

Summary

Competition Policy under Shadow of “National Champions”

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in accordance with Section 44 Paragraph 1 Sentence 1 of the
Act Against Restraints of Competition (Gesetz gegen
Wettbewerbsbeschränkungen – GWB)*

Current Issues of Competition Policy

• Competition Policy and Industrial Policy

1.* In Germany the *Bundesregierung* (Federal Government) is increasingly promoting an industrial policy that directly influences economic developments by actively supporting individual enterprises or industries. Special emphasis is placed on the promotion of so-called “national champions”, large German enterprises which are hoped will take on top positions in the “world league” of the “global players”, provided they are “strong” enough. Examples are the ministerial authorisation of the E.ON/Ruhrgas merger, the privileging of “Deutsche Post AG”, which will continue due to the prolongation of its monopoly on the transport of letters until 2007, and the call for a merger to create a “strong” German bank.

2.* Thus, industrial policy interests are put before competition policy interests. In 2003 the Federal Government and the Legislator undermined the *Bundeskartellamt*’s (Federal Cartel Office) abuse control despite the Monopolies Commission’s warnings by giving legal force to the “*Verbändevereinbarungen*” (Associations’ Agreements) on transmission in the energy sector. This happened at a time when the energy companies were stifling competition that had developed after liberalisation in 1998 by charging excessive transmission fees. The Federal Government deemed the “strengthening” of companies in the energy sector more important than the promotion of competition in the generation and distribution of electricity.

3.* This spring the German Chancellor, along with the French President and the British Prime Minister demanded that the European Commission concentrates all competencies for economic policy issues with one Commission Member to ensure a consistent approach in competition policy, single market policy and industrial policy. Such a plan challenges the institutional framework of competition policy. In a general economic policy department, competition law interests would be considered as one among many issues for discussion and only when convenient. The concept of competition policy as a system subject to the rule of law would be abandoned. A similar approach is being followed in Germany itself, as can be seen in the introduction of the special right of the *Bundesminister für Wirtschaft und Arbeit* (Federal Minister of Economics and Labour) to issue instructions to the *Regulierungsbehörde für Telekommunikation und Post – RegTP* (Regulatory Authority for Telecommunications and Posts) and in the reduction of the procedural rights of third parties envisaged in the amendment to the Act Against Restraints of Competition.

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4.* The Monopolies Commission opposes these developments. It considers the concepts of economic theory and economic policy on which they are based to be partly incorrect, partly impracticable. In addition, it questions the emerging changes in the governance structures of competition policy.

“A national economy's competitiveness” – an illusion

5.* The promotion of “national champions” is usually justified as a means of strengthening the competitiveness of the German economy. The image of a national economy that competes like an enterprise in the markets is striking but factually misleading. The national economy as an entity is neither a person, nor is it an enterprise or a team engaged in competition. It is companies and persons that are engaged in competition, both in the domestic input markets as well as in their respective output markets. How successfully a company fares in competition with others depends on the sales prices it can afford to demand on national and international markets and on the relation between these sales prices and the labour costs in the respective domestic labour market. The decline of the German textile and steel sectors in recent decades is the result not only from the emergence of new competitors in the output markets but also from productivity development lagging behind labour cost development in Germany. The alignment of wage development to productivity development regulates competition between companies for employees. Companies and sectors with an above-average productivity development score better than companies and sectors with a below-average productivity development. The image of the national economy as a competitor obscures the fact that in input markets the success of one company and the lack of success of another are just two sides of the same coin.

6.* The image of the national economy as a competitor also obscures the fact that international exchange of goods and services is based on a quid pro quo relationship. A country sells certain goods and services to buy other goods and services in exchange. In this quid pro quo relationship the success of a domestic supplier in its sales abroad is necessarily tantamount to the lack of success of another domestic supplier in its purchases abroad. The decline of the German textile and steel sectors reflects the fact that it pays off for people living, working and saving money in Germany if their labour and savings are channelled into the production of cars and chemical products which are then sold to other countries in exchange for textile products and rimmed steel rather than into the production of textiles and rimmed steel in Germany itself. The individual person is not aware of this quid pro quo, which results from the interaction between the different national and international input and output markets. It excludes by definition the possibility of all sectors of a national economy being equally successful in competition at the same time. In this sense, talking about the competitiveness of a national economy is meaningless.

7.* The idea of a quid pro quo in the international exchange of goods and services even remains valid considering that a country's current account need not be in equilibrium at all times. If exports of services to other countries during a certain period of time are not balanced by imports of services from abroad during the same period, the deficit will be reflected in the capital account of the respective country. The country acquires claims against other countries which can be called in at a later date. If later the balance of debts and liabilities to the rest of the world is offset, a current account deficit emerges corresponding to a lack of success of companies in sectors in which more goods are imported than exported. If only the interest on claims is collected rather than the claims themselves, a deficit remains in the section of the current account which is not based on capital income but on the current supply of goods and provision of newly provided services. Here, the quid pro quo of the international exchange of goods and services no longer only applies to the exchange of goods and services within a certain period of time but also between different time periods.

8.* The image of a national economy as a competitor stems from the political tradition of militarism. According to this tradition, countries are rivals and the “strongest” defeats the others, annexes their territory and expels or conquers their citizens. This image has nothing to do with economics. International trade is not about subjugating other countries or preventing the subjugation of the home country, but about capitalising on the universal benefits of exchanging goods and services. It is not to the detriment of the German national economy if other economies experience growth and develop dynamically. Though it means that some companies and sectors will have to adapt, on the whole an enhancement of the international division of labour serves to increase the standard of living in all countries. The decline of the German textile and steel sectors as a result of economic developments in other countries has not impoverished Germany but, on the contrary, has provided an opportunity for it to specialise in the production of higher quality goods and services. As a result, prosperity in Germany, too, has increased.

9.* An individual country’s prosperity depends on how effectively it uses its resources in terms of labour, capital, know-how and special skills and whether it offers its citizens a high standard of living. In this respect Germany is still way ahead of most Asian and Latin-American countries. However, the standard of living in Germany is also noticeably lower than in some of its European neighbouring countries, such as Sweden, Denmark or Switzerland. These countries are barely mentioned in discussions about international competitiveness in the era of globalisation, for they are too small to evoke the eerie fascination caused by size and superior power. Sweden, Denmark or Switzerland are not particularly well suited to become modern versions of “the red colossus” or “the yellow danger”. However, the standard of living achieved in these countries poses the true challenge to German economic policy. Their example shows – aside from military encounters – that a nation’s autonomy and economic prosperity does not depend on the size of its territory and population. What really counts is that it effectively uses its own resources, increases its productivity through innovation and supplies goods which are geared to its strengths in the quid pro quo of international exchange of goods and services, without “national champions”.

Implications for assessing “national champions”

10.* Government support for “national champions” in specific sectors, such as the building up of “Deutsche Post AG” into a world leading logistics company, impairs the competitiveness of German companies in other sectors, such as the car industry. The impairment takes place indirectly via price adjustments in input, output and monetary markets. Its causes are therefore not immediately evident for those concerned. Nevertheless, there is a connection between promoting the competitiveness of the “national champion” and impairing the competitiveness of other companies, and this connection needs to be taken into account by politicians if they want to avoid being accused of irresponsibility. Advocates of a policy that promotes “national champions” should therefore explain why they consider it appropriate to raise the importance of logistic services in German exports and play down that of, e.g., cars. How can the Federal Government know that it is better for Germany, or rather, its citizens, if relatively more postal services are supplied than cars? The same question applies to the motive of creating or saving jobs which is regularly referred to in this context. It is true that government support for the competitive position of a company or sector may help to create or save jobs in the respective company or sector. At the same time, however, jobs in other companies and sectors whose competitiveness is impaired because the “national champion” is privileged are put at risk. The fact that those concerned are in general not aware of this cause-effect relation does not relieve the government of responsibility for these negative consequences of its policy.

11.* The underlying cause-and-effect mechanisms can be illustrated in the discussion between the Federal Minister of Economics and Labour and the

Bundesminister für Umwelt (Federal Minister for the Environment) in the spring of 2004 about the effects of an emissions regulation based on tradable certificates in the energy sector. The Federal Minister of Economics and Labour was of the opinion that the costs for emission certificates unduly hindered the international competitiveness of the German industry. It is true that the costs for emission certificates are part of energy costs and thus generally result in increased costs for all enterprises. In the course of time, however, price adaptations in input and output markets occur which challenge the Economics Minister's view: output prices rise, real wages fall or rise less than they would without the introduction of emission trade. As a result the relative prices of goods and services shift in such a way that energy-intensive goods and services become more expensive in relation to others and less energy-intensive goods and services become cheaper. The competitiveness of companies and industries producing the latter is ultimately strengthened, also in international markets. The emissions regulation based on tradable certificates mainly burdens suppliers of input goods and services. Due to unavoidable adjustments their prices fall more or rise less than they would do without the emissions regulation. This applies in particular to real wages which are ultimately burdened by the introduction of the emissions regulation based on tradable certificates, even if politicians do not admit this.

12.* Economic scholars mostly agree that governmental attempts to intervene in production structures should be avoided unless there are particular reasons for “market failure”. The same principle applies to the interrelation of production and trade in the international exchange of goods and services. Just as they are ill suited to judge which goods and services should be produced, politicians and bureaucrats are equally incapable of judging which goods and services are cheaper to purchase abroad rather than to produce at home. Such decisions are usually better left to the millions of consumers and companies who are directly affected by them, and to the markets that co-ordinate the activities of these millions of consumers and companies. A policy of government support for “national champions” that intervenes in these structures, favoring some companies and impeding others, runs contrary to this principle and therefore requires specific justification.

13.* When evaluating “national champions” one should be aware that the perception of facts may be distorted because the beneficiaries of state intervention are more conscious of its effects and thus make themselves heard in the political process to a greater extent than those who suffer from state intervention. In addition, industrial policy does not help to raise the general standard of living but rather acts in the interest of a few. If today industrial policy protects companies of the energy sector or “Deutsche Post AG” from competition, such policy is in the specific interest of these companies, their employees and their shareholders, but consumers will suffer from it. An industrial policy that only protects individual companies and sectors from competition stands in the tradition of Bismarck's protectionism introduced after 1879 when protective tariffs on agricultural products and iron and the cartels that emerged from this served the interests of Prussian Junkers and industrialists from the Ruhr Valley and burdened consumers and workers with excessive prices.

14.* The effects of the one-sided promotion of sector specific “national champions” as described above cannot be avoided by extending promotion to all sectors. Here, again, it would lead to false conclusions if one were to generalise the partial thinking applied to individual companies and sectors and to apply this to the economy as a whole. Where individual industries are promoted through state subsidies, consumers are ultimately burdened with taxes needed to finance these subsidies. Where individual industries are promoted by protecting them from competition and thus enabling them to make monopoly or oligopoly profits, consumers are also excessively burdened by monopoly or oligopoly prices. In both cases economic activity is impeded altogether. For example, the ubiquitous monopolies and cartels during the Weimar Republic contributed considerably to the

fact that Germany was a far cry from full employment even during the “golden” twenties.

Promotion of “national champions” – a strategic foreign trade policy?

15.* Some deny the relevance of the concerns described above arguing that the classical theory of international trade presumes the existence of functioning, competitive markets while the theory of so-called “strategic trade policy” shows that with economies of scale and scope, a country can indeed benefit from active industrial policy. They argue that with an active industrial policy the state ensures that the respective monopolists or oligopolists are located at home. Therefore it is the national economy that benefits from the monopoly and oligopoly profits gained worldwide.

16.* In principle, the argument that the classical theory of international trade does not pay enough attention to the relevance of economies of scale and scope and of monopolies and oligopolies is justified. However, the integration of monopoly and oligopoly effects in the theory of international trade during the eighties did not, contrary to the argumentation outlined above, achieve academic consensus on the utility of a strategic trade policy. Authoritative surveys conclude that such a policy is in practice predominantly detrimental.

17.* Even within the limited scope of theoretical models the argument for a strategic trade policy is rather weak. Within the analytical framework of these models strategic trade policy only seems reasonable if one assumes that the monopoly and oligopoly profits gained abroad exceed the costs of concentration of market power in the domestic markets; this assumption is in particular problematic if the domestic sales of the respective company constitute an essential part of its total sales. A further necessary assumption is that oligopolistic competition results in substantial profits for the companies concerned. As soon as a duopoly with intensive price competition exists, the policy needs to be changed. Finally, the models only work under the assumption that domestic shareholders benefit from the companies’ profits. If foreigners hold company shares, this condition is not fulfilled.

Further doubts arise if one moves beyond the limited scope of argumentation of the theoretical models. How does a policy maker know which sectors or companies are suitable subjects of strategic foreign trade policy? How does he know which technologies need to be developed and who is suited best to do this? How can he assure that the companies that receive funding or enjoy protection from competition do not use these benefits as an incentive to relax and fall back in the development of new products and production processes?

18.* Practice has confirmed the validity of the objections outlined above. Exemplary for the problem of identifying sectors, companies and technologies suitable for government support is the failure of “Deutsche Bundespost (Telekom)” and other PTT administrations in Europe to develop Internet technologies for electronic data communication. One of the main reasons why Germany lags behind the United States in Internet technology is that for years the Bundespost has used its monopoly on fixed-line telecommunication services to actively prevent the development or further development of data exchange networks based on TCP/IP protocols in order to implement the OSI standard favoured by European postal and telecommunication monopolies. The development of the OSI standard itself was delayed because “Deutsche Bundespost” failed to actively involve users in the development of the system, as had been done in the case of the Internet; such an involvement could have been organised within the framework of the German electronic network for scientific research.

19.* The example of France does not disprove this critical assessment either. The proclaimed activism of French industrial policy and the media’s admiration for the dedication and hands-on approach of the respective ministers bear no relation to this

policy's record of success. The “war industries” coal and steel, on which French policy focused in the fifties, soon proved to be industries of the past. The billions spent by the French government during the sixties and seventies for the development of Concorde were mainly wasted, as were the billions that were earmarked for developing a French computer industry.

20.* Neither can Airbus be regarded as a complete success. It is true that the mere existence of EADS prevents a monopoly of Boeing in the production of certain aircraft types for civil aviation. However, even without EADS there would not be a Boeing monopoly but rather a duopoly of Boeing and McDonnell-Douglas. According to current empirical research, the market entry of Airbus Industries was a decisive factor in McDonnell-Douglas' decision to leave the market. Therefore, to evaluate the success of state support for Airbus one would have to consider the duopoly of Boeing and McDonnell-Douglas as a standard for comparison rather than the monopoly of Boeing. Industrial policy makers may be troubled by the fact that in this scenario both duopolists are located in the United States. However, for consumers this would not make much of a difference as long as the intensity of competition does not suffer. Considering the economies of scale involved, this is rather unlikely unless one assumes a situation of political conflict in which the US administration impedes or stops the export of civil aircraft.

In addition, interest payments on subsidies granted for decades need to be taken into account. Profits earned today by a company are in themselves no evidence for economic success based on theory of strategic trade policy. The theory could only claim to be successful if the profits proved in retrospect that the subsidies had been profitable investments.

21.* Japan is often quoted as an example for successful industrial policy over the decades. The control of the competitive behaviour of Japanese companies exercised by the Japanese Ministry of International Trade and Industry (MITI) is legendary. According to current empirical studies, however, the Japanese economy is characterised by a duality with internationally highly competitive, productive and innovative sectors, such as the car industry, on the one hand and on the other hand internationally less competitive, productive and innovative sectors such as the chemical industry or certain consumer goods industries. The nationally and internationally successful industries are characterised by a lack, or even a deliberate rejection, of state intervention and by intense competition, also in domestic markets. Barriers to market entry and the cartels fostered by the MITI can mainly be found amongst the underdeveloped sectors.

22.* Consequently, an industrial policy that is oriented towards strategic trade policies appears to be rather a theoretical concept than a strong basis for a successful economic policy. As a theoretical construct it ignores to a great extent the difficulties of identifying suitable technologies, companies and industries as well as the incentive effects of state support. The theory does not recognise competition as an incentive for innovation and as a means to discover new technologies. Experience proves that the classical dictum which states that active competition policy is the best form of industrial policy is absolutely correct. The Federal Government is therefore advised to encounter the French example with the same insistence on active competition policy as that practised by Ludwig Erhard, German Economics Minister in the fifties, even if this may not always be easy in the face of calls in the media for more activism in economic policy.

23.* The commitment of the Federal Government to create a “national champion” in the banking sector raises particular concerns. The issue here is not only the extent of the active and deliberate promotion of such a “champion” but also the scale of a possible government guarantee in a crisis and the incentive effects such a government guarantee could have on those concerned. Since the seventies numerous banking crises have occurred as a result of worldwide structural changes in the financial sector. Whether these crises should be regarded as a transition phenomenon

of structural change or as a lasting element of a new structure with higher risks for interest rates, currencies and economic activities remains to be seen. However, empirical studies agree that the more banks rely on being “too big to fail” and on the conviction that the state will not desert them in the end, the more crises occur and the more serious they become. In some cases this policy proved to be too much even for the state itself.

24.* As regards Germany, one should not forget that the interplay of banking crises and monetary crises in the summer of 1931 was decisively shaped by the policy of those major banks with a network of branches (Deutsche Bank, Danatbank, Dresdner Bank, Commerzbank) who in the short term had excessively refinanced themselves abroad and, in comparison to other banks, had pursued a rather careless liquidity policy because they trusted the Reichsbank to privilege them in the supply of liquidity, as it had in the past. The run of foreign investors against the German currency and the German banks rendered the Reichsbank incapable of meeting this expectation; the resulting banking crisis led to a fatal deepening of the economic crisis. The connection made between the size and the potential strength of the respective banks proved to be illusory and a fiscal policy that privileged the major banks with networks of branches turned out to be an invitation for a misbehaviour which affected the whole country. After such an experience we strongly advise against state commitment to create a “national champion” in the financial sector.

Governance of competition policy and industrial policy

25.* Experience shows that strategic foreign trade policy is often less concerned with the development of future industries than with the maintenance of industrial sectors of the past, e.g. coal and steel. There is a marked difference between rhetoric and reality in industrial policy. However, there is no justification for an industrial policy which merely tries to permanently protect industrial sectors of the past and to prevent the economy from adapting to technical progress and emerging comparative advantages of other countries.

26.* The observation that industrial policy often devotes itself to the maintenance of obsolete structures rather than developing new ones is not surprising. It reflects the fact that in the political process different interests are articulated in different ways and in varying degrees of assertiveness. Industries benefiting from state protection have a much stronger lobby than companies which practically do not yet exist and which merely promise to contribute to economic growth by means of innovations. The effects of the asymmetry between the conduct of the beneficiaries and the victims of an active industrial policy as observed in the public dialogue are even further strengthened by the fact that the beneficiaries are often solely concerned with protecting their entitlements.

27.* German law has largely withdrawn the implementation of competition policy from the political process making it subject to competition law and its application by the Federal Cartel Office or the European Commission and the respective courts. Subjecting competition policy to the rule of law is a preventive measure against the threat of individual interests and arguments gaining the upper hand over general competition rules. Furthermore, the independence of competition authorities and courts guards against the dangers of discretionary powers, namely that competition rules are applied as it would be convenient in day to day politics. The law uses both means to protect the political sector from itself, or, more strictly speaking, from the temptation in the decision-making process to take notice only of those economic actors which actively and directly seek to contact it and which are in a position to articulate their interests in an appropriate way. A system more committed to the convenience of daily politics would immediately acquire the reputation of applying Byzantine methods in which it mainly matters who gains access to whom and from which the parties concerned cannot expect any legal security.

28.* The concept of competition policy as a system subject to the rule of law is based on the fact that competition policy operates with prohibitions, not prescriptions. The law or the respective competition authority prohibit certain measures or activities and leave the decision what to do instead to the parties concerned.

Active industrial policy, on the other hand, is by its nature an interventionist policy and requires the assessment of alternative strategies by a state authority. This assessment cannot be made on the basis of applying the law but requires a discretionary decision in each individual case. In practice, active industrial policy is therefore prone to being pocketed by the parties concerned.

29.* The proposal of the German Chancellor, the French President and the British Prime Minister that the European Commission should concentrate all economic policy competencies, including industrial policy and competition policy, in one hand bears the risk of overthrowing the concept of competition policy as a system subject to the rule of law. If both competition policy matters and industrial policy matters are managed by a conjoint entity it is to be expected that they will also be dealt with jointly. This would eliminate the possibility of implementing competition policy as an application of the law.

