to article 18 of procedure Regulation 659/99, in order to permit a fine tuning of the

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(1) Commission decision of 20.6.2001 on the case N 645/2000 – Austria 'Grants for biomass'.

(2) New technologies, Energy and Environment Italian Institute.

(3) In particular where the average contribution – net of any aid – of the recipients to the total investment costs, in absolute terms per kW installed, would become lower in the case of photovoltaic installations in respect of other renewable energies installations.

aid intensity with relation to the actual dynamic of the relevant market segment.

Conclusion

The relevance of the presented case is twofold.

First, as regards the merits of the case, it is susceptible to represent a useful precedent for other member States whenever they plan to go beyond 40% and up to 100% of aid intensity for investments in solar photovoltaic energy, to the extent that the relevant market features which were taken into account for the assessment of this case would still be valid.

Secondly, from a procedural point of view, and in the light of the modernisation process of State aid, a first step of which is the procedural implementing regulation ([1]), it can be deemed to represent a good example of de-dramatization of the opening of proceedings.

([1]) Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, published in OJ L 140 of 30.4.2004, p. 1.

The new German ship-financing guarantee schemes: Commission gives green light

Kai STRUCKMANN, Directorate-General Competition, unit H-4 and
Max LIENEMEYER, Directorate-General Competition, unit H-1

Introduction

On 16 December 2003 the European Commission decided to approve a new German proposal of ship financing guarantees. The guarantees will be operated in Germany's five coastal Länder (Niedersachsen, Bremen, Hamburg, Schleswig-Holstein and Mecklenburg-Vorpommern) and provide public fallback guarantees with respect to credits granted for the financing of ships built in German yards.

The Commission approved the schemes for a period until 31 December 2006. Prior to that date, the Commission will review the functioning of the new system in light of the experience gained within the first three years.

The novelty of the German schemes consists in the introduction of risk differentiation. While in the past, every guarantee had been covered by one single premium, in the future different premiums will be charged for the different risks to be covered by the guarantee. Germany devised a complex rating system comprising six risk categories allowing allocation of projects according to their respective risks.

Background

Shipbuilding projects are capital-intensive as a shipyard's annual production value exceeds its own value as a going concern. This is also acknowledged by the EU initiative 'LeaderSHIP 2015' ([1]) by which the European shipbuilding industry has initiated a programme to ensure its long-term prosperity and identified the necessity of developing advanced financing tools in order to promote the competitiveness of the European shipbuilding industry.

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

According to the EU rules, public guarantees for ship financing may be considered as operating aid but under the Shipbuilding Regulation 1540/98 could be considered compatible until the end of 2000. Thereafter, guarantees for ship financing should in principle only be allowed if they can be considered as constituting no aid or containing no aid elements. General rules for assessment of whether a guarantee or a guarantee scheme contains aid are laid down in the Commission notice on the Application of Articles 87 and 88 of the EC Treaty to state aid in form of guarantees (hereinafter 'Notice on Guarantees'). ([2]) The Notice allows for guarantee schemes to be considered free of aid if they fulfil certain criteria.

Initially, the German guarantee schemes, which had so far been provided under the Shipbuilding Regulation contained a single premium system. With its notification of April 2003 Germany had amended the schemes and proposed an entirely new guarantee system introducing risk differentiation.

Indeed, in recent years risk differentiation has become very important in the banking sector. The Basel II accord reflects new rules on banking safety under which the amount of capital European banks should hold to shield them from financial risk will not be fixed as a lump sum but depend on

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

([2]) OJ C 71 of 11.3.2000, p. 14.

the risk of the creditor. Therefore lending banks must in any event assess the risk of a non repayment of a loan. In particular credits to non-rated beneficiaries might be required to be backed by a relatively high amount of the granting bank's capital.

The German ship financing guarantee schemes

The schemes comprise two different types of guarantees essentially covering a different period of the time. Firstly, *'construction financing guarantees'* should secure the pre-financing of the construction cost of the vessel by the yard. They run until the delivery of the vessel and are provided to the financial institutions which grant the construction-financing loans to the shipyards. Secondly, *'end-financing guarantees'* shall finance the purchase of the completed ship after delivery. They are provided to the financial institutions which grant the end-financing loans to the ship owners. The secured loans have normally a maturity of 8 to 12 years.

End-financing guarantees

The system that Germany implemented for end-financing guarantees is based on risk assessment that is carried out in two stages. The first stage consists of an internal rating by the lending bank providing the loan to be guaranteed. In a predominant number of cases this rating will be done by using a rating system specifically designed for ship financing by one of the leading ship financing institutions, which was devised in the light of the Basel II accord.

In a second step the *Land* that is granting a guarantee will carry out an own risk assessment before finally allocating a particular guarantee into one of the six categories. Criteria to be considered are the management (Shipowner's market position, Company structure, Experience background),the profitability of the shipowner (Market development, Capacity to repay capital, Guarantee category area, Repayment and period, Currency risks) and further circumstances relevant to risk (risk increasing or decreasing aspects).

Since the best-rated credit risks do not require any guarantees and the worse ratings will not receive guarantees, in practice the schemes will provide guarantees to those credits which have been allocated into the middle risk levels by the bank's rating system. In practice only 'normal' risks therefore are covered by the guarantees provided under the schemes. Among them the low risk projects will be able to benefit from cheaper premiums compared to higher risk projects, which will in the future face higher premiums. In the end the spectrum of guarantees previously covered by one single premium (of 0.75% to 1% depending on the *Land* concerned) was spread over six risk categories with premium levels ranging from 0.8% to 1.5%.

In calculating the premium Germany essentially relied on the information of the last previous years (1989-2000), comprising on the one hand the scheme's revenues (from premiums, fees and from the sale of the assets of the failing undertakings) and on the other hand its costs (administrative costs and the costs of the claims).

Construction-financing guarantees

In the system foreseen by Germany for construction-financing guarantees the *Länder* make their own risk assessment on the basis of a scoring model. The eligible scores then, similar to the end-financing system, are spread over six guarantee premium categories.

Criteria to be considered are financing (secured construction-financing, project-surplus, payment terms), liquidity planning for the building period phase, processing and contractual performance (technical performance, timely performance) and additional factors influencing risk.

The commission raises no objections to the schemes

The Commission concluded that the assessed measures do not fall within the scope of Article 87(1) EC Treaty. It has applied the Notice on Guarantees and concluded that the schemes fulfil all six conditions in point 4.3, ensuring that a State guarantee scheme does not constitute State aid under Article 87(1). These conditions are:

(a) the scheme does not allow guarantees to be granted to borrowers who are in financial difficulty;

(b) the borrowers would in principle be able to obtain a loan on market conditions from the financial markets without any intervention by the State;

(c) the guarantees are linked to a specific financial transaction, are for a fixed amount, do not cover more than 80% of each outstanding loan or other financial obligation (except for bonds and similar instruments) and are not open-ended;

(d) the terms of the scheme are based on a realistic assessment of the risk so that the premiums paid by the beneficiary enterprises make it, in all probability, self-financing;

(e) the scheme provides for the terms on which future guarantees are granted and the overall financing of the scheme to be reviewed at least once a year;

(f) the premiums cover both the normal risks associated with granting the guarantee and the administrative costs of the scheme, including, where the State provides the initial capital for the start-up of the scheme, a normal return on that capital.

From the information supplied on the guarantee system it can be assumed that all borrowers eligible under the schemes are in principle able to obtain the credits from the market and that companies in difficulties are excluded from the application, as they would fall within the high-risk non-eligible categories. Therefore, condition (a) and (b) of point 4.3 are clearly met.

As regards condition (c) of point 4.3 the schemes are meeting the required 80/20 ratio. The amount of the construction financing guarantees is indeed limited to 80% of the loan provided by the banks to the yard for the construction of the vessel. Moreover, as regards end-financing structure in shipbuilding the structure is a little more complex. It is foreseen that the shipowner provides a downpayment of 20% of the ship's price and obtains a loan for the financing of the remaining 80% of the ship's price. Around 75% of the loan provided is normally secured by a ship mortgage (i.e. the value of the ship as collateral is normally around 60% of its contract price).The guarantee covers 80% of the remaining 20% of the unsecured loan, meaning in practice 16% of the contract price of the vessel. The bank has thus to retain an own risk for the remaining 4%.