From the initiators' perspective concentrating economic policy competencies in one hand may well raise the potential for policy shaping and exercising more influence. However, the politicisation of competition policy this entails bears the risk of a significant change of the economic system, moving away from a competition system controlled by the state solely by means of certain narrowly defined prohibitions, and towards state control of all developments. Practical experiences made with attempts at state control leave little hope that this change will bring about positive results.

Competing locations and the market for corporate control

30.* One last group of arguments refers to Germany's standing in the competition for company headquarters. The merger of Höchst and Rhône-Poulenc resulting in the formation of Aventis has led to the transfer of corporate headquarters from Frankfurt to Strassburg. The takeover of Mannesmann by Vodafone has led to the transfer of its headquarters from Düsseldorf to London. For the regional and local authorities concerned such transfers pose a problem. Firstly, in the future corporate decision-makers will show less consideration for the interests of the location concerned. Secondly, attractive jobs will be transferred to other places. For the municipal authorities, federal states and countries concerned this development bears the risk of a certain provincialisation.

31.* In this context the concept of the community as a competitor is of concrete and important significance. The communities' competition, however, is not about the market positions of the companies located in these communities, but about their own position in the competition for corporate headquarters. What communities "offer" to the companies is determined by the overall conditions which define the companies' relation to their locations, ranging from the legal system, the reliability of their relations to the authorities, and taxation to the public goods at the companies' disposal, the attractiveness of housing opportunities and the cultural environment, i.e. offers which in turn make it easier for companies to recruit suitable management staff.

32.* This form of competition for locations of corporate headquarters seems to have become more intensive. It is therefore up to the competent authorities at the level of the *Bund* (Federal Government), the *Bundesländer* (Federal Länder) and the *Gemeinden* (local authorities) to re-examine their own competitiveness. In both the Höchst/Rhône-Poulenc and Mannesmann/Vodafone cases the fact that a company located in Frankfurt-Höchst or Düsseldorf is subject to parity co-determination was allegedly an important consideration. In the Mannesmann/Vodafone case one can

imagine, however, that the foreign shareholders holding a total of more than 60 per cent of Mannesmann shares were also led by the consideration that they were more familiar with London as a location for a company's headquarters not only due to the language, but also because of the overall legal system. In any case the German Federal Government should re-examine Germany's standing in this competition for company headquarters.

33.* The problem concerning Germany's standing in the competition for company locations should not be mixed up with the issue of regulating the market for corporate control. The Mannesmann/Vodafone case or the more recent Aventis/Sanofi case give rise to the assumption that the competition for company headquarters solely focuses on hostile takeovers. This assumption is not true. The Höchst/Rhône-Poulenc merger and thus the transfer of the company headquarters to another country took place without a hostile takeover. The project of a merger of "Deutsche Börse AG" and the London Stock Exchange that was envisaged a few years ago was also initiated by the managers concerned. If this project had been put into practice no stock exchange worth mentioning would exist in Germany today. Similar projects envisaged by other companies which are currently discussed by the press are also to be considered as initiatives undertaken by the respective boards of directors and have nothing to do with hostile takeovers.

34.* The law on the regulation of corporate takeovers passed in the last legislative period provides executive boards with significant possibilities to defend themselves against hostile takeover attempts. The executive boards' duty of neutrality originally recommended by the commission of experts has been dropped. The board has instead been given the possibility to take defensive measures with the approval of the supervisory board even without calling a shareholders' meeting. This results in a situation similar to the one in the USA without, however, the corrective element of the fiduciary duty, i.e. the obligation a board of directors has towards the shareholders as owners which, under certain circumstances, can even justify a claim for damages.

35.* However, the experiences made in the USA during the 1990s give rise to the assumption that a strengthening of the management's position in takeover proceedings can hardly be expected to prevent takeovers and mergers but is more likely to alter the distribution of the profits expected from such operations. During the first half of the 1990s the position of US managers in takeover proceedings was considerably strengthened by court rulings and legislation. In the course of the 1990s, this did not result in less mergers and takeovers, but only less hostile takeovers; bonus payments, shares and share options served to "compensate" the managers of the companies acquired. German policy makers must also take into account that the takeover law passed will not eliminate the problem of competition for company headquarters, but will merely put the boards of directors in the place of the stock market and investment fund managers as the significant decision-makers.

36.* The financial press sometimes states the opinion that the market capitalisation of German stock companies, e.g. German banks, is too low, which is why the press considers the independence of these companies to be particularly threatened. According to the press, mergers are needed to help these companies be successful in international competition. It is true that the market capitalisation of German stock companies is relatively low in international comparison. This assessment applies equally well to the market capitalisation of individual companies and the capitalisation of all German stock companies as a whole. The scientific literature on different financial systems considers the reason for this to be the fact that the German stock corporation law, as opposed to the US or UK company laws, provides only limited protection for individual shareholders against being disadvantaged by a company's management. If shareholders have to assume that their interests are of minor concern to the executive and the supervisory board when decisions are made on the company's business policy, its policy of dividend distribution or the choice of

defensive measures in a takeover fight, they will not be prepared to pay high prices for shares. As a consequence stock companies play a relatively small role in the German economy as compared to other national economies, and German companies have less possibilities than – for example – US companies to move into new dimensions via the stock exchange.

37.* It is not true that the relatively low market capitalisation of German companies *per se* threatens their independence. If a company's low stock market rating is due to the fact that it is seen as a less attractive investment opportunity, one cannot expect that the low stock market rating alone attracts a potential investor. What is important for potential investors is whether the company's market capitalisation is low in relation to its value or, more exactly, in relation to what the investor can get out of the company after a takeover under the applicable law. One must take into account that the investor will not only have to pay a price for the individual shares corresponding to the stock market rating, but he will also have to pay for the management's cooperation and the additional control opportunities of major shareholders with blocking stakes. Neither is it true that the problem could be solved by mergers. In the Monopolies Commission's view size is no guarantee for power. Vodafone's attempt to take over Mannesmann was successful although Mannesmann had considerably grown due to several mergers, most recently the takeover of Orange, and although the value of the transaction amounted to a three-digit billion sum. As the takeover was realised by an exchange of shares the absolute size of the company acquired or its market capitalisation only played a minor role.

38.* If the takeover law prohibited an exchange of shares and insisted on a cash offer being made, as was initially discussed in the context of the Mannesmann takeover, absolute company size would constitute a greater barrier against corporate takeovers. In the case of a cash offer the financing costs would be considerably higher and the parties concerned would be unable to deny the banks', i.e. the lenders', greater influence. From the point of view of the boards of directors involved, however, this disadvantage of excluding offers to exchange shares in the case of one's own takeover attempts outweighed the advantages of greater protection against the takeover attempts of other companies.

39.* The relatively low market capitalisation of German companies threatens their independence if a merger serves to transfer the company from one legal system to another, more shareholder-friendly one, and to profit from the increase in value which can be expected as a result of this. This possibility does not exclude granting the executive and the supervisory board defensive measures against hostile takeover attempts. It merely ensures that potential profits gained by a transfer of a company to another legal system have to be shared at least partially with those who *de facto* have the competence to control the company. We are thus dealing with a partial aspect of the problem of attractiveness of locations from the point of view of the corporate managers concerned.

40.* The problem of Germany's standing in the competition for locations of company headquarters must be taken very seriously. This problem has in fact little to do with the issue of promoting 'national champions' by means of an interventionist industrial policy. The size of companies and their market capitalisation is no guarantee for maintaining the independence of companies based in Germany, neither can this be guaranteed by a company law which practically excludes hostile takeovers by putting control competencies mainly in the hands of the executive and the supervisory boards. What is solely decisive is whether the persons and management units in control think that on the basis of the legal and political conditions a change of location by means of a merger would be advantageous.

41.* From a competition policy point of view it has to be noted that a more shareholder-friendly company law would considerably enlarge the scope for innovation and market entry by newcomers. A stock corporation law which *de facto*

leaves the power of disposal over companies' assets and the use of profits to a large extent to the company insiders bears a share of the responsibility for the fact that in Germany the markets for investment capital are underdeveloped, from venture capital to the equity capital base of German small and medium-sized companies.

42.* At the end of the 1990s one could expect that Germany's lagging behind other countries in terms of venture capital financing, access to stock exchanges and market entry of innovative companies would be remedied by the success of the New Market. The developments since then give rise to concerns that this was merely a flash in the pan, caused by a general stock exchange enthusiasm in the context of the speculative bubble. The implosion of the New Market has again put into question whether equity financing can function in Germany. For newcomers to the market this development is all the more problematic as at the same time the banking sector has become even more cautious in granting loans than before, influenced by the revision of equity capital regulation under the keyword "Basel II".

43.* As a consequence of a stock corporation law which de facto largely leaves the power of disposal over companies' assets and the use of profits to the company insiders, existing companies will always have a lead over new companies in the competition for funds for financing investment. As far as the profits achieved by the existing companies are considered as evidence for good performance and particular competence in new investments as well, such a competitive advantage might be justified. It is problematic, however, if the profits concerned are not achieved by entrepreneurial competence, but on the basis of monopolistic power and state privileges. Besides, a national economy which solely relies on existing companies in choosing its investment strategies runs the risk of missing fundamentally new developments because those in charge in the companies have no feel for their potential or fear that managing such developments requires people with other skills and that these developments would thus jeopardise their own positions of power.

44.* An economic policy that looks beyond the present moment must ensure that the system of corporate finance and corporate control leaves enough space for new companies. The overall connection between the stock corporation law and the stock exchange system on the one hand and the availability of equity finance to new companies on the other must be taken into account. New promising investments are not only made possible by the fact that existing large groups of companies keep their profits within the company and reinvest them, but also by cash flowing out of the large groups and by capital markets investing these funds in new businesses, trusting that general conditions are shareholder-friendly and reliable.

● **Regulation of the telecommunications markets**

45.* In its third report on the effectiveness of competition in the telecommunications markets pursuant to Section 81 (3) of the Telecommunications Act (Telekommunikationsgesetz – TKG) the Monopolies Commission concludes that there has been a positive development as regards competition in fixed line calls. It has recommended to repeal the statutory ex-ante regulation of prices for long-distance and international calls. In the local call sector competition has increased after the introduction of carrier pre-selection codes. However, it has not yet reached the intensity which would make the preventive regulation of prices to the end customer unnecessary. Furthermore, there is no worthy of mention competition in subscriber lines. With respect to unbundled access to subscriber lines, local and regional interconnection services as well as billing and collection services, the competitors still rely to a great extent on the advance services of Deutsche Telekom AG (DTAG).

46.* In mid May 2004 the amendment of the Telecommunications Act was passed in the *Bundestag* (German Federal Diet) and in the *Bundesrat* (German Federal Council). The Act now provides for considerable substantive changes to the

previous regulatory framework, which, in the Monopolies Commission's view far exceed what is required under European law. Numerous new provisions and loosely defined legal terms undermine the reliability of the regulatory framework just as much as the extension of the decision-making competences and discretionary powers of the RegTP. The new Telecommunications Act will burden the telecommunications sector with considerable adjustment costs.

47.* A fundamental problem involves the definition of the markets to be regulated both in terms of objective criteria and in terms of the allocation of competencies between the European Commission and the regulating authority in market definition. The Telecommunications Act rightly authorizes the RegTP to deviate from the Commission's recommendation on market definition due to special features in the competition situation in the national market. The Monopolies Commission welcomes the fact that the markets to be regulated are now to be examined according to the same criteria as applied by the European Commission. Conflict with the Commission is also avoided in that with the ban on discrimination and the possibility of imposing transparency obligations the legislator provides the RegTP with additional regulatory instruments which are stipulated under European law.

48.* The access regulation poses serious risks to competition. Problematic are firstly the RegTP's discretionary powers on whether obligations to provide access are to be imposed at all and secondly, that regulatory decisions on obligations to provide access are based on subjective criteria which are either not or only to a limited extent subject to judicial review. The Monopolies Commission regrets that the Telecommunications Act is postponing the introduction of the resale of subscriber lines without call services (unbundled connection resale) for four years, to 1 July 2008 expecting a further delay in the intensification of competition in subscriber lines.

49.* Generally, the preventive regulation of fees for essential access services remains unaffected. However, fees for advance services are exempt from an ex-ante regulation, inter alia if the provider does not at the same time have significant market power in the market for services to the end customer. By this means the legislator aims to exclude operators of mobile telephone networks and alternative subscriber networks from an ex-ante regulation. i.e. termination fees. Instead, they are to subject to abuse control. The Monopolies Commission rejects this approach because subscriber network operators are a priori monopolists with regard to termination services in their own networks. It is doubtful whether this provision is compatible with European law. The Monopolies Commission welcomes the fact that the Telecommunications Act leaves open the possibility of a preventive regulation of fees for services to end customers. It is problematic that the regulator is to restrict the requirement of approval for fees to end customers to markets where the creation of a "sustainable competition-oriented market" is unlikely in the foreseeable future. Again this criterion for the imposition of obligations is inappropriate because it is not or only to a limited extent subject to judicial review.

The clarification on the costs of efficient service provision as a standard for the regulation of prices and the use of cost models in the approval procedure are to be welcomed. However, it is problematic that the RegTP can also approve prices according to the comparative market principle. The criteria which the RegTP has to consider in setting the "appropriate rate of return for the capital used" are vague. Their significance for determining the appropriate rate of return on capital is not stated in precise detail. This leads to legal uncertainty, which can altogether weaken the effectiveness of an access regulation.

50.* The Monopolies Commission also criticises the fact that the price cap procedure omits any form of cost examination both in terms of the amount of costs of efficient service provision and in terms of abuse control measures. The course of action pursued by the new law is downright grotesque when the provisions on the regulations of fees stipulate a consistency requirement in Section 25 (2) TKG,

prohibit abusive fees in Section 26 (1), at the same time indicate a cost-price squeeze as fulfilling a presumption requirement for abusive predatory practices in Section 26 (2) and finally – in Section 33 (2) Sentence 2 – regard the conditions of Section 26 “as fulfilled” if a fee is set according to the rules for the price-cap procedure. The cost-price squeeze between fees for end customers for analog connections and the rental for subscriber lines for competitors, which has so drastically held back competition in subscriber lines in recent years, would be completely covered by Section 33 of the new law. The new law ignores the fact that the price-cap procedure only provides ceilings for prices and thus is suitable only as a measure against excessively high prices and not against predatory price cutting.

51.* The Monopolies Commission opposes the tendency of the law to increase political influence on the regulatory authority and on fundamental regulatory decisions. This applies both to the possibility of the Economics Ministry issuing individual instructions to the regulatory authority and the transfer of competencies to the so-called President’s Chamber. The Monopolies Commission recommends that the personal independence of the President and the Vice Presidents be improved by changing their statutory position and extending their terms of office. Additional political influence is likely to follow from the extension of the participation rights of the Advisory Council. Under the new law it advises the RegTP in particular in “fundamental market-relevant decisions”. It is to be assumed that in particular the Federal Länder will try to use the additional participation rights to establish a counterweight to the right of the Federal Government to issue instructions to the RegTP. The Monopolies Commission opposes this development. From a legal point of view it is questionable whether such a participation right is compatible with the independence of the regulatory authority required under European law.

52.* In identically worded resolutions the German Federal Diet and the German Federal Council have advocated postponing a change of jurisdiction from the administrative courts to the civil courts for five years. In the view of the Monopolies Commission such a long interim period is only acceptable if the Cartel Division of the *Bundesgerichtshof* (Federal Supreme Court) is designated as the direct court of appeal. It is apparent that in the coming years the courts will play a key role in interpreting the law in view of the wide range of new, often unspecific regulations and legal terms. At least the appeal process should not be left to a court whose competence is to expire in the foreseeable future and for which the development of the necessary judicial expertise would not be worthwhile. The only trial court in the interim period is the *Verwaltungsgericht Köln* (Cologne Administrative Court). As the Cologne Administrative Court has substantial expertise in the particularly complex field of telecommunications law it would be useful if some experienced judges at this court were transferred or delegated to the *Oberlandesgericht Düsseldorf* (Düsseldorf Court of Appeal) in the case of a change of jurisdiction. The Federal Government should also consider significantly reducing the interim period of five years stipulated by the Federal Diet and the Federal Council.

- **Regulation of the postal markets**

53.* The extensive exclusive licence of Deutsche Post AG substantially restricts the volume of the liberalised markets. Competitors of Deutsche Post AG play merely a secondary role. In the Monopolies Commission’s view the monopoly held by Deutsche Post is not adequately regulated. Undiminished high profits from its letter services bear witness to this. Furthermore, Deutsche Post’s strategy of legal action against competitors is causing legal uncertainty. This situation has been improved by a recent decision of the *Oberverwaltungsgericht Münster* (Münster Higher Administrative Court). According to this decision overnight and time-certain delivery are to be categorised as higher value services. As regards preparatory postal services the Postal Act (Postgesetz – PostG) stands in contradiction to the European legal framework. This area should be liberalised. This view is also shared by the European Commission, which has called upon the German Federal Government to

amend the Postal Act accordingly. In the meantime, the Economics Ministry has reacted to this letter promising that it will liberalise preparatory postal services in the amendment of the Postal Act. Furthermore it should be noted that Deutsche Post AG is trying to hinder competition by two trademark proceedings. In the first case, the registration of the date stamp as a trademark has been deleted as contrary to public policy. The second case involves the brand name “Post” (German for “Mail”). In the Monopolies Commission’s view this registration by Deutsche Post AG is also unjustified and should thus be deleted.

- **Competition in the waste management and recycling sector**

54.* The Monopolies Commission has spoken out in favour of the introduction of more competition in the waste management and recycling sector. As regards the *Verpackungsverordnung* (Packaging Regulation) this means firstly, decoupling licence fees from the use of the “Green Dot” sign, secondly, the non-discriminatory awarding of service contracts and guarantee agreements. Thirdly Dual System’s (Duales System Deutschland – DSD) competitors must be allowed to co-utilise the collection and sorting facilities of the disposal companies commissioned by DSD. By now, these demands on DSD have to a large extent been realized. The Monopolies Commission welcomes this development as well as the slowly arising competition with other dual systems. The Commission views as critical the initial invitation to tender for service contracts, which has ensued in a substantial number of uneconomical offers. New invitations to tender will follow this year. The Monopolies Commission advocates that there should be no re-municipalisation of service contracts. DSD should be able to negotiate personally with the disposal companies in respect of PCC sales packaging. As regards a reform of the Packaging Regulation in the Monopolies Commission’s view the first consideration should be to relax the obligation for DSD to offer nationwide services. In competition policy terms the British licence model may be an attractive alternative to the existing system.

55.* In the municipal waste disposal sector the Monopolies Commission called for a continuation of the liberalisation process. The disposal of commercial waste should be exposed entirely to competition without further delay. Next, the domestic waste sector should be liberalised either by inviting to tender for regional concessions, i.e. competition for the market, or by competition within the market. In addition the Monopolies Commission calls for a reform of the recycling concept under European law. In this context it supports the proposals of the Environment Council for a less restrictive interpretation of the recycling concept in the Recycling and Waste Management Act in adaptation to European Law and at the same time for establishing new (primarily case group related) provisions to guarantee that recycling is given priority if it is really of ecological advantage. Without such a reform it is likely, going from current developments, that restrictions to the free movement of goods will increase in cases where environmental policy interests are intermingled with the interests of national waste disposal companies.

- **Amendment of the GWB (Act against Restraints of Competition)**

56.* In December 2003 the Federal Ministry of Economics and Labour submitted a Ministerial Draft for the Seventh Amendment to the Act against Restraints of Competition. On 26 May 2004 the Cabinet passed the Government Draft. One aim of the amendment is to adapt German competition rules to the amended provisions governing European competition law. At the same time the legislator plans wide-sweeping changes to newspaper merger control.

57.* With its special report no. 41 the Monopolies Commission commented on the changes to general competition law as envisaged in the Ministerial Draft. With reservation it agreed to the introduction of a directly applicable exception system.