The most crucial test for the schemes to meet was whether they are ‘in all probability self-financing’, as stipulated in condition d) of point 4.3 of the Notice on Guarantees. In another ship financing case concerning Italy the Commission has opened formal proceedings under Article 88 (2) EC ([1]) indicating that it had doubts whether one-premium schemes could be considered in all probability self-financing. The decision states in point 32: ‘Since the use of the scheme is not compulsory and at the same time it is possible to assess individual risks (as a market to provide such guarantees exists), the one premium guarantee system at hand would not appear to be in all probability self-financing. This is so because it would always be possible, for the potential beneficiaries, to find another guarantor willing to cover the risk of the companies with lower than average risk at cheaper premiums than the average premium. This would leave the guarantee scheme only with the higher than average risks.’

On the contrary, the risk differentiation applied by the new German schemes is a significant element for self-financing, because it ensures that all projects are charged with premiums that correspond to their respective risk. This has the effect that the potentially higher rate of default incurred with riskier projects is remedied by higher revenues through the higher premiums charged whereas the lower premiums charged to lower risks ensure that the scheme remains attractive also for these projects. The risk differentiation therefore allows for a broad population of the scheme and at the same time ensures that its revenues will cover the potential costs incurred.

The Commission concluded that the schemes could be viewed as ‘self-financing’ in the sense of the Notice on Guarantees as the revenues from the premiums could be expected to cover the cost of defaults and the administrative costs, i.e. the operating costs and not the capital costs. This follows from point 4.3 (f) of the Notice on Guarantees, which states that the premiums must cover ‘the normal risks associated with granting the guarantee and the administrative costs of the scheme’. Furthermore, it is stipulated only ‘where the State provides the initial capital for the start-up of the scheme, a normal return on that capital’ must be included, which was not the case in the present schemes.

Finally, the last issue was how to define the Notice on Guarantee's concept of being in *all probability* self-financing. Although it could be argued that in order to draw such a conclusion one needs to consider a full economic cycle including all its ‘probabilities’, including a hypothetical economic downturn, the Commission decided to accept reliance on the information of the last previous years (1989-2000), where the scheme's revenues predominantly have been able to cover the costs and even to generate surpluses. It considered that, as the spread of premiums into six categories was established with view to this past experience and the increase in premiums charged to risks above average is likely to lead to an increase in revenues,

([1]) Aid C 28/03, OJ C 145 of 21.6.2003, p. 3, see in particular points 29 to 34.

the schemes will also in the future be able to cover their costs.

However, the Commission envisaged that the system had to be reviewed at some point. Therefore, the schemes were only approved until 2006. Thereafter, a review should be conducted on the basis of the data gained within the annual monitoring of the schemes.

The decision specified that within the yearly reports that are to be submitted for the constant review of State guarantees as foreseen in point 7 of the Notice on Guarantees the following data was to be provided for each risk category:

— revenues from the charged premiums (before costs and defaults and recoveries),
— total revenues (including recoveries),
— number and amount of defaults (displayed individually),
— administrative costs (excluding default payments),
— total costs (including default payments),
— total return (difference between total revenues and total costs),
— the cases where the final rating differed from the initial bank rating.

As on the basis of this data Germany will review the terms on which guarantees are granted and the overall financing of the schemes on a yearly basis, also condition (e) of point 4.3 is meet.

Conclusion

The decision to approve a new German proposal of ship financing guarantees introduces indeed a novelty in so far as the introduction of risk differentiation is concerned. Such differentiation must be welcomed as it is clearly a measure to align state guarantees to market conditions. Moreover, it will make sure that high-risk projects will in the future face premium payments commensurable with the risk that is being insured.

Furthermore, it can not be excluded that this case could serve as an example for the future assessment of guarantees schemes in the shipbuilding sector. The Commission will soon have this opportunity when it has to decide about the above mentioned Italian ship-financing guarantee system.