Such a system would lead to less control by the competition authorities. Thus, the Monopolies Commission stated that to ensure efficient competition control it was of fundamental importance that private enforcement be strengthened and the powers of the authorities adapted and extended accordingly. The Monopolies Commission suggests to enlarge the group of claimants and to endow consumers and consumer associations with an extensive right of action. In its opinion it is essential to ease the burden of proof for private claimants. To effectively deter cartel offenders a provision should be adopted into law allowing the rightful claimants to demand double damages. As regards the powers of the authorities, provisions on administrative fines should be more severe. Also, extensive duties to render official assistance to other national competition authorities and the European Commission should be introduced into the law.

58.* The Government Draft leaves the basic features of the previous Ministerial Draft unchanged. In so far the recommendations of the Monopolies Commission still apply. There have been individual modifications, especially to the rules on private prosecution and administrative fines. In Section 33 the Government Draft reintroduces the protective law requirement in the case of private claims. The Monopolies Commission, on the other hand, still advocates abandoning this requirement in order to eliminate uncertainties about the right of action and to simplify appeals. In the Monopolies Commission's view the plan to bind German civil courts to the decisions of national competition authorities and the European Commission is an appropriate step because it makes it much easier for the private claimant to prove a violation of cartel law. However this binding effect must have a wider application than encouraged in the provision, i.e. not just in the case of claims for damages but also in claims to a forbearance, against enrichment and the contractual entitlement to benefits. A rule of recognition should be elaborated with respect to the decisions of foreign authorities and court rulings. In addition a provision should be introduced into the law according to which the alleged cartel members are obliged to present facts to the courts which fall within their sphere of activities. With a view to legal certainty an explicit rule for the assessment of damages should be introduced into the law prohibiting a passing on defence and regulating the right of action of downstream contract partners.

59.* As regards the "skimming off" of excess profits by the competition authorities under Section 34 of the Government Draft the fault requirement should be cancelled as foreseen in the Ministerial Draft. Competence for the prosecution of administrative offences is, also according to the Ministerial Draft, to be concentrated with the competition authorities because they are specialized in competition law and in comparison to public prosecutors have a particular proximity to the facts of the cases. Well-developed cooperation between national competition authorities and the European Commission is particularly important for an efficient prosecution of cross-border restraints of competition. Therefore it is necessary to oblige German competition authorities to provide comprehensive official assistance.

60.* In respect of merger control in general the Monopolies Commission vehemently rejects the planned restriction of temporary injunctions because otherwise third party rights in merger control would in fact be paralysed.

61.* In its special report no. 42 the Monopolies Commission dealt with the proposals in the Ministerial Draft on merger control in the press. In principle, under German competition law the same rules apply to mergers involving press companies as to other mergers, in particular the same substantive test (market dominance). However the scope of merger control is more broadly applied in the press sector.

62.* The Ministerial Draft proposed a change to the previous legal position in two aspects. Firstly the extended scope of merger control to press companies was to be reduced by raising the thresholds for taking up merger cases. Secondly, an exemption clause was to be introduced for press concentrations which fall under merger control. Accordingly mergers leading to the creation or strengthening of a

dominant position were to be cleared if certain arrangements had been taken before the merger took effect. These arrangements were to safeguard that the newspapers or magazines acquired were sustained in the long-term as independent media units, and that the purchaser would be unable to substantially determine the journalistic orientation of the newspapers or magazines acquired. There would have been a presumption, that such arrangements had been made, if an independent third party would acquire more than a 25 per cent share in the company and would be entitled to a co-determination right in fundamental decisions. The necessary arrangements would have to have been ensured through conditions and obligations. For these conditions and obligations the existing prohibition of permanent conduct control would have been lifted.

63.* In its special report the Monopolies Commission took the view that the plan in the Ministerial Draft to raise the criteria thresholds for taking up merger cases is still acceptable from a competition policy point of view. However it opposed raising the thresholds any further. Moreover the Monopolies Commission spoke out vehemently against the planned introduction of an exemption for newspaper mergers as envisaged in the Ministerial Draft. Already its basic concept of replacing diversity through competition by internal corporate diversity was inappropriate. Such a move would have jeopardized rather than ensured journalistic diversity. The Monopolies Commission also had serious misgivings about the specific model of ensuring diversity proposed in the Ministerial Draft. The suggested private law “arrangements” were not suited to prevent an editorial thinning-out of the newspaper acquired if the purchaser and minority shareholders were in agreement with one another. In addition the possibility of an unconstitutional control of press content by the Federal Cartel Office could not be ruled out. Irrespective of its fundamental misgivings against the proposed regulation it was beyond the comprehension of the Monopolies Commission why the draft did not contain any precautions to protect the journalistic independence of the newspapers already owned by the purchaser, why the area of application of the exception was not limited to financially weak newspapers and why the exemption also applied to the magazine market. The Monopolies Commission came to the conclusion that the introduction of the exemption proposed in the Ministerial Draft would have led to considerable concentration in the press, a thinning-out of journalistic diversity and a significant fall in job opportunities for journalists. It also saw grave consequences for the professional independence of the Federal Cartel Office. Furthermore the Monopolies Commission fundamentally opposed special measures aimed to stop structural change in individual sectors. The introduction of special competition rules for press companies would ultimately whet the appetite of other sectors for exemptions and so jeopardize the overall validity and acceptance of competition law. However it suggested that the treatment of advertising over the internet as a separate market be constantly revised and called for a broader interpretation of the requirements for a failing company defense. Yet the companies concerned could not be exempted from proving the necessity for the rescue of a newspaper or magazine.

64.* In the Government Draft on the Seventh Amendment to the Act against Restraints of Competition the proposals for the press sector have been revised. Firstly, unchanged from the Ministerial Draft, the extended application of merger control to press companies is to be reduced by raising the criteria thresholds for taking up merger cases. Secondly a revised version of the exception is envisaged. Thirdly, cooperations between newspaper publishers as regards advertising are to be fully exempted from the prohibition of cartels.

65.* The Monopolies Commission welcomes the fact that the revised exemption is limited to newspapers and its application is now made conditional upon a test of necessity. However, it is to be criticized that the necessity for a rescue operation is to be assumed if there was a decline in proceeds from advertising and inserts over the last three years or these fell considerably below the average proceeds of comparable newspapers. These presumption criteria are not a suitable way to

identify failing newspapers because they focus only on the proceeds from advertising and inserts and not on economic profits.

66.* The revised provisions for the protection of media diversity after a newspaper merger are not appropriate to protect the newspapers concerned from the thinning-out of editorial content. The co-determination or veto right of the minority shareholder, even on the question of closing the purchaser's newspapers, is such a powerful restriction of entrepreneurial freedom in decision-making that the exception will only find application if the purchaser can be assured that the minority shareholder will not actually act independently. In addition, the discontinuation of one of the newspapers is possible at any time, so long as the minority shareholder is in agreement. Moreover the limited control exercised by the Federal Cartel Office remains a constant control of conduct, even if this is not clearly stated in the Government Draft. To sum up, the Government Draft is abandoning the principle of competition in the newspaper sector without being able to ensure journalistic diversity.

67.* The envisaged abuse clause which prohibits the use of the exemption clause if its application, repeated in close sequence, leads to the creation or strengthening of dominant positions of the same companies on regionally neighbouring markets, will be unable to prevent and at best only slow down the formation of regional newspaper chains. Moreover, the criterion of "repeated application in close sequence" is totally vague. It is not clearly stated after which amount of time a new merger is permissible. Clear rules are indispensable, especially in such a sensitive area as the press. It would be extremely problematic if a politically acceptable publishing group was granted a short waiting period whereas others had to wait longer.

68.* A new element which does not appear in the Ministerial Draft is the unconditioned legalisation of agreements between newspaper publishers about cooperation in advertising. The Monopolies Commission considers this provision as equally problematic as the facilitation of mergers by means of the exemption clause. The aim of the cooperation agreements envisaged in the Government Draft is to restrict price and quality competition in the advertising market rather than to cut costs. These advertising cartels will lead to higher advertising prices, to the detriment of small and medium-sized companies in particular. The aim of the Government Draft is obviously to maintain the diversity and quality of the existing supply of journalistic content by enabling the economic exploitation of advertising customers. This type of "deal" which grants monopoly profits, anticipating a "quid pro quo" by newspaper companies is extremely problematic for the economic order since it fundamentally undermines the competition order as the legitimization of economic activity. It is also extremely doubtful whether increased profits will really be used to rescue newspapers whose existence is at risk. It can be assumed that most of the advertising cooperations will be concluded between economically successful newspapers. In the case of a financially stricken newspaper it will be much more interesting for competitors to take it over by taking advantage of the exemption rule. It is also to be expected that a cooperation in the advertising market will reduce the intensity of competition in the reader market as well. The result will be that readers, too, have to pay higher prices for less quality.

69.* To sum up, the Monopolies Commission recommends that both the revised exemption clause and the clearance of advertising cooperations be rejected. Raising the thresholds for taking up merger cases, however, as already elaborated in the special report, is acceptable in competition policy terms.

● **Current Ministerial Authorisation procedure issues**

70.* In a special report required under Section 42 Paragraph 4 Sentence 2 GWB on the Ministerial Authorisation case involving E.ON's application for clearance of

its intended acquisition of a majority shareholding in Ruhrgas, a majority of the Monopolies Commission argued against authorisation. In his decision of 5 July 2002, the Federal Minister of Economics authorised the envisaged merger subject to certain obligations. On the basis of third-party action, the *Oberlandesgericht* (Court of Appeal) in Düsseldorf expressed concerns about the decision and suspended the implementation of the merger. In his second Ministerial Authorisation, the Federal Minister of Economics slightly modified the obligations and once again authorised the merger. The Monopolies Commission had previously analysed the new aspects in a supplementary special report and confirmed the view expressed in its first special report on the case, i.e. that the Ministerial Authorisation applied for should not be issued, even subject to obligations.

In January 2003, the plaintiffs of the third-party action reached agreement with the merging parties in an out-of-court settlement after receiving substantial economic concessions from E.ON as compensation.

71.* The Monopolies Commission also prepared a special report in a second Ministerial Authorisation case. It advised the Federal Minister of Economics not to authorise the planned concentration of Holtzbrinck/Berliner Verlag involving the acquisition of the *Tagesspiegel* newspaper. Following the hearing at the Federal Ministry of Economics, the Minister called upon the applicants to substantiate their claim that the *Tagesspiegel* was not for sale in a neutral procedure “usual in the market” to be carried out by a third party. In the main proceedings, the evaluation of this process was the subject of the Monopolies Commission’s second special report on this Ministerial Authorisation case. The Commission upheld its recommendation that the concentration applied for should be rejected and not granted even subject to obligations, which it had substantiated in its previous report.

72.* In November 2003, Holtzbrinck Verlag sold off its share in the *Tagesspiegel* to its former manager, Pierre Gerckens, following the withdrawal of its application for Ministerial Authorisation. The merger was prohibited once again because, in the view of the Federal Cartel Office, the *Tagesspiegel* is still to be considered as belonging to the Holtzbrinck Group even after its acquisition by Mr Gerckens. The Monopolies Commission shares this view. It also attaches great importance to the fact that if the *Tagesspiegel* were to be sold to a third party again, the Holtzbrinck Group would be entitled to receive 50% of any proceeds of that sale. As a result of this clause, the Holtzbrinck Group, as the owner of the Berliner Verlag, would have significantly less interest in competing with the *Tagesspiegel* in its traditional West Berlin markets, even if it did not retain direct economic control over the *Tagesspiegel*.

73.* In the Holtzbrinck/Berliner Verlag Ministerial Authorisation case, there is a discrepancy between the applicants’ statement and the sale of the *Tagesspiegel* to Mr Gerckens. According to the original statement, the *Tagesspiegel* was making considerable losses and could only survive in combination with the Berliner Verlag. In the sales procedure organised by Sal. Oppenheim, bidders were rejected because they were not willing or able to bear the *Tagesspiegel*’s losses over an extended period and thus could not sufficiently guarantee that operations would continue at present levels. After the sale to Mr Gerckens, the *Tagesspiegel*’s losses were no longer an issue.

The inconsistency of the applicants’ statements in the Holtzbrinck/Berliner Verlag Ministerial Authorisation case raises serious concern about the way in which the statutory procedure is used. If Mr Gerckens is able to run the *Tagesspiegel* as an independent company in spite of its long-term losses, then the applicants pursued a case for nine months on the basis of a statement that was factually incorrect, at considerable public expense, only to realise from one day to the next that the opposite was the case. Such conduct can hardly be called anything but “abusive”.

74.* In both Ministerial Authorisation cases, the question arose as to the permissibility of obligations. The Court of Appeal in Düsseldorf held in December 2002 that there were well-founded doubts as to the legality of the obligations imposed by the Federal Minister of Economics in the E.ON/Ruhrgas case. The Court considered divestiture obligations to be permissible, but not obligations to remove market barriers or regulate sales, or organisational obligations, or controls on investment by the companies involved in the merger.

75.* In a legal opinion commissioned by the Monopolies Commission, it is argued that in assessing the legal limits of the content of obligations not only the ban on subjecting companies to continued control, but also other merger control principles and rules, such as general administrative law, should be taken into account. This means that measures directed at the market structure which are to be carried out and monitored *uno actu*, such as sales obligations, are permitted. What is problematic, however, are obligations intended to limit a company's influence or to open up the market to competitors. Organisational obligations and obligations which restrict a companies' influence on its subsidiaries are certainly impermissible if the ownership of equity remains unchanged.

76.* On a number of past occasions, the Monopolies Commission has complained that the Federal Cartel Office and the Federal Minister of Economics had taken clearance decisions involving obligations amounting to continued long-term monitoring of enterprises' conduct. Therefore, it proposes the adoption of a presumption provision in the Act Against Restraints of Competition aimed at limiting conduct-related obligations:

“In case of doubt, long-term monitoring of conduct shall be deemed to exist if the conditions or obligations have as their subject actions to be taken more than two years after the decision of the Federal Cartel Office has come into force.”

77.* The envisaged lifting of the ban on conduct-related obligations in the planned amendment on press mergers has been deleted in the meantime. Yet, the safeguards specified in Section 36 Paragraph 1a of the draft amendment to the Act Against Restraints of Competition within the meaning of the presumed situation do fall under the category of measures for limiting a company's influence, compliance with which would have to be monitored by the Federal Cartel Office on an ongoing basis.

78.* The withdrawal of the appeals by parties to the proceedings in the E.ON/Ruhrgas case led to ongoing discussions on the legal protection of third parties in antitrust proceedings. In particular, “paying off” third-party appellants, and the fear that third-party claims could be lodged with the abusive purpose of blocking projects, thereby hindering investment, have led to an amendment being proposed in the draft of the Seventh Amendment to the Act Against Restraints of Competition. According to the draft, an appeal against a merger clearance decision can only have a suspensive effect if the plaintiff can claim that his rights were infringed as a result of the authorisation being granted.

The Monopolies Commission has opposed this proposal, because in its view, it would undermine the entire protection of third-party rights. Should the bill be passed nevertheless, additional safeguards should be set up to protect third parties. These would include the introduction of class action, which should be allowed not to be based on a claim that a subjective right is being infringed. If need be, it would be conceivable to establish a right for consumer protection organisations to receive a third-party summons to attend proceedings. This provision would also resolve the problem of “paying off” third-party appellants.

79.* The Holtzbrinck/Berliner Verlag case in particular highlighted that the Federal Ministry of Economics does not have the specialist capabilities to assess fully and conclusively the situation presented in individual cases. The Monopolies

Commission therefore sees a need to require claimants to fulfil their obligation to present the facts of the case, without having an opportunity to later rectify them during the proceedings themselves, and to place higher demands on their evidence; even slight doubts would justify giving priority to the goal of preserving competitive market structures at the expense of the planned concentration.

Providing facts and arguments of key importance to the decision at a later stage leads to problems when taking a Ministerial Authorisation decision. The Monopolies Commission recommends that only information known at the time of the ministerial hearing should be taken into account when making the decision.

80.* The most recent Ministerial Authorisation cases also pose fundamental questions about the nature of this instrument. In the E.ON/Ruhrgas case, the concept of security of supply was presented as a public-interest concern without there being any direct connection with either of the merging parties. In the Holtzbrinck/Berliner Verlag case, on the other hand, the public-interest concern was closely linked with the existence of the *Tagesspiegel* as an independent newspaper. In an attempt to base a kind of guarantee of a single company's livelihood on the abstract notion of press diversity, claim was laid to privileges inconsistent with a performance-based free market economy. It is thus questionable whether the instrument of the Ministerial Authorisation is appropriate in the Holtzbrinck/Berliner Verlag case at all.

● **Amendment of the Handwerksordnung (Crafts Code)**

81.* Two laws were adopted at the end of 2003 to reform the law on the craft sector. The key elements of the new rules are as follows:

- they reduce the number of crafts requiring a Master Craftsman's Certificate from 94 to 41 (Annex A of the Crafts Code);
- they facilitate market entry by former apprentices to crafts which are subject to registration (Section 7b of the Crafts Code);
- they abandon the principle that craft firms must be owner-run (Section 7 Paragraph 1 of the Crafts Code);
- they facilitate market entry to the craft sector by engineers, university graduates and state-certified technicians (Section 7 Paragraph 2 of the Crafts Code);
- they make it easier for citizens of other EU countries to furnish proof of their qualifications (Section 9 Paragraph 2 of the Crafts Code);
- they allow graduated exemption from contributions to Chambers of Crafts for new entrepreneurs (Section 113 Paragraph 2 of the Crafts Code);
- they make it easier for simple craft activities to be performed on a self-employed basis (Section 1 Paragraph 2 of the Crafts Code).

82.* The reasons given for the bill state that the amendment's aim is to overcome the structural crisis in the craft trades. The *Bundesverfassungsgericht* (Federal Constitutional Court) considered the original purpose of the law, with its "interest in maintaining and promoting the health and efficiency of craftsmen's trades as a whole" to be a particularly important public interest, and, in its landmark decision in 1961, considered the limitation of the free choice of profession the Crafts Code involves to be compatible with the constitution. In the present draft the only reasons mentioned for restricting access to a craft trade relate to "hazardous" trades and the provision of vocational training. Thus, the principles for assessing the constitutional permissibility of the Craft Code that were decisive in the Federal Constitutional Court's landmark ruling of 1961 no longer apply.

83.* The Monopolies Commission continues to hold that the hazardousness of craft trades is not a cogent reason for regulating market entry. A special additional qualification for former apprentices in hazardous craft trades does not seem to be necessary. If the current law on liability is thought to be inadequate, an obligation to take part in regular specific basic and further training on hazards would be more useful than a Master Craftsman's Certificate, which has to be passed just once. The requirements to be fulfilled to obtain a Master Craftsman's Certificate are also not justified with regard to the provision of vocational training.

84.* In the view of the Monopolies Commission, the negative definition of "essential activities" as a criterion for setting up one's own business in a craft sector trade without a Master Craftsman's Certificate, which reflects only existing case law, fails to clarify the legal situation. The vagueness of the legal terms makes it difficult or impossible for a self-employed craftsman to judge in individual cases whether it is lawful for him to perform work without a Master Craftsman's Certificate in a craft that is subject to authorisation. In its ruling of 7 April 2003, the Federal Constitutional Court upheld a tradesman's claim for clarification of questions of doubt as to the legal permissibility of his activity. In this context, the Court emphasised the right to effective legal protection, as the individual concerned could not be expected "to have to clarify questions of doubt regarding administrative law as a criminal defendant."

Following a poll, the *Bundesverband unabhängiger Handwerkerinnen und Handwerker* (Federal Association of Independent Craftswomen and Craftsmen) established that neither the competent Federal or Land Ministries nor the competent regulatory authorities were able to provide any useful information for compiling a list of "essential activities" for which a self-employed person was required to have a Master Craftsman's Certificate.

85.* The Monopolies Commission sees the 2004 amendment to the Crafts Code as an important step towards a further liberalisation of the craft sector, albeit not a final one. 90% of firms are not affected by the removal of 53 of the 94 crafts previously on the list of crafts requiring the craftsman to have a Master Craftsman's Certificate.

Changing the purpose of the law reopens the question of the constitutional implications and permissibility of restricting access to craft sector professions. In the view of the Monopolies Commission, neither hazardousness nor the provision of vocational training justifies restricting market entry.