Temporary defensive mechanism to shipbuilding extended by one year

Andrea CIERNA, Directorate-General Competition, unit H-1

The temporary defensive mechanism ('TDM') introduced by Council Regulation (CE) No 1177/2002 of 27 June 2002 (1) has already been described in the spring issue of the Competition Policy Newsletter (2). Since then, the TDM, due to expire by the end of March this year, has been prolonged until 31 March 2005.

The TDM allows direct aid up to 6 % of contract value before aid for four types of ships: container ships, product tankers, chemical tankers and Liquefied Natural Gas (LNG) carriers. It was introduced after the failure of the Republic of Korea ("Korea") to implement the so-called Agreed Minutes relating to world shipbuilding, signed between the EU and Korea in June 2000, which had as their purpose the restoration of fair and transparent competitive conditions. The TDM is designed to offset unfair practices by Korea in the shipbuilding sector.

The Commission proposed the prolongation of the TDM in view of the fact that a solution to the problem of Korean unfair competition in the sector has not so far been reached on bilateral (3) or on WTO level (4).

The proposal was submitted to a consultation procedure and was first endorsed by the European Parliament.

Discussions concerning the proposal in the Council revealed differences in opinion between the Member States on the TDM itself and on its current form. Some questioned the effectiveness of using State aid to deal with unfair practices at the international level and feared that this could be used as a 'de facto' reintroduction of operating aid to the shipbuilding sector. Others pleaded for an extension of the material scope of the mechanism to other types of ships and for an increase in the allowable aid intensity.

At the outset, the Commission firmly stressed that the TDM in no way intended to reintroduce the operating aid abolished in the sector in year 2000 and that it continued to be an exceptional measure, limited in scope and time.

The Commission defended its proposal by explaining that any modification of the material scope would require a thorough investigation resulting in strong evidence of injury and of serious prejudice caused to the European shipbuilding industry in a particular ship type and concluded that current market developments gave no indication of the need for such an investigation.

As to the question of allowable aid intensity, the Commission stressed that it adopted, at the end of last year, the new Framework on State aid to shipbuilding (5). The Framework, based on the important work carried out by the 'LeaderSHIP 2015' initiative, has created an appropriate environment enabling the shipbuilding industry to improve its competitiveness, in particular by modifying the possibility for the industry to receive innovation aid.

The Council adopted the Commission's proposal by qualified majority without modification as Council Regulation (EC) No 502/2004 of 11 March 2004 (6).

The TDM has so far been implemented in five Member States: Germany, Denmark, the Netherlands, France, and Spain. All of the implementing schemes were approved by the Commission in 2003 and expired on 31 March 2004. The Commission is monitoring the application of the schemes based on information provided by the Member States.

(1) OJ L 172 of 2.7.2002, p. 1.

(2) Bruno Gencarelli: 'E la nave va': développements récents de la politique des aides d'Etat à la construction navale. Competition Policy Newsletter 1/2004, p. 74.

(3) Korea has still not implemented the Agreed Minutes.

(4) A WTO panel is currently hearing the case brought by the EU against Korea with regard to subsidies to Korean shipbuilding. The TDM was extended until the termination of the WTO dispute settlement proceedings, which should be instrumental to a restoration of fair competitive environment.

(5) OJ C 317 of 30.12.2003, p. 11.

(6) OJ L 81 of 19.3.2004, p. 6.

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* At the moment of going to press, the exact date (in 2004) when these officials are to take up their posts has not yet been decided.