There is certain risk that the new regulations to ease the requirement for a Master Craftsman's Certificate may not be effectively enforced due to conflicts of interests. In general, it is the Chambers of Crafts that decide which activities require a Master Craftsman's Certificate and which do not. While they do have the necessary expertise, the Chambers do not have the neutrality the issue requires on account of their statutory task of representing their members' interests; this is at the expense of potential new entrepreneurs. Making it easier for former apprentices to run their own business is thus only to be welcomed because it dismantles discrimination of German citizens, for which there continues to be no factual justification in the crafts listed in Annex A of the Crafts Code, compared to other EU citizens. The Monopolies Commission holds that equal treatment for both groups on the conditions under which other EU citizens are allowed to work as self-employed craftsmen in Germany would have been the right approach for the legislator to take. This is all the more the case since the problem of domestic discrimination within Germany will become an increasingly heated issue in the wake of the European Union's eastern enlargement. The provision for former apprentices depends on them proving that they have previously been engaged in self-employed activity. If this proof has to be provided in the form of confirmation by their former employers, this would mean that the former employer would be taking a decision on a possible future competitor in the same sector and possibly the same region. In the view of the Monopolies Commission, the vague legal term "managerial activity" should be

specified by means of objectively verifiable criteria, and their application should not be left to the master craftsman or the craft organisation.

86.* The Monopolies Commission continues to advocate the complete abolition of the requirement for a Master Craftsman's Certificate as a condition for market entry to craft sector trades. In the past, it has already pointed out that the situation in the craft sector has no special economic status and thus also does not justify any legal exceptions under the Trade Regulation Code. That remains true in the context of today's changed statutory conditions, albeit in a smaller number of craft areas. Other countries' experience, but also a comparison of crafts that require a Master Craftsman's Certificate in Germany with crafts that do not, make the reasons for upholding this regulation seem ill-founded. The introduction of a Master Craftsman's Certificate on a voluntary basis in crafts where this qualification is not compulsory meets the need to send a signal of quality to the public and to the competition within the craft sector and therefore represents a significant improvement in the legal framework conditions for crafts, in line with the Monopolies Commission's past recommendations. The expectation on the part of the parliamentary parties supporting the government that the amendment will make the laws governing the craft sector "fit to meet the challenges of the future, with secure future prospects, and fit for Europe" could be fulfilled all the better if there was more liberalisation and the regulation requiring craftsmen to have a Master Craftsman's Certificate was completely abandoned.

● **A new substantive test in merger control?**

87.* The new EC Merger Regulation (ECMR), which came into force on 1 May 2004, contains, among other things, a new substantive test. Whereas under the previous regime, the European Commission was obliged to prohibit a merger that would have "created or strengthened a dominant position", the new criterion for prohibiting a merger is that it "significantly impedes effective competition" (referred to as the SIEC test). Market dominance continues to be mentioned as an example of a significant impediment to effective competition, however. Another amendment is to be found in the ECMR's recitals. They will enable a merger to go ahead in future if efficiencies at least counteract the proposed concentration's adverse effect on competition.

88.* In order to make an adequate assessment of the new prohibition criterion it is necessary to take other, related reforms into consideration. These reforms are part of a "more economic approach", by means of which the Commission is attempting to base its competition policy more strongly on explicitly economic reasoning. In the field of merger control, these include in particular the publication of guidelines on assessing horizontal mergers and the appointment of a Chief Economist.

The more economic approach to merger control is motivated firstly by criticism of many economists that official practice to date has often not been based on rigorous economic reasoning, secondly by three cases in which decisions by the Commission to prohibit mergers were overturned by the Court of First Instance. In these cases, the Commission's line of argument concerning competition was subjected to criticism, some of it harsh.

The more economic approach is particularly evident in the guidelines on horizontal mergers which have meanwhile been published. In the guidelines, the Commission presents a number of traditional models based on monopoly and oligopoly theory. As far as anticompetitive effects are concerned, the focus is not on the legal distinction between individual and collective dominance, but rather on the economic distinction between unilateral and coordinated effects.

89.* While the introduction of a more economic approach does not depend on a change in the test applied for assessing mergers, the question arose as to whether

there was a “gap” in the market dominance test because it did not include all economically relevant effects on competition. The discussion related mainly to unilateral effects in oligopoly and focused in particular on the example of the Airtours case. The Commission had prohibited the merger between the British travel agencies Airtours and First Choice because it was afraid that it would lead to the creation of a collective dominant position. The Court of First Instance overturned this decision, since in its view the Commission had failed to prove that the merger led to a collective dominant position. In the text of the decision, the Court only referred to the conditions which must be met in order for there to be a finding of coordinated effects. However, some observers were of the opinion that unilateral effects should also have been examined in the Airtours case. After the decision, however, it was unclear whether these effects can be fully covered by the concept of dominance.

However, the Airtours decision had at best highlighted the danger of a gap in the market dominance test. Nevertheless, it was decided to change the substantive test in order to ensure legal clarity on unilateral effects.

90.* The Monopolies Commission welcomes the intention to base European merger control to a greater extent on economic reasoning. It also welcomes the fact that for reasons of legal security, the term market dominance will be retained as an example of a significant impediment to competition. It rejects interpretations that see the market dominance test simply as a presumptive example that can be rebutted: On the contrary, if a dominant position is created or strengthened, competition will always be significantly impeded. It should be examined separately whether efficiencies are created and passed on to consumers.

91.* In principle the Monopolies Commission considers it to be desirable for German merger control, too, to focus more strongly on economic analysis. This does not necessarily mean departing from the dominance test that has been applied in Germany to date. Furthermore, the introduction of a more economic approach would also involve certain practical problems. In particular, the question arises as to how the courts would handle economic arguments and evidence. In addition, the open and partly ambiguous formulation of the SIEC test could be susceptible to considerations motivated by industrial policy.

92.* The Monopolies Commission therefore strongly advises against introducing the SIEC test into German law in the current Seventh Amendment to the Act Against Restraints of Competition. The wish to harmonise German and European law cannot in itself justify such an amendment. There are no legal or practical aspects requiring immediate harmonisation. Precisely because the SIEC test would only make sense in conjunction with the introduction of a more economic approach, the decision on it should not be taken before a thorough discussion has taken place. If a decision should then be taken in favour of the new merger prohibition criterion, all parties concerned would have time to prepare for the new merger control policy.

93.* However, the Monopolies Commission does consider it to be desirable for the Federal Cartel Office to strengthen and institutionalise its economic competence by now. In the view of the Monopolies Commission, this could best be done by setting up an economics division. This may require the Federal Cartel Office to take on more staff.

94.* Shortly before this Biennial Report went to print, the Federal Ministry of Economics and Labour dispatched a consultative document advocating the adoption of the SIEC test in German merger control. It seems likely that thought is being given to reforming the substantive test already in the Seventh Amendment to the Act Against Restraints of Competition. The Monopolies Commission cannot understand why such a proposal is introduced at this moment, as the essential information on the new European substantive test has been known since the beginning of this year. In the view of the Monopolies Commission, it would be extremely problematical if a decision on a question of such central importance to competition policy as that of the

substantive test for mergers were to be taken in a “fast-track procedure” and without a thorough debate. It therefore appeals to the legislative bodies to postpone the consultations on adopting the SIEC test in the Act Against Restraints of Competition until after the Seventh Amendment to the Act Against Restraints of Competition has been adopted.

● **Progress in developing concentration statistics**

95.* Since the late eighties, the Monopolies Commission has been pressing for enterprises to be recorded in the official economic statistics as economic decision-making units, not just as legal units. The European Union has for a long time been pursuing the aim of recording enterprises that consist of a number of legally-independent units and enterprise groups, particularly conglomerates¹, in order to keep track of competition and concentration in the Common Market. The regulations passed to this end by the European Council back in 1993 have not yet been applied by the *Statistisches Bundesamt* (Federal Statistical Office), however.

96.* In 1998, the German legislator provided for the application of European law in official statistics to include supervisory relations between affiliated enterprises in the official business register. This has not yet been done. At the end of 2000, the German Federal Diet also placed the Federal Statistical Office under an obligation in Section 47 Paragraph 1 GWB to take into account enterprise groups within the framework of the Monopolies Commission’s compulsory report on concentration. By mid-2002, the Office had not yet fulfilled this legal requirement either.

97.* Since there was no foreseeable end to this stand-still of the Federal Statistical Office’s activities in this area, the *Statistische Ämter der Länder* (Land Statistical Offices) took the initiative and jointly developed a concept to include enterprise groups in the official processing of concentration statistics for the Monopolies Commission. This concept was successfully applied to the production industry (mining, quarrying and manufacturing – sections C and D of the German Classification of Economic Activities, 1993 edition) in the reporting year 2001. The empirical results in Chapter II of the present report are based on this work.

98.* In a Federation-Land working group consisting of the Federal Statistical Office, five Land Statistical Offices (on behalf of the other Federal Länder) and the Monopolies Commission, a methodological concept has been developed with great commitment and expertise in line with the requirements of the Monopolies Commission’s Fifteenth Biennial Report.

As a result of this process, the official statistics offices identified 17,461 enterprises out of the 38,198 enterprises in the Monopolies Commission’s file on the production industry (with at least 20 persons employed) which belong to enterprise groups, out of a total of 400,000 enterprises belonging to groups contained in the file. Thus, enterprise groups in the production industry in 2001 accounted for

45.7% of the enterprises,

81.8% of the turnover and

73.6% of the number of employed.

¹ The word “conglomerate” has been used throughout the text for the German term “Konzern” under German commercial law. This is to avoid ambiguous overlaps e.g. with the term “group” or “enterprise group”. Under European statistics law, the term “Unternehmensgruppe” (enterprise group) is an umbrella term covering all controlled associations of enterprises, and may include the so-called “Gruppenoberhaupt” (head of group) – i.e. it does not only refer to “Konzerne”.

The *Fachgruppen* (responsible divisions) of the Federal Statistical Office have structured the overall result in accordance with various structural features. The results are presented in Chapter II of this report.

99.* The Monopolies Commission planned to examine the enterprise groups included in the statistics further in order to see to what extent they are to be regarded also as “groups of competitors” within their economic activities. For incomprehensible legal and factual reasons the directorate of the Federal Statistical Office decided to prevent the analysis of the supervisory relations of enterprise groups applied for by the Monopolies Commission as follow-up processing for Federal purposes. Therefore, the Commission was unable to compile Chapter I of the present report. This chapter on the competitive significance of network structures of interlocking capital and enterprise group formation by German enterprises is empirically and methodically fundamental for its work.

An examination of the Monopolies Commission’s application for a structural analysis to be carried out took several months. After that, the Federal Statistical Office decided to carry out this analysis for the Commission itself. The condition was, however, that for the analysis of the approximately 17,000 companies concerned, the Monopolies Commission should give the Federal Statistical Office a licence to access all of the approximately 400,000 individual entries on German enterprises belonging to groups obtained from private data providers. The Monopolies Commission cannot understand this request, based on the argument of the requirement for statistical secrecy, and it can only be described as irrelevant and legally incorrect.

Moreover, forwarding the data would have constituted a breach of the Monopolies Commission’s contractual agreements with its private data providers. The contractual commitments of the Monopolies Commission, as a Federal institution without a legal personality of its own, place an obligation on the Federal Government as a legal unit and all its subordinate agencies. A request by the Federal Statistical Office that the Monopolies Commission breach a contract would thus be tantamount to the Office itself attempting to breach an agreement.

At the same time, the Federal Statistical Office acts in contradiction with the strict demands, subject to sanction, which it – rightly – demands for the protection of its own data. The Federal Statistical Office has not only damaged the confidence of private data providers through its unfounded blockade, but has also violated its obligation to carry out follow-up processing for Federal purposes under the Federal Statistics Act (Bundesstatistikgesetz – BStatG) and has counteracted the expectation of the legislator and of the Federal Government that amending Section 47 Paragraph 1 GWB would result in findings of significance to competition policy.

100.* For future reports by the Monopolies Commission, too, the Federal Statistical Office upholds its demand that the Monopolies Commission should provide it with information on the economy as a whole, even if the report on concentration in enterprise groups only covers specific economic sectors. That means identifying the approximately 400,000 enterprises belonging to an enterprise group out of the approximately 3 million German companies. This holds even if the official statistics authorities were only able to process just 4% of the total data, as in the case of the production industry. The market value of the complete data and their processing is in excess of € 1 million. Such a waste of public funds is untenable. Therefore, it would be impossible to fulfil the statutory mandate of Section 47 GWB to include enterprise groups in the official statistics.

101.* An equally serious matter is that in September 2002 the Federal Statistical Office submitted a report with serious technical shortcomings to the German Federal Diet, shortly before the end of the legislative period. The report could have led to incorrect political conclusions and provides grounds for doubting the Federal Statistical Office’s loyalty towards the Federal Diet. The Federal Statistical Office

gives the impression that the legislator's mandate to summarise data on enterprise groups pursuant to Section 47 Paragraph 1 GWB is technically largely unworkable and causes disproportionately high costs. This is clearly incorrect. Before the report was completed, the Land Statistical Offices had pointed out to the Federal Statistical Office that the procedures it was using were technically inappropriate and ineffective. The data technology concept developed by the Federal Länder, which is significantly more effective and more reasonably priced, forms the basis of Chapter II of the present report.

102.* The question arises as to whether the disputed decision-making process of the Federal Statistical Office could have been prevented by having an effective legal and supervisory authority. In future, it should be ensured that administrative means are not used to prevent the Monopolies Commission's examinations required pursuant to Section 47 Paragraph 1 GWB. In the wake of this experience, it seems that it will be necessary to clarify the legal bases laid down in Section 47 Paragraph 1 GWB, insofar as the shortcomings in the legal application are due to questions relating to the interpretation of statistics law. The Monopolies Commission would share the view of the Federal Ministry of the Interior that the questions in dispute between the Monopolies Commission and the Federal Statistical Office can be settled from the text of the law, as long as the obvious matter is accepted that the Monopolies Commission prepares statistics together with the Federal Statistical Office for Federal purposes (Federal statistics) in accordance with Section 47 GWB, and not for "its own" purposes. This task requires close de facto and legal cooperation between the two agencies and the exchange of the necessary information.

103.* On a number of occasions the Monopolies Commission has aired the need for Section 47 GWB to be amended to clarify the legal situation. It is already irrefutable on account of necessary technical reasons to continue to involve the Land Statistical Offices in the Commission's future work. Following a relevant suggestion by the German Federal Diet, the Monopolies Commission therefore proposes supplementing Section 47 GWB by a new Paragraph 2. The necessary cooperation between the Monopolies Commission, the Federal Statistical Office and the Land Statistical Offices could possibly be organised also on the basis of statutory authorisation of a regulation to be issued by the *Bundesministerium für Wirtschaft und Arbeit* (Federal Ministry of Economics and Labour) in agreement with the *Bundesministerium des Innern* (Federal Ministry of the Interior).

I. The competitive significance of participatory network structures and enterprise group formation

104.* As part of its statutory mandate, the Monopolies Commission planned to analyse and evaluate the findings of concentration statistics calculated by the Federal Statistical Office in order to establish a connection between enterprise group formation and the level of concentration from the point of view of competition policy. This examination was blocked by the directorate of the Federal Statistical Office. Thus, the Monopolies Commission was unable to fulfil this part of its statutory mandate.

II. The degree of economic concentration in the economic sectors and in the production of goods, taking enterprise and supplier groups into account

105.* In the present Biennial Report, the Monopolies Commission has examined the influence of conglomerate and enterprise group formation by enterprises and suppliers on the level of concentration in the economy for the first time. This was

possible since in 2001 the legislator placed the Federal Statistical Office under the obligation in Section 47 Paragraph 1 GWB to use the information provided by the Monopolies Commission on interlocks in the economy in processing concentration statistics for the Monopolies Commission. Including conglomerate and enterprise group formation fulfils long-standing requirements of the European Union and the German Federal Government. In the past the findings of the official concentration statistics were heavily distorted as they were based on a formal definition of an enterprise based on the smallest relevant legal unit rather than on the economically-relevant decision-making unit.

106.* For the reporting year 2001, the Monopolies Commission identified 395,409 conglomerate and affiliated enterprises (including conglomerates and other controlled affiliations) belonging to a total of 121,360 enterprise groups out of a total of approximately 3.31 million German enterprises. Overall, approximately 80 per cent of the enterprise groups consist of up to three companies. There is a wide spread of absolute frequencies, however; 2,310 enterprise groups control between ten and 19 enterprises, 30 enterprise groups control more than 200 enterprises, and ten groups control more than 500 enterprises.

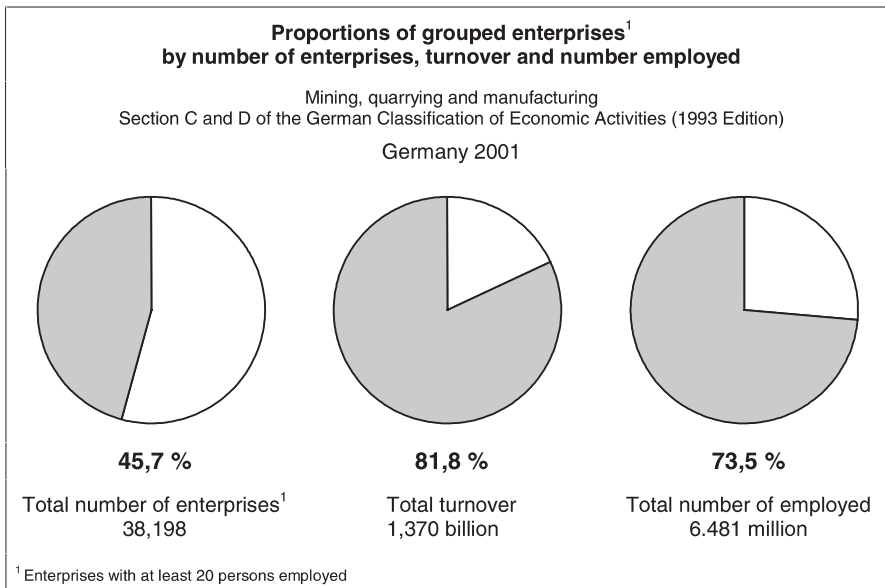
There are 3.31 million German-based enterprises

- of which 40.1% are subsidiaries
 - of which 66.7% are controlled subsidiaries
- of which 28.7% are controlled subsidiaries and enterprises which are the final owner
 - of which 47.4% are enterprises belonging to groups consisting of two or more enterprises

107.* The present Biennial Report is limited to a descriptive, statistical analysis of the influence of group formation on the concentration level within the framework of official statistics. Due to data not being provided, the Monopolies Commission was unable to carry out a study of the key question for competition policy - the extent to which enterprises and suppliers in a group can be regarded as competitive units. This situation is presented in more detail in the introductory section (Section 9.2. of the complete version of the Biennial Report).

For the most part, the study is also limited to the production industry (mining, quarrying and manufacturing – sections C and D of the official German Classification of Economic Activities, 1993 edition), because the Statistical Offices to date have only been able to carry out the necessary processing of the official statistics on enterprises and production in this sector according to enterprise and supplier groups. On the basis of this data, the selected sections C and D of the official German Classification of Economic Activities, covering a total of 38,198 enterprises with at least 20 persons employed, may be structured as follows, as regards the proportion of the enterprises belonging to a group, their turnover and the number of their persons employed.

The large proportion of enterprises belonging to groups in mining, quarrying and manufacturing indicates that group formation is a key principle of the economy's organisational structure. The proportions among suppliers covered by the official production statistics, based on the categories of goods supplied, are comparable. It may be presumed that there are similarly significant proportions in other economic sectors, particularly in the wholesale and retail sector, and in the service sector. Of the approximately 400,000 members of the more than 120,000 enterprise groups in Germany, 25% are to be found in the wholesale and retail sectors, 50% in the service sector.



Methodological bases

108.* The Monopolies Commission uses the term “enterprise group” according to the definitions of the European Union. These are an integral part of a series of decisions by the European Council to create an empirical basis of a European economic and competition policy. The term “enterprise group” is based on the central concept of entrepreneurial control, which in principle includes all permanent possibilities of influencing a unit of a legally independent company. In order to implement a Council Regulation passed in 1993, the German legislator provided for the inclusion of the feature of control in the official business register in the *Statistikregistergesetz* (Statistics Register Act) back in 1998 with a view to identifying enterprise groups. However, to date, this rule has not yet been implemented by Germany’s statistical offices, although it directly applies under European law.

109.* In economic terms, there is a wide spectrum of possible types of control relationship, subject to constant change on account of the dynamics of the economy. At one end of the spectrum is the accounting group. As well as capital interlocking, there are interlocking directorates, special contractual ties in the form of control contracts or profit-transfer agreements and the like, agreements on the management of joint ventures, strategic alliances and partnerships or membership of a cooperation system on the supply side (e.g. purchasing associations) or the sales side (e.g. franchises). In borderline cases, an enterprise is controlled merely by virtue of its practical economic dependencies, for example, if it is part of the sales or purchasing system (e.g. just-in-time-production) of another enterprise as an exclusive supplier or purchaser. The different forms of control relationship may exist on their own or side by side. Thus, in many cases, a long-term investment in the equity capital of an enterprise also reflects corresponding representation on its control bodies or directorate.

110.* There is limited scope for identifying control relationships for empirical purposes and defining them operationally for statistical application. Following lengthy preliminary work in cooperation with the Statistical Offices of the Member States, the Statistical Office of the European Communities (Eurostat) has developed a concept for statistical purposes based on majority investments of equity capital as a sufficient control criterion. This concept is also used by the Monopolies Commission.

The Monopolies Commission defines an enterprise group as being two or more enterprises controlled by a single ultimate owner or head of the group (GH) via one or a number of steps or chains due to its majority interest/ownership of equity capital, whereby this owner is not itself controlled by any other majority shareholders. The ultimate owner belongs to a national enterprise group if it is itself an enterprise and has its headquarters in the country concerned. The same applies to European or international enterprise groups, *mutatis mutandis*. Control relationships based on other circumstances (inter alia control contracts) are included insofar as information on them is available. A detailed account of the legal bases and conceptual relationships is contained in the Monopolies Commission's Fourteenth Biennial Report 2000/2001.

111.* The Monopolies Commission is aware that a control concept that is limited to a majority interest of equity capital is only defensible as a “stylised fact” for statistical purposes. Apart from qualitative features of entrepreneurial control, it has to be taken into account that majority interest does not suffice, and is not necessary for the exercise of control in all cases.

As well as an enterprise's share of equity and share capital, the share of voting rights at annual general meetings and shareholder meetings and the actual presence of the shareholders, including proxies (voting rights of nominee shareholders), cumulative votes, special blocking equity stakes, “golden shares” and the like, have to be taken into account. A controlling influence is even possible with a minority shareholding. This is the case, for example, if besides an equity owner with a considerable share of equity capital below the majority, there is only a significant latent group of small shareholders (widely-dispersed shareholdings). Thus, it would be worth considering to develop a rule based on the structure of capital shareholdings in an enterprise.

Data sources external to and inherent in statistics

112.* The Monopolies Commission obtained the information on enterprise group formation in Germany from generally-accessible, commercially-available data sources on corporate interest. It developed the enterprises' interest networks from the individual data, structured them according to control on the basis of majority shareholdings and deduced from these the existing enterprise groups and ultimate owners. The Federal Ministry of Economics and Labour supported the development of the concept, the methodology and the procedure in a research project. The Monopolies Commission's last, Fourteenth Biennial Report 2000/2001 processes this body of data in detail according to the data sources used, the number of enterprises in a group, the proportion of shareholdings, enterprises' headquarters and ultimate owners in the Federal Länder, economic activities, legal forms and the government's shareholding as the ultimate owner.

113.* The number of enterprises in a group controlled by an ultimate owner does not in itself convey sufficient economic information. Apart from the fact that further equity interests of less than the absolute majority may play a role, the turnover and the number of employed are important empirical indicators of enterprises' and enterprise groups' economic weight from the point of view of economic and competition policy. However, initially the enterprise groups identified by the Monopolies Commission were not included by the official statistics office on the basis of their turnover and number of employed in the concentration statistics processed for the Monopolies Commission. The link required here between the information established by the Monopolies Commission on an enterprise's membership of an enterprise group and the individual pieces of information about single enterprises ascertained by the official statistics office failed to be made at that time on account of the administrative resistance of the Federal Statistical Office. However, it is necessary to create a link between information external to statistics and inherent in them, as the official information on individual enterprises' turnover and number of employed as well as their classification within an economic sector

are more precise and consistent than is ascertainable from generally accessible sources. However, for the present report the Land Statistical Offices at least did connect information external to and inherent in statistics for manufacturing enterprises in the reporting year 2001 for the present report.

114.* For the present report, the processing of official statistics to obtain statistics on concentration relating to economic activities and the production of goods is limited to sections C and D, i.e. mining, quarrying and manufacturing. Enterprise and/or supplier groups are taken into account. The data is from 2001, the most recent year from which data is available by now. The present report on concentration is limited to these sectors on account of the statutory scope of the calculation of the official annual structural statistics, on which calculations of concentration are based. Apart from agriculture, forestry and fishing, which have not been included in the Monopolies Commission's report on concentration to date, regular official statistical surveys are only compulsory for the production industry, wholesale and retail trade, hotels and restaurants, and, since 2001, selected services.

115.* The surveys on the wholesale and retail trade, hotels and restaurants and the service sector are carried out on a sample basis, however, and their results are not representative as regards enterprises' membership of an enterprise group. Empirical indications of the representativeness of the official statistics database, which is limited to the production industry, may be taken from the 2001 turnover tax statistics. These statistics recorded approximately 2,921,983 taxpayers across all economic sectors, with pre-tax turnovers from supplies and services of € 4,272,885 billion. 10% of this, with 292,214 taxpayers, derives from the selected industries mining, quarrying and manufacturing which, with a turnover of some € 1,559 billion, makes up a share of 34.5%. That means that for the overwhelming majority of enterprises, no information is available on corporate concentration from primary statistical data collected by official statistics authorities. The limitation of the database to the production industry contains an additional limitation with respect to enterprises' size. In the production industry, so-called full surveys of enterprises are carried out, but they are usually limited to firms with at least 20 persons employed. Thus, the findings of concentration statistics are based only on more sizeable enterprises. For the methodological reasons with respect to wholesale and retail trade, hotels and restaurants as well as the service sector, the sample surveys additionally introduced in recent years for companies with less than 20 persons employed are unsuitable to assess the existence of enterprise groups. This is especially true since the size of the sample does not allow any statements to be made concerning concentration statistics.

116.* Alternative calculations by the Monopolies Commission on the basis of the 2001 turnover tax statistics show that limiting the group of enterprises studied to approximately 13.1% of enterprises in the production industry, a relatively small proportion, results in a significant over-estimation of the absolute level of concentration, and an under-estimation of the relative level of concentration, in the group of reporting companies as a whole, despite their relatively high share of turnover, at 87.9%.

To sum up, the limitation of the statistical database leads to a significant loss of information required for a comprehensive or representative study of concentration in the economy.

117.* In future, there may be a possibility of carrying out statistical studies of concentration in all economic sectors and largely without limits to the data collected if the official business register is completed in line with the provisions of the Statistics Register Act of 1998. Thus it would include complete and reliable information both from surveys and generally accessible sources, as well as from courts and administrative sources – particularly the *Finanzverwaltungen* (financial authorities) and the *Bundesagentur für Arbeit* (Federal Employment Agency).

At the working level the Federal Statistical Office started to carry out initial test calculations on the use of the business register as an alternative data source, inter alia on turnover and persons employed, to individual pieces of information collected from enterprises on a primary statistical basis. In addition, the Office checked the possibility to use commercially available sources of data on companies' equity interest for statistical purposes, such as those already used by the Monopolies Commission.

118.* If the processing of statistics on concentration by the Federal Statistical Office for the Monopolies Commission under Section 47 GWB is based on the official business register kept non-centrally by the Land Statistical Offices, the consequences will be far-reaching in terms of data technology, methodology and content. This includes the Federal copy of the register being up-to-date and consistent, unambiguous features to identify the registered enterprises and suppliers, an indication of their membership of an enterprise group, a possible extension of the enterprise groups covered by the report and of concentration features, transparency of the respective periods covered and updating periods, reliable, consistent and sound data deriving from different official surveys, as well as heterogeneous administrative and commercial sources, comprehensible assessment procedures and precise definitions.

119.* Progress in developing the business register and further developing the official statistics authorities' system of registering enterprises should not only be compared with their situation in the past, but with present and future alternatives.

The performance of the information infrastructure of the official statistics authorities is at least potentially in competition with private information providers as regards obtaining, preparing, processing and analysing economic data. The current competition of commercial providers and the increasing need for information by the specialist field, business, governments and administrations at national and international level, have led to a considerable increase in the data on offer over a period of a few years. The data sources have been widened to cover small and medium-sized companies, management relations and transnational enterprises, and the increasing depth of information enables accounts data to be accessed directly. Differentiating and consolidating the available data makes the information base more transparent and consistent. In addition, quality has improved in terms of the reliability and updating of individual items of information to take the latest developments into account. Complementary software solutions and access possibilities are available, enabling a comprehensive and detailed data assessment and analysis to be carried out that is tailored to the specific information needed, permitting links to be made with external information for further processing or referencing and qualification.

The dynamic rate of development in information and data technology in the field of producing and processing economic data requires to examine alternatives in each case on an ongoing basis. In the long term, the Federal Statistical Office and the Land Statistical Offices will not be able to avoid competition in this field. They must face the fact that in the future, users will increasingly compare the services of official statistics authorities with those offered by private data producers and will expect an appropriate price-performance ratio.

120.* Also, competition and benchmarking are of significance for the examination and further development of the data sources and processes necessary for reporting on concentration. In the long term, the Monopolies Commission regards it as problematical to rely exclusively and permanently on the business register produced by the official statistical authorities. The development of the official registration system and the database has been behind schedule for some time and will continue to be linked with uncertainties concerning its time-frame and content in the future, as well as being limited to German enterprises. It therefore continues to be necessary to carry out a quality and cost comparison between official and private data sources.

121.* For these reasons, the Monopolies Commission compared the information provided by the official statistics authorities on enterprises' membership of groups using the pertinent information from the private provider, the Verband der Vereine Creditreform e.V. (Federation of Credit Reform Associations, registered association).

For the 26 two-digit economic divisions in the production industry, this private data source covers a total of 61,462 enterprises, approximately 1.6 times the number of enterprises with at least 20 persons employed covered by the official statistics (38,198 companies). In contrast, their data on the proportions of enterprises belonging or not belonging to an enterprise group are very similar: approximately 15% and 85% respectively. The same is true of the proportion of enterprise groups, approximately 5%, and the proportion of the resulting units, i.e. non-affiliated enterprises and groups, approximately 90%.

Among the two-digit economic divisions, the influence of the higher total number of enterprises continues. In all sectors, a larger number of enterprises is covered by the private data sources than by the official source. In approximately half of the economic divisions, the number is more than twice as large. The relationship between the number of affiliated enterprises and the associated number of enterprise groups is a corresponding proportion of the total number of enterprises. Since the database used in each case has a direct influence on the empirical results, the reasons for the discrepancies between the two data sources should be checked.

Empirical results

122.* The major empirical result of taking enterprise groups into account in the Monopolies Commission's report on concentration using the official statistics is the fact that of the 38,198 enterprises in the production industry examined, 17,461, or 47.71%, belong to a group consisting of two or more enterprises. These account for € 1.121 billion or 81.81% of turnover, and 4.766 million or 73.56% of persons employed.

These ratios mean that a considerable proportion of economic activities in the production industry takes place in controlled enterprises within a group. It becomes clear that the largest enterprises are among them considering the fact that the proportions of turnover and the number of employed are over-proportionally large in comparison with the number of enterprises.

**Number of enterprises, turnover and persons employed¹
according to whether enterprises belong to an enterprise group²
in the production industry**

Sections C and D of the German Classification of Economic Activities (1993
edition):
Mining, quarrying and manufacturing

Germany 2001

Membership of an enterprise group	Enterprises		Turnover		Persons employed	
	Number	Proportion	Turnover	Proportion	Number	Proportion
	Number	%	billion €	%	'000s	%
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Affiliated enterprises	17,461	45.71%	1,121	81.81%	4,766	73.56%
Non-affiliated enterprises	20,737	54.29%	249	18.19%	1,713	26.44%
Total	38,198	100.00%	1,370	100.00%	6,479	100.00%

Notes

¹ Enterprises with at least 20 persons employed.

² Membership of an enterprise group with two or more enterprises.

Source

Monopolies Commission on the basis of working documents of the Federal Statistical Office, group IV A, last updated 18 May 2004

123.* Breaking down the total of 17,461 grouped enterprises² in the production industry according to the size of the respective enterprise group to which they belong, the following picture emerges: nearly half (48.15%) of the enterprises are in groups comprising up to three enterprises and three-quarters (76.50%) are in groups consisting of up to ten members. The corresponding proportions based on turnover and the number of employed are much smaller, however. That means that groups consisting of just a few members contain mainly smaller enterprises, measured in terms of their turnover or their number of employed. That corresponds to the fact that 14.9% of turnover and 11.9% of persons employed are concentrated in the 405 largest enterprise groups, consisting of 200 or more enterprises, which applies to 2.3% of all enterprise groups.

124.* Conversely, breaking down the 12,447 enterprise groups with at least one enterprise in the production industry, including members that operate in other economic sectors as well, one gains an impression of the actual size of the groups operating in the production industry.

Of the 12,447 enterprise groups recorded as consisting of 17,461 enterprises in the production industry, 10,077, or 81% of enterprise groups, have only one enterprise in the production industry. 57.7% of all grouped enterprises fall into this category. Just 21 groups, or 0.2%, contain more than 20 enterprises. The fact that enterprise

² In the following enterprises belonging to an enterprise group are generally referred to as 'grouped enterprises'.

groups which are smaller in terms of numbers also contain relatively small enterprises in terms of their share of turnover and their number of employed is in line with the above-mentioned general correspondence across all grouped enterprises and enterprise groups.

The relatively large number of enterprises belonging to groups in which only one member of the group operates in the production industry is a reason to subject this category to particular observation. These enterprises may have a special competitive position in relation to other, non-grouped enterprises.

125.* Interpreting the relationships between grouped and non-grouped enterprises, enterprises which are the only representative of a particular economic sector in their group have a special status. When the other members of the enterprise group belong to other economic sectors, the enterprise group constitutes a partial group of just one enterprise in this particular sector. Since the individual enterprises do not form a group of two or more enterprises in the economic sector concerned, they may be classified alternatively as non-grouped enterprises.

In terms of competition policy, these enterprises have a special status beyond their respective market share in relation to non-grouped enterprises. They may derive benefit from the financial strength of the group as a whole or have special access to purchase and sales markets through enterprises within their group operating in upstream or downstream economic sectors. This should be the case if the concept of control that constitutes an enterprise group derives from a strategic objective of the ultimate owner or if an enterprise group itself is already to be regarded as one complex enterprise.

At the working level the Federal Statistical Office started to carry out first test calculations in order to define the characteristics of the horizontal and vertical relations existing between grouped enterprises. To this end, the enterprises' main economic activity is first of all ascertained at a more finely-graduated level of economic classification.

126.* From the point of view of competition policy the geographical concentration of the 17,461 grouped enterprises in the production industry according to Federal Länder is also of special interest. It indicates that 10,915 of the 12,447 enterprise groups in the production industry have members with headquarters in just one Federal Land. That figure includes the 10,077 enterprises or groups which have only one enterprise in the production industry in any case. 1,374 groups operate in two to three Federal Länder, 158 in more than four, and twelve in more than ten of the 16 Federal Länder.

It may be presumed that the geographic diversity of the enterprise groups is not only connected with the number of member enterprises, but also with their size. Thus, the 0.1% of the enterprise groups whose member enterprises have their headquarters in ten or more Federal Länder account for 2.4% of the turnover and 7% of the persons employed.

127.* The 26 two-digit economic divisions in the production industry for which figures are available vary in size, measured on the basis of the number of enterprises with at least 20 persons employed that have their economic focus in the sector concerned. The economic sectors containing the largest number of enterprises is based on their absolute number or their proportion of all 38,198 companies:

28	Manufacture of fabricated metal products except machinery and equipment	6,181 companies (16.18%)
29	Manufacture of machinery and equipment not elsewhere classified	5,883 companies (15.40%)

15	Manufacture of food products and beverages	4,942 companies (12.94%)
25	Manufacture of rubber and plastic products	2,650 companies (6.93%)

128.* The weighted average proportion of non-grouped enterprises in these economic divisions is 54.3%. In addition, 30.7% of enterprises, while belonging to a group, are the only member of that group in the production industry. Thus, 85.24% of the enterprises in one of these economic divisions do not belong to a group. The proportion of grouped enterprises varies considerably between different economic divisions in the production industry. Grouped enterprises made up the following maximum and minimum proportions of the total number of enterprises:

23	Manufacture of coke, refined petroleum products and nuclear fuel	78.7%
15	Manufacture of food products and beverages	30.3%

The proportion of grouped enterprises which are the only member of their group in the respective economic section varies between 60% and 20%:

23	Manufacture of coke, refined petroleum products and nuclear fuel	57.5%
15	Manufacture of food products and beverages	19.4%

The number of units, i.e. the number of non-grouped enterprises plus the enterprise groups is reduced by approximately 10% as a result of enterprise group formation. Later calculations show that when weighted according to turnover, it is the largest enterprises in particular that form enterprise groups, leading to a significant change in the enterprise size distribution, and thus to an increase in the absolute concentration level.

129.* The account of the situation regarding the size structure of grouped enterprises related to their number is supplemented by their turnovers. In absolute and in relative values, measured by the turnover of all enterprises, which amounts to € 1,370,471 million, the turnover of the economic sections with the highest turnover was as follows:

34	Manufacture of motor vehicles, trailers and semi-trailers	€ 258,599 million (18.87%)
29	Manufacture of machinery and equipment not elsewhere classified	€ 157,671 million (11.50%)
24	Manufacture of chemicals and chemical products	€ 133,574 million (9.75%)
15	Manufacture of food products and beverages	€ 128,302 million (9.36%)

130.* The relative turnover structure indicates that on average, just 18.2% of the turnover derives from non-grouped enterprises. In addition, the turnover of enterprises which, while belonging to a group, were the only enterprise in that group operating in the production industry, is 28.4%. Together, 46.6% of turnover is generated by non-grouped enterprises in one of the two-digit economic divisions. These proportions are considerably smaller than the corresponding proportions based on the number of enterprises. That means that these enterprises are relatively small. While the proportion of grouped enterprises in the production industry is 14.8%, the corresponding share of turnover is 53.5%.

131.* Within the production industry, there are significant variations in the ratio between the number of enterprises and their turnover. While there tends to be a discernible link between the proportion of grouped enterprises in relation to their number and their turnover, there are major divergences. The maximum share of turnover of grouped enterprises, including those which are the only member of their group in an economic section, is as follows:

11	Extraction of crude petroleum and natural gas; service activities incidental to oil and gas extraction, excluding surveying	96.5%
16	Manufacture of tobacco products	95.9%
34	Manufacture of motor vehicles, trailers and semi-trailers	94.9%
23	Manufacture of coke, refined petroleum products and nuclear fuel	94.8%

The minimum values are as follows:

15	Manufacture of food products and beverages	59.4%
30	Manufacture of office machinery and computers	63.4%

Economic division 30 also has the smallest proportion of turnover deriving from a group within an economic section in the production industry, at 6.5%.

132.* Analysing concentration statistics, the Monopolies Commission sets store by differentiating between the concepts of enterprises and suppliers.

The official statistics authorities generally allocate enterprises according to their main economic activities depending on the proportion of the value added, and their total turnover is allocated to that economic activity. Consequently, some of an economic activity's total turnover does not derive from that activity, while parts of enterprises which are typical of the sector, which have their economic focal areas outside the relevant economic sector – here sections C and D of the production industry – are not included.

The official statistics classify suppliers under production statistics. These include both enterprises operating in just one economic sector, and diversified companies that also operate as suppliers in the sector concerned, but which do not have their economic focus in that area. Whereas turnover is used as a criterion of concentration, in diversified enterprises, only the share of turnover that is earned in the relevant sector is used as a criterion of concentration.

The institutional and functional distinction between the economic units highlights different aspects of relevance to competition. They relate both to diversification and the formation of enterprise groups, and may be connected in a number of stages, from plants or divisions within an enterprise, to enterprises and enterprise groups.