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Reporting directly to Mr Monti

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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/index_2003.html

Speeches by the Commissioner, 1 January – 30 April 2004

Proactive Competition Policy and the role of the Consumer – Mario MONTI – Dublin, Ireland (European competition day) 29 April

Antitrust e regolamentazione nell'industria delle comunicazioni elettroniche principi e prospettive – Mario MONTI – Castel dell'Ovo Napoli, Italy (Seminario organizzato dall'Autorità per le Garanzie nelle Comunicazioni) 22 March

Convergence in EU-US antitrust policy regarding mergers and acquisitions: an EU perspective – Mario MONTI – Los Angeles, USA (UCLA Law First Annual Institute on US an EU Antitrust Aspects of Mergers and Acquisitions) 28 February

Remarks at the European Regulators Group Hearing on Remedies – Mario MONTI – Brussels, Belgium (Public hearing on remedies under the new regulatory framework for electronic communications networks and services) 26 January

The New EU Policy on Technology Transfer Agreements – Mario MONTI – Paris, France (Ecole des Mines) 16 January

Speeches and articles, Directorate-General Competition staff, 1 January – 30 April 2004

Liner Shipping: the EU Competition Perspective – Lowri EVANS – London, UK (Containerisation International 7th Annual Liner Shipping Conference) 22 April

Why can't the market decide (Panel 1) – Herbert UNGERER – Oxford, England (Oxford IPPR Media Convention) 13 January

Media Concentration & Convergence: Competition in Communications – Philip LOWE – Oxford, UK (Oxford Media Convention 2004, Institute of Policy Research) 13 January

Community Publications on Competition

New publications and publications coming up shortly

- ***Competition policy newsletter, special edition 1 May 2004***
- ***European Union Competition policy – 2003***
- ***Competition policy newsletter, 2004, Number 2 – Autumn 2004***

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Press releases
1 January – 31 April 2004

All texts are available from the Commission's press release database RAPID at: http://europa.eu.int/rapid/start/ Enter the reference (e.g. IP/03/14) 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/04/574 – 30/04/2004 – Commission closes probe concerning Interbrew's practices towards Belgian beer wholesalers

IP/04/573 – 30/04/2004 – Commission settles Marathon case with Gaz de France and Ruhrgas

IP/04/571 – 30/04/2004 – Commission calls for action to boost competitiveness of the Radio and Telecommunications equipment industry

IP/04/551 – 28/04/2004 – Securities trading: Commission sets out its strategy and priorities for clearing and settlement

IP/04/528 – 23/04/2004 – Commission welcomes agreement among European regulators on competition remedies to be used in the field of electronic communications

IP/04/470 – 07/04/2004 – Commission adopts new safe harbour for licensing of patents, know-how and software copyright

IP/04/469 – 07/04/2004 – Commission approves alliance between Air France and Alitalia

IP/04/436 – 01/04/2004 – Commission warns Greece about exclusive rights granted to PPC for electricity production based on lignite

IP/04/411 – 30/03/2004 – Commission finalises modernisation of the EU antitrust enforcement rules

IP/04/382 – 24/03/2004 – Commission concludes on Microsoft investigation, imposes conduct remedies and a fine

IP/04/377 – 23/03/2004 – On-line services: EU ratifies Council of Europe Convention on notifying new national rules

IP/04/365 – 18/03/2004 – Commissioner Monti's statement on Microsoft

IP/04/343 – 16/03/2004 – Preparing the future and making the most of the past: the Commission adopts a communication on European cinema

IP/04/328 – 11/03/2004 – European Commission welcomes agreement against unfair competition from subsidised third country airlines

IP/04/285 – 02/03/2004 – Car prices: Despite price convergence, buying abroad often remains a good deal

IP/04/281 – 01/03/2004 – Competition probe leads to decrease in tariffs for broadband access via line sharing in Germany

IP/04/272 – 26/02/2004 – Commission welcomes new powers to apply the competition rules to air transport between the EU and third countries

IP/04/185 – 09/02/2004 – Commission calls for abolition of unjustified restrictions of competition in professional services

IP/04/148 – 03/02/2004 – Commission approves UK reduction of excise duty in favour of bioethanol used for road transport

IP/04/134 – 30/01/2004 – Commission launches sector inquiry into the sale of sports rights to Internet and 3G mobile operators

IP/04/2 – 05/01/2004 – Commission clears deal between Telenor and Canal+ regarding Nordic satellite pay-TV distribution

State aid

IP/04/503 – 20/04/2004 – Commission approves aid for new float glass plant operated by e-glass AG in Saxony-Anhalt

IP/04/502 – 20/04/2004 – Commission approves aid for air logistics centre operated by DHL Airways GmbH in Leipzig/Halle

IP/04/500 – 20/04/2004 – Commission approves aid for extension of DOW's PET production site in Schkopau, Saxony

IP/04/499 – 20/04/2004 – Commission approves aid in favour of Sachsenmilch, a subsidiary of Theo Müller GmbH & Co KG

IP/04/498 – 20/04/2004 – Commission approves aid set to increase freight transport on short-sea shipping in UK

IP/04/497 – 20/04/2004 – Commission gives go-ahead to defer regional aid scheme for road transport in the Lake Maggiore area (Italy)

IP/04/496 – 20/04/2004 – Start-up aid for rail and maritime services in Friuli-Venezia Giulia: Commission closes the investigation procedure

IP/04/495 – 20/04/2004 – Total EU State aid for manufacturing, services, coal, agriculture, fisheries and transport falls to EUR 49 billion in 2002

IP/04/413 – 30/03/2004 – Commission investigates new aid scheme for -Spanish coal-mining companies

IP/04/406 – 30/03/2004 – Commission approves modified German environmental tax, including special rules for energy intensive users

IP/04/405 – 30/03/2004 – Italian scheme in favour of undertakings buying undertakings in liquidation infringes EU State aid rules

IP/04/404 – 30/03/2004 – Gibraltar planned corporate tax not in line with EU State aid rules

IP/04/383 – 24/03/2004 – Streamlining State aid control

IP/04/355 – 16/03/2004 – In-depth investigation into restructuring aid for Bull

IP/04/354 – 16/03/2004 – State aid probes into Italian direct tax incentives in favour of newly listed companies and of companies participating in trade fairs abroad

IP/04/353 – 16/03/2004 – Commission approves R&D aid for Altis Semiconductor in France

IP/04/352 – 16/03/2004 – Commission gives green light to Infineon chip production site in Portugal

IP/04/290 – 03/03/2004 – Commission to stop examining small amounts of State aid in the transport sector

IP/04/289 – 03/03/2004 – Combined transport by rail: Commission authorises an Italian aid scheme

IP/04/235 – 18/02/2004 – Commission proposes new rules to increase legal certainty for services of general economic interest

IP/04/234 – 18/02/2004 – Commission approves aid for restructuring of Bankgesellschaft Berlin

IP/04/231 – 18/02/2004 – Commission approves rescue aid for the National Printing Office in France

IP/04/228 – 18/02/2004 – Commission raises no objections to a total exemption from excise duty in favour of biofuels in Germany

IP/04/226 – 18/02/2004 – Commission approves aid in favour of Wacker Siltronic AG for a large investment project in Saxony, Germany

IP/04/157 – 03/02/2004 – The Commission's decision on Charleroi airport promotes the activities of low-cost airlines and regional development

IP/04/152 – 03/02/2004 – Probe into potential misuse of hotel subsidies

IP/04/151 – 03/02/2004 – Commission opens proceeding on a State aid project for compensation of stranded cost in Poland

IP/04/147 – 03/02/2004 – Commission approves aid in favour of AMD Fab 36 LLC & Co. KG in Saxony, Germany

IP/04/146 – 03/02/2004 – Commission launches aid probe into Dutch public service broadcasters

IP/04/115 – 28/01/2004 – Second Commission decision on restructuring of Czech bank Ceská sporitelna, a.s.

IP/04/81 – 21/01/2004 – Coal industry: Commission authorises France to grant closing aid to its last two mines

IP/04/80 – 21/01/2004 – Bus transport: Commission approves German regional aid on the ‘promotion of pollution control and climate protection’

IP/04/77 – 21/01/2004 – Shipbuilding: Commission proposes extension of EU support until 31 March 2005

IP/04/73 – 21/01/2004 – No concerns on capacity transfer between East German shibuilders Volkswerft Stralsund and Aker MTW Werft

IP/04/72 – 21/01/2004 – Pension transfer from Belgacom to the Belgian State does not involve State aid