133.* Examinations of the influence of group formation on the concentration level, carried out separately for enterprises and suppliers, confirm the importance of distinguishing between suppliers and enterprises, not only from a methodological but also from an empirical point of view. When comparing the findings of concentration statistics, it should be noted that, as well as additional differences resulting from data-collection techniques, there is an overlap between the influence of enterprise diversification, which always affects a number of economic sectors, on the number and size structure of suppliers in a particular economic sector, and the influence of group formation on the number and structure of enterprises which have their economic focus in that area, leading to different constellations.

134.* An observation of the influence of group formation by enterprises and suppliers on the examined sections C and D, i.e. mining, quarrying and manufacturing, produces the result shown in the table below.

Even at the highly aggregated level of economic divisions C and D of the production industry included here, there are far-reaching connections between size, diversification, group membership and the level of concentration of enterprises and suppliers. A total of 3,242, or approximately 7.8%, of suppliers, belong to enterprises which have their economic focus in other sectors, e.g. construction, wholesale and retail trade or services. As a result of group formation

- ... the number of enterprises falls from 38,198 to 33,184 economic units, i.e. non-grouped enterprises and enterprise groups. The number of suppliers falls from 41,440 to 35,586 units;
- ... the concentration rate CR-100 for enterprises rises from 36.6% to 44.1%, and that of suppliers from 29.7% to 37%.

Any increase in the proportions by more than 7 percentage points, or more than 20% in relative terms, is highly significant in view of the fact that of 38,198 companies and 41,440 suppliers, the 100 largest enterprises in each group – i.e. approximately 0.25% of the units – already account for some 37% of total turnover or 30% of the value of goods produced.

135.* If the production industry is structured according to so-called main industrial groupings (not including energy), i.e.

intermediate goods,
investment goods,
durable goods,
non-durable goods,

the ratio of enterprises and suppliers presents a more differentiated picture. In intermediate goods, the number of units falls by approximately 36% after categorising suppliers as enterprises, and when grouped enterprises are categorised as groups, the number of units falls by a total of 46%. In the wake of this process, the proportion of the gross output or turnover of the 50 largest units – i.e. the concentration rate CR-50 – rises from approximately 22.8% to 28.3% and 31.4%. Similar figures apply to the other main groups. For investment goods and durable goods, the total number of units falls by approximately 31.7% and 31% respectively, while the concentration rate CR-50 rises from approximately 48.7% and 44.1% respectively to approximately 53%.

Table:

Not taking group formation into account	
● Enterprises	38,198
Turnover	€ 1,370 billion
Persons employed	6,481 thousand
Turnover of the 100 largest enterprises	€ 502 billion
Concentration rate CR-100	36.6%
● Suppliers	41,440
Gross output	€ 1,030 billion
Gross output of the 100 largest suppliers	€ 306 billion
Concentration rate CR-100	29.7%

Taking group formation into account	
● Enterprises and enterprise groups	33,184
Number of enterprise groups	12,447
Turnover	€ 1,370 billion
Number of persons employed	€ 6,478,913
of which in enterprise groups	
– companies	17,461
– turnover	€ 1,121 billion
– persons employed	4,766 thousand
Proportional values in enterprise groups	
– companies	45.7%
– turnover	81.8%
– persons employed	73.6%
Turnover of the 100 largest units	€ 604 billion
Concentration rate CR-100	44.1%
● Suppliers and supplier groups	35,586
Number of supplier groups	12,299
Gross output	€ 1,030 billion
of which in supplier groups	
– suppliers	17,153
– gross output	€ 796 billion
Proportional values in supplier groups	
– suppliers	41.4%
– gross output	77.3%
Gross output of the 100 largest units	€ 380 billion
Concentration rate CR-100	37.0%

136.* A picture of the influence of enterprise and supplier group formation on the concentration level that is closer to the market reality gradually emerges from studies of 26 two-digit goods and economic divisions in the production industry.

As a result of group formation, the number of economic units in different economic divisions decreases to different degrees; in the case of suppliers, it falls by between -1 and -76 in a sector, and in the case of enterprises it falls by between -2 and -654 units. In both cases, the number drops by up to 20%. With few exceptions, the reductions in the absolute values for suppliers and enterprises are closely correlated.

In a first step, information on the decrease in the number of suppliers and enterprises helps to evaluate how strong the influence of group formation is in each of the goods and economic divisions, since one main factor determining the absolute concentration level, alongside the size structure, is the number of units.

137.* Examinations of the two-digit economic divisions show that in almost all economic divisions, there is a significant increase in the inequality of turnover and output distribution among enterprises and suppliers after taking group formation into account. The relative increase in the inequality of distribution as a proportion of the coefficient of variation for enterprises is most pronounced in the following economic divisions:

22	Publishing, printing and reproduction of recorded media	63.9%
26	Manufacture of other non-metallic mineral products	55.4%
27	Manufacture of basic metals	46.2%

The figures show that in these divisions it is mainly larger enterprises that are involved in group formation. In theory, it would also be conceivable for relatively small enterprises to be particularly involved in group formation, leading to the size of enterprises being harmonised. However, this is only the case in four economic divisions and to a limited extent :

30	Manufacture of office machinery and computers	-1.5%
37	Recycling	-3.8%
16	Manufacture of tobacco products	-3.8%
11	Extraction of crude petroleum and natural gas; services activities incidental to oil and gas extraction, excluding surveying	-9.4%

138.* The absolute level of concentration is simultaneously determined by the number of economic units and their size structure. Whereas the number of units always decreases as a result of group formation, the level of inequality in unit size distribution may increase or decrease, depending on whether larger units increase in size at the expense of smaller units or vice versa. Both effects may amplify or retard each other. However, due to the axiomatic basis of concentration measurement, the absolute concentration level always increases when a number of units are combined.

139.* The Monopolies Commission has measured the status of and change in the absolute level of concentration using the Herfindahl index, a complete measure that takes the individual size of all units into account. It is supplemented by concentration rates, due to their greater clarity. These could also be used to establish whether enterprise and supplier groups are formed within or outside a dominant size category, e.g. the largest 100 units, whether a group made up of smaller units grows to become a member of a size category consisting of larger units or whether the dominance of a size category is reinforced when it is in combination with smaller units.

140.* In approximately half of the goods and economic divisions, the value of the Herfindahl index was significantly higher after taking group formation into account:

In ten of the 24 two-digit goods divisions studied, the absolute concentration level of suppliers rises by more than half, and in two divisions by a maximum of approximately three-fold.

In nine out of 26 economic divisions, the absolute concentration level of enterprises also rose by the same dimensions.

Measurements using the Herfindahl index indicate the greatest relative differences between the absolute concentration level before and after taking supplier group formation in two-digit goods divisions into account:

22	Publishing, printing and reproduction of recorded media	201.2%
26	Manufacture of other non-metallic mineral products	195.8%
27	Manufacture of basic metals	150.3%

The most pronounced relative increases among enterprises relate to the relevant two-digit economic divisions:

22	Publishing, printing and reproduction of recorded media	200.8%
26	Manufacture of other non-metallic mineral products	165.8%
27	Manufacture of basic metals	134.0%

A detailed analysis could relate the different rates of change to the initial level of concentration and its determining formal factors according to the number and size distribution of the units. It would also be possible to measure the reduction in the difference between the absolute and relative concentration levels in comparison with its maximum level. This would better take into account that a concentration level that is already higher before taking group formation into account only slowly approaches its maximum level, even when group formation is more pronounced.

141.* A significant influence of group formation on the absolute concentration level can also be demonstrated for suppliers and enterprises at the level of four-digit economic and goods classes. This is not self evident. It is only the case if group members are not distributed among various economic sectors, but constitute a group or partial group within one economic sector. Information is available concerning suppliers in a total of 246 four-digit goods classes, and for enterprises in 158 economic classes.

In 34 out of 246 four-digit goods classes, no group formation is to be observed.

Of the other 212 goods classes, the absolute concentration level rises by more than 20% in half of cases when measured using the Herfindahl index after taking group formation into account.

The maximum is approximately 180% in goods class 2513 (Manufacture of other rubber products), 162% in goods class 2612 (Shaping and processing of flat glass) and 143% in goods class 2222 (Printing not elsewhere classified).

142.* The following results apply to four-digit economic classes:

In 27 out of 158 four-digit economic classes, no group formation is to be observed.

In 131 four-digit economic classes, the rise in the absolute concentration level is more than 20% in half of cases, as in the case of goods classes. The maximum is nearly 200%, i.e. nearly three times the original value.

The largest increases in the concentration level are in economic activity 2513 (Manufacture of other rubber products) at 197%, economic activity 2663 (Manufacture of ready-mixed concrete) at 104% and economic activity 2955 (Manufacture of machinery for paper and paperboard production) at 94%.

The increase in absolute concentration not only results from a decline of up to approximately 30% in the number of suppliers and enterprises in individual goods and economic classes. Group formation is usually accompanied by a significant shift in size structures to the benefit of the largest suppliers and enterprises.

In addition, the influence of group membership has an effect on enterprises' market position, not only through bundling market segments within an economic sector. The competitive position of a supplier or enterprise is also influenced, for example, by membership of a purchasing or sales system organised by an enterprise group which is part of a vertical chain of value added whose members are in different economic sectors. These connections need to be studied separately.

143.* The data situation at the official statistics authorities has not yet enabled supply relations and turnover existing between suppliers and enterprises within a goods or economic sector to be taken into account. These flows of goods and services, also within a group, result in duplications when calculating the market volume and market shares. Also, additional distortions result from the use of internal prices instead of market prices.

For this reason, the Monopolies Commission has carried out test calculations for enterprises based on the number of employed rather than turnover. The results of the influence of group formation on the absolute concentration level are significant as well. However, they do not rule out the possibility of significant differences between the amount of an enterprise group's actual external turnover and the unconsolidated total amount of statistically recorded turnover of the grouped enterprises. Thus, measuring the influence of supplier and enterprise group formation on the concentration level in a way that is objectively adequate and undistorted, remains a task to be resolved.

III. Levels and trends of large company concentration (aggregate concentration)

144.* Identifying the 100 largest companies in all economic sectors on the basis of the criterion of value added forms the starting point of the Monopolies Commission's report evaluating the status and development of aggregate concentration. This analysis relates solely to domestic conglomerate divisions. The study of the group of large enterprises thus defined covers the ties between the one hundred largest enterprises with regard to their share ownership, cooperation through joint ventures and interlocking directorates. In addition, it checks the involvement of the one hundred largest companies in mergers notified to the Federal Cartel Office pursuant to Section 39 GWB. The monitoring of the one hundred largest companies in terms of their value added is supplemented by the identification of the largest industrial companies, wholesale and retail companies, transport and service companies, financial institutions and insurance companies, all measured in terms of sector-specific volumes of business.

145.* Analysing the one hundred largest companies based on their value added of domestic conglomerates makes it possible to compare companies *in different industrial branches and economic sectors* with regard to their contribution to the national product. If the data required to calculate the domestic value added could not be obtained from the annual report of the respective company, a survey was conducted. If neither the published company data nor the results of the survey provided detailed data to ascertain the individual companies' value added, it was estimated. A comprehensive examination of the estimation methods using the data

obtained from surveys enabled the Monopolies Commission to verify that the estimation procedure was of a sufficiently high quality.

146.* *The total value added of the one hundred largest companies was approximately € 240 billion. It fell by 12.21% in comparison with 2000. However, the value added of all companies in the period covered by the report rose by 3.82% (1998/2000: 3.9%). The hundred largest companies' share in the value added of all companies thus decreased by approximately one-sixth (17.0%, 2000: 20.07%).*

147.* *Analysing the “100 largest companies” according to rank intervals of ten highlights that the reason for the reduction in major companies' share of the total value added is mainly due to the weak development of the value added in the forty largest companies. The reduction of the average value added in the lower-ranking groups was also considerable, whereas it was relatively moderate among companies ranking 41 to 60.*

The share of the ten largest companies in the value added of the hundred largest ones was 43.69%; this was below the value of the previous period (44.79%). The proportion contributed to the value added by the twenty largest of the 100 largest companies dropped, too, i.e. from 63.45% in 2000 to 61.95% in 2002.

148.* *If the relevant data could be established for both years, the development of the major companies between 2000 and 2002 was also analysed in terms of number of employed, physical assets and cash flow as well.*

79 companies were included in the examination of the number of employed. These were among the hundred largest ones in both years covered by the report. Their share in the employment figure of all companies was 13.55% in 2002 as compared to 13.67% in 2000. Thus, as employers the large companies have once again declined in importance.

Information on the physical assets of domestic conglomerate divisions was available for 56 companies for both years. Financial institutions, insurance companies and service companies were not taken into account. The balance-sheet of physical assets and non-material assets of the companies examined rose during the period covered by the report from approximately € 270 billion to approximately € 282 billion.

In order to calculate the cash flow data was available of 47 companies in the categories covered by the report for 2002 and 2000. The cash flow of the companies examined dropped from approximately € 92 billion in 2000 to approximately € 65 billion in 2002.

149.* *Among the hundred largest companies, 74 of the controlling companies (75 in 2000) had the legal form of an *Aktiengesellschaft* (joint stock company), making this the dominant legal form among the companies covered by the report, as was the case in the past. The number of *Gesellschaften mit beschränkter Haftung* (limited liability companies) also increased by one, as did the number of limited partnerships within the meaning of Section 264a HGB (German Commercial Code); the category *Einzelkaufmann* (sole proprietor) is no longer represented, however. The number of public corporations or incorporated public-law institutions is now three, a reduction of two.*

150.* *As well as value added, other criteria are often used to evaluate companies' size, which are sector-specific and can directly be checked in the annual accounts. In the case of industrial, transport and service companies, as well as wholesale and retail companies, this criterion is turnover. The preferred way to judge the size of financial institutions is their balance-sheet total, and of insurance companies it is their premium income. Value added, however, is to be seen as a superior size criterion, as it allows to compare companies across sectors, unlike the above-mentioned criteria that characterise the volume of business. In addition, it reflects the level of their vertical integration. Thus, analysing the largest companies*

according to their volume of business is a supplementary examination shedding more light on the significance of large companies in individual economic sectors.

The ranking based on value added and on the sector-specific volume of business coincide to the extent that at least 70% of the companies that have the largest volume of business in individual economic sectors are as well among the 100 largest companies defined on the basis of value added.

The development of the business volume of the largest companies exceeded the general market development only in the wholesale and retail trade and in the insurance industry. Aggregate concentration thus declined in the majority of industries. Measured by the business volume of the ten largest companies in a sector as a proportion of all companies operating within a sector, the insurance and banking industries continue to have the highest concentration.

In 2002, the *fifty largest industrial companies had an aggregate turnover of € 591 billion compared with € 588 billion in 2000*. This corresponds to growth of 0.5% (1998/2000: 17.3%). According to turnover tax statistics, the production industry achieved total turnover of € 1,921 billion in 2002 and an increase in turnover of 0.9% in comparison with 2000. Thus, the growth in turnover of the largest industrial companies was just slightly lower than the sector's average.

The turnover of the ten largest wholesale and retail companies increased by 7.5% between 2000 and 2002. Its growth surpassed overall growth in the sector (0.3%) by far. Together, the ten largest wholesale and retail companies achieved turnovers of € 126 billion in comparison with turnover of all companies in the sector, which amounted to € 1,333 billion. Thus, the largest companies in the sector once again saw above-average growth. The list of the largest wholesale and retail companies is incomplete, as in previous years, as some large company groups could not be taken into account due to their lack of *consolidated annual accounts*, although it has to be assumed that they are under unified control. Thus, concentration in the wholesale and retail sector is underestimated.

The total turnover revenues of the ten largest companies in the transport and services sector amounted to € 125 billion in 2002. Thus, they achieved growth in turnover of 3.2% in comparison with 2000, lagging behind the growth in turnover of all companies in this sector (9.1%).

The balance-sheet total of the ten largest financial institutions in 2002 was € 3,509 billion, a decrease of approximately 1.3% in comparison with 2000. In contrast, the balance-sheet total of all financial institutions increased by 3.4%. The unconsolidated balance-sheet total of the banking conglomerates' consolidated banking groups was € 3,666 billion in 2002. The share of the ten largest financial institutions in the balance-sheet total of all companies in this sector thus fell from 52% to 50.38% in comparison with 2000.

The ten largest *insurance companies achieved a total premium income amounting to € 111 billion*. The rate of change of their premium income amounted to 17.5%, in comparison with 11.7% growth among all insurance companies. The share of unconsolidated gross premium incomes of the ten largest insurance companies in the gross premium income of all primary insurance and reinsurance companies amounted to 60% for the business year 2002 (57.8% in 2000). Of the economic sectors reviewed here, the insurance industry was thus the industry whose volume of business was generated to the greatest extent by large companies.

151.* On the one hand, the shareholder structure of large companies are examined to identify capital ties between the *one hundred largest companies*, and on the other hand, the overall *shareholding structure* of the companies covered by this report are analysed. There was no major change in the ownership of most of the 100 largest companies. However, there was a considerable reduction in publicly-owned shareholding in some large companies (Energie Baden-Württemberg AG, Deutsche

Telekom AG, Fraport AG Frankfurt Airport Services Worldwide, Deutsche Post AG, Volkswagen AG). The changes in capital ties between the one hundred largest companies were partly due to changes in the ranking composition, and partly due to the acquisition and sale of capital shares.

There were only minor changes in shareholder groups accounting for the majority of equity capital in the large companies examined. As in 2000, 25 companies were in the 'majority in individual foreign ownership' category, the most frequent category (23 in 2000). The number of companies in which the majority of shares is broadly dispersed was only slightly smaller. A shareholder category of increasing importance comprises individual persons, families and family foundations (19 cases). In 2002, the fourth-largest group in terms of the number of companies it contained comprised 15 large companies, the majority of whose equity capital could not be attributed to another large company, individual foreign ownership, public ownership, individual persons, families and family foundations or broadly-dispersed ownership or other shareholders (18 in 2000). In four cases, the shareholdings of the 100 largest companies amounted to more than 50%. The number of companies owned by public authority has fallen by one in comparison with 2000 to eleven.

As in previous years, Allianz AG held most shareholdings in other companies in the 100 largest companies category, 22. In 2002, 39 (42 in 2000) companies in the group of the 100 largest ones were shareholded companies of another large company, and 22 (27 in 2000) were shareholders. In only four (5 in 2000) of the companies examined more than 50% of the total shares were held by companies in the 100 largest category. The number of cross-shareholdings fell from eight in 2000 to four in 2002, whereby two interlocking shareholdings were no longer included in the group of large companies on account of mergers.

152.* The number of intercompany links by joint ventures among the twenty largest companies fell in 2002, with 37 such relationships compared to 38 in 2000. There was a total of 76 joint ventures (91 in 2000). In some cases, there was contact between two companies in a number of joint ventures, but in no case did more than two companies participate in a joint venture. Companies in the energy and chemical industries once again were outstanding for their particularly intensive cooperation through joint ventures operating in the same sector as the holding companies.

As well as the twenty largest companies, for the first time the Monopolies Commission also looked at interlocking in joint ventures among financial service institutions in the group of the 100 largest companies. In 2002, they had 18 contacts, a lower level of interlocking than the banks included in the study, which had 11 (16 in 2000). The largest proportion of joint ventures operated as investment and management companies as well as in other services and in the finance industry.

153.* Analysing interlocking directorates the Commission only looks at the connections between companies in which one or more persons at the same time are members of the executive or controlling body of at least two companies in the group of the 100 largest ones. In 2002, 30 of the 100 largest companies (37 in 2000) sent members of their management to the controlling bodies of other companies in this group. They were thus represented in the controlling bodies of 63 companies (59 in 2000) in the group examined. The total number of interlocking directorates via management representatives was 103 (139 in 2000), thus decreasing once again between 2000 and 2002. The number of interlocking directorates involving the representatives of financial institutions and insurance companies dropped as well, as was the case in previous years, amounting to 30 compared to 64 in the year 2000. The question of whether companies involved in the same economic sector have interlocking directorates is of interest from a competition policy point of view. In the reporting year 2002, there were 17 such interlocking directorates (25 in 2000). The number of cases in which an interlocking directorate went hand in hand with capital interests fell by two to nine compared to 2000.