Merger

IP/04/578 – 30/04/2004 – Commission clears Ford acquisition of Polar Motor

IP/04/565 – 29/04/2004 – Commission clears joint acquisition of Grundig by Turkey's Beko and Britain's Alba

IP/04/562 – 29/04/2004 – Commission clears acquisition of Swedish non-life insurer If Skadeförsäkring by Finland's Sampo Oyj

IP/04/561 – 29/04/2004 – Commission clears acquisition of building materials distributor Dahl by Saint Gobain

IP/04/545 – 26/04/2004 – Commission approves planned acquisition of Aventis by Sanofi-Synthélabo subject to conditions

IP/04/486 – 15/04/2004 – Commission clears the acquisition of FLS Aerospace by SR Technics

IP/04/484 – 15/04/2004 – Commission accepts divestiture proposals submitted by AB Volvo

IP/04/443 – 01/04/2004 – Commission clears Cargill's acquisition of sole control of BCA

IP/04/403 – 30/03/2004 – Commission clears J&J acquisition of Merck's stake in their non-prescription drugs venture

IP/04/402 – 30/03/2004 – Commission clears termination of joint venture between P&O and Royal Nedlloyd

IP/04/393 – 26/03/2004 – Commission clears the acquisition of Triaton by HP

IP/04/368 – 19/03/2004 – Commission approves acquisition of German slaughterhouse Nordfleisch by Dutch Best Agrifund

IP/04/361 – 18/03/2004 – Commission clears acquisition of Carling coke plant by Dillinger Hütte and Saarstahl

IP/04/357 – 17/03/2004 – Commission approves acquisition of German brewery Holsten by Carlsberg

IP/04/342 – 15/03/2004 – Commission clears acquisition of Messer's activities in Germany, the UK and the US by Air Liquide subject to conditions

IP/04/337 – 15/03/2004 – Commission clears RTL's acquisition of sole control over M6

IP/04/329 – 12/03/2004 – Commission clears acquisition of UK shower maker Baxi by BC European Capital Funds

IP/04/321 – 10/03/2004 – Commission clears takeover of Atis Real International by BNP Paribas Immobilier

IP/04/318 – 10/03/2004 – Commission approves merger in the Spanish life insurance sector

IP/04/292 – 03/03/2004 – Commission clears JV between Toshiba and Samsung in the optical disk drives markets

IP/04/211 – 17/02/2004 – Commission clears joint control of Internet platform by ThyssenKrupp and Arcelor

IP/04/209 – 16/02/2004 – Commission clears acquisition of majority shareholding in Hahn + Lang by Volkswagen

IP/04/200 – 12/02/2004 – Commission opens in-depth investigation into Sony/Bertelsmann recorded music venture

IP/04/194 – 11/02/2004 – Commission clears merger between Air France and KLM subject to conditions

IP/04/175 – 06/02/2004 – Commission clears control of Polish steel company PHS by LNM group

IP/04/174 – 06/02/2004 – Commission gives green light to the acquisition of MGE by Schneider

IP/04/135 – 30/01/2004 – Commission agrees to modify Rhodia commitment in Hoechst/Rhône-Poulenc decision

IP/04/92 – 23/01/2004 – Commission welcomes INA/AIG's decision to abandon their planned acquisition of French bearings maker SNFA

IP/04/88 – 22/01/2004 – Commission clears acquisition by Bain Capital of Interfer and Brenntag

IP/04/83 – 21/01/2004 – Commission clears Koch's purchase of Invista from DuPont

IP/04/82 – 21/01/2004 – Commission approves General Electric's purchase of diagnostic pharmaceuticals maker Amersham

IP/04/73 – 21/01/2004 – No concerns on capacity transfer between East German shibuilders Volkswerft Stralsund and Aker MTW Werft

IP/04/70 – 20/01/2004 – EU gives itself new merger control rules for 21st century

IP/04/15 – 07/01/2004 – Commission gives go-ahead for Lagardère to acquire part of the publishing business of Editis (former VUP)

General

IP/04/511 – 21/04/2004 – Commission marks sweeping competition reforms

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