154.* Through its study of the involvement of the *100 largest companies in the mergers of undertakings notified to the Federal Cartel Office pursuant to Section 39 Paragraph 6 GWB*, the Monopolies Commission underlines the competition policy relevance of external growth of the 100 largest companies. Out of a total of 2,449 mergers notified in 2002/03 (2000/01: 2,570), companies from the group under review were involved in 950 cases (2000/01: 1,814). When multiple entries are removed, the share of the one hundred largest companies in the total number of mergers thus decreased again from 49% to 39%, the level of the examination period 1998/99.

155.* The overall impression in the reporting period is that concentration declined slightly with regard to various size criteria and in most economic sectors. The process of ongoing concentration evident in previous years continued only in the wholesale and retail sector and in the insurance industry. In contrast, the importance of large companies dropped in production industry, services, transport and banking. Large companies' share of the value added also diminished, as did their significance as employers and their participation in the mergers notified to the Federal Cartel Office after being put into effect.

Interlocking directorates and cross-shareholdings among the 100 largest companies are characterised by a downward trend as well. As in the past, this is partly due to mergers of previously closely interlocking members of the group of the 100 largest companies and the increasing significance of international conglomerates.

IV. Abuse control of dominant enterprises and merger control

Abuse control

156.* The abuse control of dominant companies has increased in importance during the period covered by this report. This is mainly due to the increase in the number of proceedings in the power-line dependent electricity sector. In these proceedings, the Federal Cartel Office dealt mainly with cases of competition being restricted as a result of excessive fees for network use. A number of other proceedings on linked transactions and excessive fees for the transfer of subscriber data in the telecommunications sector were halted before an injunction was issued. In the period covered by the report, the Federal Cartel Office also dealt with cases of sales below cost price. In this context, it updated its principles for interpreting a provision introduced by the Sixth Amendment of the Act Against Restraints of Competition.

157.* The Monopolies Commission judges positively the removal of an existing linked transaction by Premiere Medien GmbH & Co KG. The cause for concern was the so-called closed character of the d-box, which means that Premiere World could only be received with the d-box and conversely, only services encoded in Betacrypt or uncoded services could be received by the d-box. The economic freedom of contract in the decoder market was achieved through enabling other decoder suppliers to enter the market with their Betacrypt CI modules alongside d-box. The Monopolies Commission also sees the deterrence effects of abuse control in the Federal Cartel Office's proceedings against an attempt by Deutsche Bahn AG to tie the invitation to tender for contracts to supply diesel locomotives and coaches to the sale of its maintenance plants in Nuremberg or Delitzsch. Deutsche Bahn AG refrained itself from its project of a tied invitation to tender. The procedure did not resolve the open question whether Deutsche Bahn AG has a dominant position in the procurement market for diesel locomotives and wagons. The Monopolies Commission assumes that if proceedings had continued, the dominant position of Deutsche Bahn AG would have been established.

158.* In September 2003, the Federal Cartel Office suspended abuse proceedings against Deutsche Telekom AG (DTAG) after DTAG agreed to reduce the costs of providing subscriber data to information service providers – as the basis for calculating the fees to be charged for these services – by just under € 90 million to € 49 million. The competition authority carried out abuse proceedings in close cooperation with the RegTP, which provided administrative cooperation, particularly in examining the cost documents. In accordance with Section 12 Paragraph 1 TKG, the fees that a telecoms service provider can charge another provider for making subscriber data available are based on the costs of efficient supply. Due to insufficient documentation of the costs and shortcomings in the submitted calculation it was impossible to determine these costs beyond reasonable doubt. In order to avoid further time-consuming investigations after a request for additional information, the Federal Cartel Office and DTAG agreed on a reduction of costs by 45% for a retroactive period of nine months.

159.* The halting of abuse proceedings on the basis of a negotiated settlement between the Federal Cartel Office and DTAG was in the interest of the enterprises concerned and, in the view of the Monopolies Commission, is to be welcomed. At the same time, the agreement also highlights the weaknesses of abuse control by the competition authority. On the one hand, the enterprise that has been taken advantage of within the meaning of competition law cannot appeal against the “agreement” between the competition authority and the dominant undertaking, even if this agreement is at its expense. On the other hand, competition law has limited scope to enforce competitive prices. Under Section 19 Paragraph 4 Item 2 GWB, abuse exists if a dominant undertaking demands payment which differs from that which would very likely arise if effective competition existed. This payment is usually determined by looking at a comparable market. In this case, the competition authority considered this to be impossible as the conditions in the countries examined are not comparable. Instead, the Federal Cartel Office’s assessment was based on the costs of efficiently providing a service pursuant to Section 12 Paragraph 1 TKG, including substantial security supplements. In the view of the Monopolies Commission, it is very likely that this approach entails costs which are still clearly excessive. This view is supported by the fact that the RegTP, on whose cost examination the competition authority’s estimate is based, calculated the costs of efficient provision of the service on the basis of highly excessive capital charge rates. One reason for this is that investment-specific risks and thus the appropriate risk premiums are appreciably lower in the regulated sector, including subscriber lines and the corresponding subscriber data, than in the enterprise as a whole. Another reason is that the RegTP uses inappropriate procedures in dealing with the taxation of share and outside capital. Both effects have a significant impact. Finally, costs which tend to be excessive are further increased by the Federal Cartel Office’s security supplements.

160.* An analysis of comparable markets in other European countries showed that in some countries allowable costs of providing subscriber data are considerably lower than in Germany. However, the Federal Cartel Office did not consider calculating the costs on the basis of comparable markets as fees in these countries are either regulated or are simply based on data transmission costs. In the view of the Monopolies Commission, however, it is difficult to believe that the remarkably large difference between the costs charged in Germany and Great Britain or France are to explained solely by fixed costs and overhead surcharges.

161.* In the period covered by the report, the Federal Cartel Office took further proceedings pursuant to Section 20 Paragraph 4 GWB on account of the ban on sales below cost price. Proceedings which have been completed and now have legal force were taken against a drugstore operator, Dirk Rossmann GmbH, and its majority shareholder and authorised representative, Dirk Rossmann. The company was accused of having unfairly hindered small and medium-sized competitors over an extended period of time by exploiting its superior market power in offering

photographic services not merely occasionally and, without any objective justification, below their cost price. In this case, according to the Federal Cartel Office's investigations, Rossmann's cost price, taking into account rebates, discounts, annual bonus and so-called advertising grant, was constantly higher than its sales price throughout the three-month period under discussion.

162.* The antitrust authority's view is that these sales below cost price could not be objectively justified by saying that Rossmann was simply reacting to similar offers by its larger competitors in the drugstore retail trade, the market leader Anton Schlecker and dm-drogeriemarkt GmbH & Co. KG. Thus, the Federal Cartel Office's view followed that of the Federal Supreme Court in its decision in the case of Wal-Mart Stores, the retail conglomerate, in which it ruled that major conditions had to be fulfilled before the presumption could be made that sales below cost price were objectively justified. According to the Court, such conduct is only justified, if the damage through the offers of the competitors is so grave that it outweighs the interests of small and medium sized enterprises. Moreover, in the view of the Federal Supreme Court, justification may only be considered, even in such a case, if the enterprise could not wait for the intervention through public authorities or courts. The Monopolies Commission disagrees. It must be possible, even for an enterprise with a relatively strong position in the market, to defend its market position against competitors. In principle, this applies regardless of size and market position of the enterprise triggering the price war, but especially if it is a larger competitor with an even stronger market position. The objective justification cannot depend on whether the damage would be large enough to drive the relevant enterprises to insolvency, or whether their livelihood is not threatened, for example on account of other business activities, or whether they might be in a better position than smaller competitors to bear any costs that might arise. Otherwise, one would be moving away from a market-orientated view towards an enterprise-orientated view, so that an objective justification might depend on the position of the respective enterprise in other markets. An urgent warning is to be made against such a development, as it involves considerable risks in making any objective justifications at all.

163.* The Monopolies Commission also maintains its basic opposition to the provision banning sales below cost pricing. Since the conditions and accounting modalities between retailers and their suppliers are often diverse and complex, in most cases it is difficult or impossible to establish the cost price beyond all reasonable doubt. This provision leads to uncertainties on the part of larger retail enterprises, i.e. the enterprises targeted by Section 20 Paragraph 4 Sentence 2 GWB, as to the legality of special offers. Moreover, the protective purpose of the norm is doubtful. On account of their purchase volume large retail enterprises have better purchasing conditions than their small and medium-sized competitors in any case, which they use in pricing competition. The advantages of small and medium-sized companies are competitive parameters unrelated to price, such as having a specialised range or providing expert advice. Instead of protecting small and medium-sized enterprises in their competition against large enterprises with a high level of market power, the ban on sales below cost price weakens price competition between large enterprises at the expense of consumers.

164.* During the period covered by the report, the Federal Cartel Office issued two first-time rulings on abuse practices relating to excessive fees for network use in the electricity industry, thereby testing different concepts for determining appropriate transmission fees. In the case of Thüringer Energie AG (TEAG) the authority demonstrated the existence of price abuse exclusively on the basis of cost monitoring, thereby using the cost calculation principles set out in the report by the working group on electricity network use, which differ on some points from the calculation principles of the Associations' Agreement on Electricity II plus. In contrast, the authority established price abuse in the proceedings against the Stadtwerke Mainz on the basis of the comparable market concept. As a benchmark the Office uses the total revenues per kilometre of the distribution network of the

Stadtwerke Mainz, which it compares with values of RWE Net AG. In both abuse cases, the responsible Decision Division set a ceiling for the permissible total network revenues, which may not be exceeded in future by the enterprises concerned. The Monopolies Commission welcomes the fact that in demonstrating the existence of abusively excessive fees for network use, the Federal Cartel Office not only resorts to the comparable market principle, but is also moving towards cost monitoring. The comparable market principle poses fundamental conceptual problems, as a comparison of network revenue does not allow structurally excessive monopoly prices to be demonstrated. However, cost monitoring, too, involves fundamental problems relating to the allocation of overheads to network operation and the question of the costs of efficient operational management. In order to be able to establish at least the relative efficiency of a network operator, the Monopolies Commission proposes using cost-orientated benchmarking models in examining fees for network use in the electricity industry.

In both cases, the Court of Appeal in Düsseldorf suspended the immediate execution of the ruling on abusive practices issued by the Federal Cartel Office. In the meanwhile, it decided in favour of the companies concerned in the main proceedings. In so doing, the Court firstly rejected the setting of a profit ceiling, which in its view amounts to a preventive price control not covered by competition law, and secondly said that when demonstrating the existence of abusive pricing, the Federal Cartel Office should not limit its examination to the total profit from network operation, but should also examine individual prices, as it could not automatically be assumed that disproportionately high total revenues were the result of abusive pricing. Finally, in the view of the Court, the Federal Cartel Office had not disproved the presumption of “good expert practice” introduced by the amendment to the Energy Industry Act (Energiewirtschaftsgesetz – EnWG) for the principles of price calculation of the Associations’ Agreement on Electricity II plus, according to which both TEAG and the Stadtwerke Mainz had calculated their network fees. In the view of the Monopolies Commission, considerable doubts about this legal interpretation by the Court of Appeal are in order with regard to the effects of the presumption of “good expert practice” for the price-setting principles of the Associations’ Agreement on Electricity II plus. The subordinate application of the provisions of competition law is incompatible with the text of the amended version of Section 6 Paragraph 1 Sentence 5 EnWG, according to which the application of Section 19 Paragraph 4 and Section 20 Paragraphs 1 and 2 GWB remain unaffected. The Court also leaves open how the law’s presumptions of “good expert practice” can be disproved. In the view of the Monopolies Commission, this legal interpretation by the Court of Appeal makes it practically impossible to control fees for network use. The Monopolies Commission cannot comprehend the view cited by the Court that there is no connection between abusively excessive overall revenues and abusively excessive individual fees. Here, the Court fails to recognise that ultimately, abusive overall revenues are always due to abusive individual fees. In contrast, the Monopolies Commission considers the Federal Cartel Office’s approach of basing evidence of abusively excessive network fees on total network revenues to be suitable. In principle, this is an adequate way to take account of the economically complex problem of allocating fixed costs and overheads to individual services.

165.* In another proceeding involving abusive practices, the Federal Cartel Office established that the network company RWE Net AG charged its competitors abusively excessive prices for metering and billing services. Metering and billing services cover the purchase, installation and maintenance of electricity meters, reading the meters and cashing. The fees for these services are billed to third companies that use RWE’s network for transmissions. To establish that the prices charged by RWE were abusive the Office compared them to the respective fees charged by Thüringer Energie AG. The decision by the Federal Cartel Office was suspended by the Court of Appeal in Düsseldorf on the grounds that it could not be presumed that there was an objectively independent market for metering and billing

services, as an electricity trader transmitting energy would not ask for billing and cashing services to be provided separately from network use by an enterprise other than the network operator. The Monopolies Commission is of the opinion that the question of product market definition in dispute between the Federal Cartel Office and the appeals court only plays a minor role in this case, as a separate examination of metering and billing prices for the purposes of competition law must remain possible even if the relevant services only represent part of the total market for network use services. Metering and billing prices constitute a non-volume component of network fees that is clearly distinguishable from other components, and one that is usually invoiced separately to network users. In the view of the Monopolies Commission, the Court of Appeal's decision to suspend the Federal Cartel Office's ruling on abusive practices simply on the grounds that no separate product market exists for the metering and billing services in question thus raises considerable doubts from the point of view of competition policy.

166.* The Federal Cartel Office's abuse proceedings against Mainova AG, which denied so-called site network operators a connection to its medium-voltage network, sets a precedent for future, similar cases. The operation of site networks covers the establishment or lease and the operation of networks, transformer stations and substations on private land to supply a number of final customers. Mainova had refused to allow the connection of a site network, referring to its statutory obligation to provide energy to end consumers and to connect and provide energy as laid down in Section 10 EnWG, which applies only to end consumers. Another question in dispute between the Federal Cartel Office and the enterprise against which legal action was taken was whether the establishment and operation of site networks constituted a separate product market. The Court of Appeal in Düsseldorf passed a temporary injunction in favour of the Federal Cartel Office on this question. In this regard, the Court also established that the provisions of the Energy Industry Act to which Mainova referred in the grounds for its appeal do not limit the application of Section 19 GWB. The Monopolies Commission shares this view. It is of the opinion that the formation of single partial markets along the value chain in the wake of the liberalisation of energy markets, and thus the unbundling of vertically-integrated supply structures, must be possible in principle. In particular, market definition cannot be left up to the vertically-integrated monopolist. Competition for site networks opens up competition to set up cost-effective power stations and to efficiently operate low-voltage grids, leading to a cost-effective general supply.

Merger control

167.* According to the Federal Cartel Office's merger control statistics, their number of cases dropped to 2,449 in 2002/2003, a reduction of just under 5%. New notifications have declined by 11.5% compared to the period covered by the previous report, from 3,303 to 2,923. The bulk of mergers were horizontal mergers. Main examination proceedings (second-phase cases) were initiated in 130 cases. In 78 cases, proceedings were completed, and in 18 of these cases, obligations and conditions were imposed. There were 38 pre-notification stage cases. Eight mergers were prohibited, of which five have become final. As was the case in previous reporting periods, the dominant type of merger involves the acquisition of shares. This is followed by acquisition of assets and the setting up of joint ventures.

168.* Within the framework of their decision-making practice under merger control law, the Federal Cartel Office and the Court of Appeal in Düsseldorf continue to assume that in the case of cross-border markets the relevant geographic market under the Act Against Restraints of Competition cannot be larger than the territory of the Federal Republic of Germany. In any examination of dominance, effective domestic competition as a result of foreign enterprises is always taken into account in the context of the overall assessment of all relevant circumstances. However, the aim of the legislator is that the economically relevant market should be the decisive factor, both in defining the market and in assessing dominance, even

if that market is larger than the territory of the Federal Republic of Germany. Since clarification to this effect within the context of the Sixth Amendment to the Act Against Restraints of Competition in 1998 has had no effect on decision-making practice, this is to be guaranteed by further supplementing Section 19 Paragraph 2 in the upcoming Seventh Amendment to the Act Against Restraints of Competition.

169.* The presumption criteria of Section 19 Paragraph 3 GWB require the market shares in the relevant product and geographic markets to be quantified. Thus, the basis for assessment of dominance is lacking if the national competition authority has no way of reliably establishing the market structure in a larger relevant geographic market due to a lack of investigative and enforcement powers. Unfortunately, in practice this is often the case. As a result, the planned legal amendment means that merger control in cross-border markets is substantially ineffectual. In the view of the Monopolies Commission, this should be countered by having domestic market conditions serve as an indication of the market conditions in the relevant geographic market. In addition, the inclusion of a clause in Section 39 Paragraph 3 GWB could be considered to the effect that when enterprises notify a concentration affecting a cross-border market, they should give details of their market share and the estimated market share of their three to five largest competitors in this market. This would correspond to the obligation to disclose market shares pursuant to Section 39 Paragraph 3 Item 4 GWB. This requires enterprises to provide information on market shares within the context of notifying a merger, including the basis of their calculation or estimate, if these are at least 20% within Germany, or a major part of it. Finally, it should be recalled that the problem of the lack of investigative powers outside the area of validity of the Act Against Restraints of Competition could be reduced by requiring foreign competition authorities to support German investigative activity within the framework of merger control. The legal bases for this are overdue. To date, neither the European Community nor individual states have made sufficient efforts to create them.

170.* In the Holtzbrinck/Berliner Verlag case the decision of the Federal Cartel Office raised the question of how to establish dominance in markets with differentiated products. The Monopolies Commission shares the view of the Federal Cartel Office that the merger of Holtzbrinck and Berliner Verlag would have strengthened a dominant position and thus had to be prohibited. However, the argumentation for the ban should have been based to a greater extent on an analysis of the strategic possibilities and of the specific characteristics of the newspaper markets in Berlin, particularly with regard to the heterogeneity of the newspapers on offer and their readers' preferences.

171.* In differentiated markets, the scope of conduct is restricted in particular by companies whose products are addressed to the same target group. If, as a result of a concentration, the competition for certain target groups no longer exists, greater exploitation of these customers is an obvious strategy. In the Holtzbrinck/Berliner Verlag case, the Monopolies Commission arrived at the assessment that a merger would likely result in greater exploitation of readers in East Berlin. According to this assessment, the *Berliner Zeitung* would give up its aim of extending its position in the western part of the city, leaving that territory to the *Tagesspiegel*. As a consequence, the *Berliner Zeitung* was likely to see a price hike or a fall in quality, to the particular disadvantage of readers in East Berlin.

172.* In general, it may be concluded from the Holtzbrinck/Berliner Verlag case that in markets characterised by differentiated products, the analysis of the market structure should be supplemented by a comprehensive analysis of the heterogeneity of consumer preferences and enterprises' strategic possibilities. Understanding these preferences is the central prerequisite for judging the scope of conduct enterprises have as a result of their market share. The current law not only permits such an analysis (Section 19 GWB), but actually requires it.

173.* In a letter dated 15 August 2001, E.ON AG notified to the Federal Cartel Office its acquisition of 51% of the shares in Gelsenberg AG, Hamburg, and in a letter dated 9 November 2001, it notified to the Federal Cartel Office its acquisition of 99.6626% of the shares in Bergemann GmbH, Essen. Through these two mergers, E.ON intends to acquire a majority of the capital and voting rights in Ruhrgas AG, Essen. The Federal Cartel Office prohibited both mergers with largely similar arguments, as they were likely to strengthen dominant positions in sales of both natural gas and of electricity. Ruhrgas' dominant position in the market for supply of natural gas to distributors would be strengthened as gas sales to E.ON's conglomerate enterprises and holdings would be secured by the merger and Ruhrgas would also acquire the opportunity to increase these sales in the future. The Federal Cartel Office assumes that in the future, taking decisions on gas supply contracts, the E.ON group will give preferential treatment to the concerns of its subsidiary Ruhrgas. The Federal Cartel Office also expects E.ON's dominant position in the markets for the supply to large gas customers and local gas redistributors to be strengthened, as Ruhrgas would no longer be a potential competitor for supplying their customers. In addition, the Federal Cartel Office presumes that the dominant position of a duopoly consisting of E.ON and RWE in supplying large power customers and redistributing energy supply enterprises would be strengthened. This strengthening would result from E.ON gaining considerable competitive influence over the most important domestic natural gas importer and supplier as a result of the merger, thus gaining structurally-secure access to natural gas, an increasingly important primary source of energy for generating electricity.

174.* In general, the Monopolies Commission considers the Federal Cartel Office's assessment to be convincing, both with regard to gas and electricity markets. However, the E.ON/Ruhrgas case also raises fundamental questions concerning the concept of dominance and on dealing with vertical integration in merger control. A major problem is that the concept of dominance is based on an individual market, while the effect of vertical mergers on competition mainly results from the interaction of different markets. In the E.ON/Ruhrgas case, one could ask how Ruhrgas' position in long-distance gas markets could be strengthened by favourable sales conditions while at the same time the position of the E.ON companies in gas redistribution markets could be strengthened by favourable purchasing conditions. Methodologically, this raises the question as to how the transformation of market transactions into internal conglomerate transactions resulting from vertical integration should be included in an analysis of dominance. Vertical integration changes the market itself, as enterprises which were independent suppliers or demanders before the merger do not operate independently any more. The real effect of vertical integration on competition arises less in markets where business shifts as a result of vertical integration to become wholly or partly internal conglomerate business, than in upstream supply markets and downstream sales markets. It is more difficult for competitors to enter these markets if, in order to do so, they have to enter two markets simultaneously. The Federal Cartel Office takes account of the market foreclosure effect resulting from vertical integration arguing that potential competition through Ruhrgas ceases to exist. However, mistakes may result from this line of argument insofar as the market foreclosure effect is not limited to the loss of potential upstream competitors, but may also restrict competition in the downstream market. On the other hand, a schematic application of this argument could lead to any purchase or sale of a natural monopoly being prohibited, since simply by showing a buying interest, the purchaser indicates that he may also be a potential competitor.

175.* In the period covered by the report, several mergers by oligopolists were cleared because the Federal Cartel Office regarded it as proven that oligopolistic dominance was unlikely to be strengthened. Here, too, the Monopolies Commission is of the opinion that a more intensive examination of strategic possibilities should have been carried out. In particular, the danger that through a narrowing of the

oligopoly, unrivalled collective dominance might replace any residual competition that previously existed was insufficiently taken into account .

176.* The conditions for the emergence of collective dominance are to be seen as favourable if there is a high level of market transparency, i.e. if it is easy for oligopolists to infer competitors' behaviour from changes in market data. Collective dominance is further facilitated, if there is potential for threats and reprisals which serve to maintain discipline within the oligopoly. Moreover, the existence of a coordination mechanism is required, enabling oligopolists to collude. This can take place in informal relations between enterprises' staff, for example. It is also possible for the market to be divided up according to region or product variants so that no competitive incursions are made into other companies' "territory".

177.* In the mergers of BASF and the Northeast Pharmaceutical Group Corporation in the market for synthetically-produced Vitamin C, of Avery Dennison and Jackstädt in the market for self-adhesive labels and of Gyproc and Lafarge in the market for gypsum plasterboard slabs, the conditions for presuming oligopolistic dominance pursuant to Section 19 Paragraph 3 GWB were fulfilled. The Federal Cartel Office nonetheless cleared mergers that led to a narrowing of these oligopolies. In the view of the Monopolies Commission there were at least pointers in the above-mentioned cases that the conditions specified above favouring the emergence of collective dominance may have been fulfilled. Exception is to be taken to the fact that in its decisions referred to above, the Federal Cartel Office did not sufficiently examine these pointers. Thus, the probability of oligopolistic dominance being strengthened was underestimated.

178.* In the period covered by the report 2002/2003, 18 mergers were cleared with obligations or conditions, of which eleven cases were cleared in 2002 and seven in 2003. Resolutive conditions are getting increasingly important.

The practice of imposing obligations in public transport is of particular interest from the point of view of competition policy. In merger cases involving public transport, the Federal Cartel Office imposed the obligation or resolutive condition that the licences or transport contracts were to be allocated through competition for the market. The Monopolies Commission is sceptical as to the practice of imposing obligations in public transport. The intensity of competition may be presumed to be considerably restricted if the major competitors collude for the award of new licences. The obligations or resolutive conditions cannot compensate for worse competitive conditions.

179.* The Monopolies Commission considers the way the Federal Cartel Office has used conditions and obligations to be problematic, and even illegal, as in a case like Getinge/Maquet. The obligations imposed here are conduct-related obligations which have to be monitored over an envisaged period of ten years, the usual forecast period for competition law considerations. The interpretation that this is a one-off measure to open up the markets, which happens to last ten years, would remove all meaning from the relevant legal standard. The fact that the Federal Cartel Office tries to translate impermissible conduct-related obligations into contractual conditions under private law does not contradict this assessment. The Getinge/Maquet case also indicates that the legal standard makes sense, as it will hardly be possible to guarantee fulfilment of the envisaged obligations for a ten-year period.

180.* The Monopolies Commission continues to view the competition situation in the energy sector with great concern. By acquiring shares in municipal utilities and regional providers, the large transmission companies succeeded in further securing their sales of electricity and gas in the end customer markets during the period covered by the report. The Federal Cartel Office assumes that E.ON and RWE constitute a dominant duopoly in the nation-wide markets for the supply of electricity to redistributors and large customers. In addition, almost all municipal

utilities and regional suppliers have a monopoly in their traditional supply area, the regional markets for the supply of electricity and gas to household and small business customers. Nevertheless, only two of numerous mergers notified were prohibited, of which one prohibition was challenged at the Court of Appeal in Düsseldorf: Two further cases were withdrawn by the applicants.

181.* One reason for the surprisingly small number of prohibitions in view of the market situation is to be found in the major importance of the minor-merger clause in evaluating notified mergers. Particularly in the gas markets, but also in the electricity markets, end customer markets are not subject to merger control in many cases, as the turnover in the market concerned is below the minor-merger limit. However, the significant competitive influence of municipal utilities' shareholdings here derives not from the significance of one single market, but from the combined effect of many small shareholdings, each of which would be insignificant on its own.

182.* The four German transmission companies, EnBW, E.ON, RWE and Vattenfall, have further expanded their market power in the German power market by means of a strategy of vertical forward integration. Small consumers have borne the brunt of this development. Since the final demand for electricity is extremely inelastic, municipal utilities and regional distributors were able to pass on their excessive purchasing prices to consumers. Offers by independent energy suppliers, which are considerably lower than the prices of regional power providers, continue to be unlikely in the future on account of excessive fees for network use.

183.* The level of intensity of competition in local public transport is to be regarded as extremely low. To date, the competent authorities have made insufficient use of the possibility of opening up markets through awarding contracts by means of competition. Market entry is also impeded by the amount of investment that is necessary and by access to information on the transport industry. As a result, DB Regio and municipal transport companies dominate public transport.

184.* The decisions of the Federal Cartel Office are evidence of the danger that municipal transport companies that have a dominant position in regional public transport markets attempt to reinforce this position by merging with dominant companies in neighbouring transport areas or with DB Regio subsidiaries. In the relevant cases, mergers were only permitted upon the condition that in future, there will be Europe-wide calls for tender in the transport areas concerned.

185.* In the view of the Monopolies Commission, doubts arise as to whether these conditions compensate for the negative effects of mergers. In the case of mergers with enterprises beyond the limits of neighbouring markets, obligations affecting only one of the markets concerned appear to be insufficient. It may be that ultimately, mergers involving regionally dominant companies will lead to a dominant position in a wider area.

186.* Another problem arises from the fact that competitive pressure in local passenger rail transport in Germany is unevenly distributed. This gives DB Regio the opportunity to defend its market share by means of a strategy of cross-subsidies. DB Regio may use revenues from regions where it faces no competition to assert itself against the competition in other regions.

187.* At the moment, the intensity of competition in public transport is very low. Thus, competition policy's objective of opening up markets can only be achieved if it is made obligatory to award contracts through a competitive process. Most probably, it is not sufficient to leave this possibility at the discretion of the public authorities approving the award of contracts. The low level of willingness to subject municipal transport companies and DB Regio to competition means that the hoped-for benefits of more intensive competition – such as increased efficiency of the

service-providers, which could ultimately reduce the need for public grants – will not be realised.

188.* As in previous years, the Monopolies Commission's report on the development of competition in the wholesale and retail trade focuses on food retailing. In spite of a high level of concentration, food retailing continues to be characterised by highly intensive competition. The importance of price competition for consumers becomes evident considering that it is the low-budget supermarkets in particular that are gaining market shares, whereas enterprises with other sales lines are increasingly getting into economic difficulties. The concentration activities in the period covered by the report give no cause for concern regarding competition. As in the period covered by the previous report, they are related to corporate restructuring or are the result of market exit. They did not involve any notable shifts in market share.

189.* In drug-store retailing, the concentration developments which have been taking place for years have continued. In particular, Tengelmann's efforts to restructure or sell its drug-store chain kd kaiser's drugstore GmbH, and the expansion efforts of Dirk Rossmann GmbH, Burgwedel, and of Schlecker have led to further take-overs during the period covered by the Monopolies Commission's report. The take-overs have not led to the creation or strengthening of dominant positions, neither in regional sales markets for drug-store goods nor in the purchase markets for individual products or product groups. However, in view of the level of concentration reached in drug-store retailing, the Monopolies Commission is of the opinion that additional mergers between leading drug-store chains should be checked carefully.

190.* The Federal Cartel Office has tolerated purchasing cooperations by food and drug-store wholesalers and retailers since the end of 2002, arguing that the law would be changing in the foreseeable future and that it would thus be impossible to enforce a prohibition order. When regulation 1/2003 came into force on 1 May 2004, purchasing cooperations no longer constituted a substantive breach of competition law. Although they do in principle fall under the ban contained in Article 81 Paragraph 1 of the Treaty establishing the European Community (EC-Treaty), adverse effects on prices, production, innovation or diversity and quality are only likely if the participating enterprises have a joint market share of more than 15% of the respective purchasing or sales markets. The Monopolies Commission concurs with the Federal Cartel Office in its assessment that while the purchasing cooperations of Globus/EDEKA/AVA (food traders) and Rossmann/Müller (drug-store goods) did contravene competition law under the law in force during 2003, a ban would not have been enforceable in 2004 due to changes in the legal situation.

European merger control

191.* Two developments were of key importance for European merger control practice in the period covered by the report 2002/2003. Firstly, the Council of the European Communities approved the second reform of the Merger Control Regulation on 20 January 2004. For the time being, this brought to an end a reform process lasting several years. The reform replaces regulation (EEC) 4064/89 of 1989 by regulation (EC) 139/2004, which came into force on 1 May 2004 – at the same time as regulation 1/2003. The European Commission published "Guidelines on the assessment of horizontal mergers" in parallel with the Merger Control Regulation.

192.* The changes in merger control affect both substantive and procedural aspects. From the point of view of substantive law, the new text of the substantive test in Article 2 Paragraph 3 of the new version of the ECMR is of outstanding significance. The so-called SIEC test (significant impediment to effective competition) replaces the test of dominance. Currently there is still a remarkable level of uncertainty as to the future interpretation of the new substantive test.

Hopefully, in the future the European Commission will continue to issue a prohibition in all cases in which the conditions of dominance are fulfilled under the existing legal situation. However, it can no longer be ruled out that clearance decisions will be taken in such cases on the basis of the new substantive test. In this context, the importance the European Commission attaches to efficiency aspects is likely to be of crucial importance. In this area, too, however, much remains unclear and vague. The amendment to the substantive prohibition criterion and the greater consideration given to efficiency advantages gives the Commission much wider scope for decision-making than hitherto in judging mergers. Moreover, it is clear that there will be a marked increase in legal uncertainty.

193.* From the procedural point of view, the referral regime has been altered and deadline arrangements have become more flexible. In principle, this is to be regarded positively. It is noticeable, however, that the ECMR reform makes it considerably easier to refer cases to the European Commission, while arrangements for referring a case to Member States remain largely unchanged. Also, the newly-introduced possibility for the merging parties to request the referral of a case makes it considerably easier for responsibility to be transferred to the European Commission than for proceedings to be referred to Member States. In this regard, it is to be welcomed that it is only possible to refer a case to the European Commission if the Member State concerned agrees. In the context of introducing more flexibility into the deadline regime when commitments have been offered, it is problematic that the new arrangement does not provide any reliable solution for breaches of Member States' rights of participation, which have occurred frequently in the past.

194.* The legal reform has been accompanied by an organisational restructuring of the Merger Task Force. The post of Chief Economist has been created at the Directorate General for Competition. In future, he will support the work of the Directorate General with a team of economists. The staff of the Merger Task Force have been allocated to various Directorates. In addition, 'shadow' panels are to be set up to ensure that discussion takes place within the Directorate General for Competition. These measures are to be welcomed because they promote the exchange of information and experience among the staff of the Directorate General and contribute to avoiding any possible errors of judgement and inadequate evidence before the Commission issues its decisions. Finally, a liaison officer for consumer affairs has been appointed.

195.* In 2002, the Court of First Instance for the first time overturned three prohibition decisions by the European Commission. On 6 June 2002, the Court quashed the European Commission's judgement in the *Airtours/First Choice* merger proceedings case. Further rulings followed in October 2002, in which the prohibition and unbundling decisions taken by the Commission in the *Schneider Electric/Legrand* and *Tetra Laval/Sidel* cases were overturned. In all three judgements, the Court did analyse the European Commission's decisions in great detail. While the Court confirmed the Commission in some fundamental points, in many individual aspects it illustrated that the analysis of the Commission was either incorrect or superficial. The Commission did not adequately present alleged relationships and developments or provide evidence for them. In comparison with earlier rulings this was an increase in the standard of review by the Court. The rulings also contributed to changing the Merger Control regulation and to the institutional restructuring of the Directorate General for Competition.

196.* According to the European Commission, 491 notifications were submitted in Brussels during the period covered by the report, almost a third less than in 2000/2001. The European Commission closed 465 cases in Phase 1, of which 21 mergers were only permitted with commitments. In 16 cases, the European Commission initiated Phase 2 proceedings, and it concluded 15 cases after carrying out an in-depth investigation. Here, the number of cases declined considerably as well, as in 2000/2001 the Commission took 30 Phase 2 decisions. The number of

Phase 2 decisions has now fallen again to its 1998/1999 level. Of the 15 Phase 2 cases, the Commission cleared four concentrations without imposing any commitments, the remaining eleven cases were approved with remedies.

197.* For the first time since 1992, no merger was blocked in the period covered by the report. In the previous two-year period, in contrast, the Commission blocked seven mergers. In total, 18 decisions were blocked. At the moment, it is not possible to establish the exact reasons for the decrease in the number of prohibitions. This development may be linked to the fact that there has been a significant decline in overall merger activity during the period covered by the report. Another cause may be the three above-mentioned rulings by the Court of First Instance in 2002. The Court's intense criticism of the presentation of the cases and the economic basis of the administrative decisions could have led the European Commission to place the focus of its activities in the period covered by the report on reorganising European merger control. Finally, the absence of any prohibition decision may also be understood as the expression of a certain basic trend at the European level to emphasise industrial policy considerations at the expense of competition criteria. This may lead to problematic cases no longer being blocked. Instead, they are cleared with extensive and far-reaching conditions and obligations being imposed.

This impression appears to be confirmed by the fact that in the period covered by the report, the European Commission approved a number of planned mergers which led to the creation of monopolist or quasi-monopolist structures with market shares of 90-100%. The clearance texts, too, have reached a remarkable length in some cases. If it is the case that mergers had not been prohibited due to the general reorganisation of merger control or on account of trends in the European Commission's industrial policy, the Monopolies Commission would regard this as a matter of the utmost concern.

198.* Under certain conditions, the Merger Control Regulation allows proceedings to be referred from the European Commission to the Member States and vice versa within the context of the allocation of responsibilities. During the period covered by the report, the Commission partially transferred ten cases to national competition authorities, and completely referred twelve further cases to the Member States. In two cases, it rejected applications for referrals. Conversely, the Member States transferred three merger projects to the European Commission which originally came under their responsibility.

199.* In principle, the referral option is to be evaluated positively, because it allows to finetune the allocation of responsibilities. Due to their geographic and substantive proximity to the markets concerned, national authorities may often be better placed to carry out necessary investigations and to manage proceedings than the European Commission. However, the danger cannot be ruled out that in applying for the referral of a case, Member States pursue industrial or general political interests. The European Commission can counter this risk by prosecuting a Member State or by using its discretionary powers restrictively when referral applications are made. In addition, thought could be given to obliging national authorities by law to apply only competition-related criteria in making a legal assessment of transferred merger control cases. They would then no longer be allowed to take into account public-interest benefits within the context of a Ministerial Authorisation or with regard to the failing company defense. In cases of partial transfer, such a commitment would also help to avoid contradictory decisions at European and domestic levels.

200.* A clear focus of the European Commission's examinations in the period covered by the report lay in the creation or strengthening of an individual dominant position. In the view of the European Commission, not one of the Phase 2 cases led to oligopolistic dominance. In the majority of cases, the horizontal effects of the concentration were the main cause of the European Commission's serious concerns.

In contrast, vertical and conglomerate effects played only a subordinate role in the period covered by the report.

The existence of large market shares continued to be a major indication of the creation or strengthening of a dominant position. As well as the absolute and relative market shares of the merging parties and their current competitors, further criteria included in the Commission's assessment were existing barriers to market entry, the price sensitivity and strength of the demand side, the parties' joint range of products and the distribution of R&D capacities.

201.* A new development in decision-making practice is the inclusion of "closeness" between the products of the merging parties on the basis of empirical studies. The European Commission examined substitutability in a number of cases in order to clarify whether the calculated market shares accurately reflected the position of the merging parties, overestimated or underestimated them. In two cases, Siemens/Drägerwerk and GE/Instrumentarium, the Commission carried out detailed statistical and econometric studies and used its findings to reinforce its qualitative assessment. For its calculations, it polled clients and competitors and evaluated the parties' invitations to tender as well as internal documents. In the GE/Instrumentarium proceedings, the Commission included econometric as well as statistical analyses in the decision-making process for the first time. The European Commission attempted to measure the possible effect the merger would have on prices, in particular using multi-variate linear regression.

In the view of the Monopolies Commission, it can indeed be useful to carry out quantitative analyses to supplement and, if necessary, support the qualitative assessment of a merger. However, the present case also shows what kind of difficulties may be associated with a quantitative approach. A major problem consists in the fact that it is impossible to check the results presented by the Commission, as the econometric models on which they are based are not presented in detail and the calculations carried out are not explained in detail. The availability and compatibility of the data required constitute a major problem. Finally, the work involved in carrying out quantitative analyses is not negligible. In this case, it placed a burden not only on the Commission and the merging parties, but also on their major competitors and a large number of customers. In the GE/Instrumentarium case, finally, there was a remarkable discrepancy between the result of the quantitative calculations and the result of the qualitative assessment, for which the European Commission did not provide any explanation.

202.* In the Newscorp/Telepiu proceedings, the Commission dealt with the causality between a merger and dominance, or to put it more precisely, with the issue of a failing company defense. The Commission's decision does not allow any clear statement to be made about how it intends to proceed in future cases of a failing division. Nor does the decision give a clear answer to the question of whether the Commission considers the failing company defense to be applicable even if the enterprise in need of restructuring is part of the purchasing company. Due to a certain vagueness and incoherence, little precedent effect can be attributed to this decision. The Monopolies Commission is in favour of the acquiring company, too, being able to make use of the failing company defense. The reason for permitting mergers involving a failing company is that mergers of this kind merely bring about a situation that would occur soon in any case, even if there were no merger. This policy reason does not depend on whether it is the acquired or the acquiring company that has to be reorganised.

203.* In the period covered by the report, the European Commission approved a number of mergers only with remedies. It is remarkable that the explanations on the conditions and obligations imposed, which are generally to be found in an annex to the decision, often reach an amazing length. In the Promatech/Sulzer Textil and DaimlerChrysler/Deutsche Telekom/JV proceedings, these explanations make up about half of the entire text of the decision. In other cases, the explanations on the

commitments and trustee mandates still make up a good third of the total volume of the decision. Part of the reason for this could be the European Commission's model texts for divestiture commitments and trustee mandates published in May 2003, which contain extremely detailed prescriptions for the relevant parts of the clearance decisions. It is to be evaluated positively that clearance practice has thus been standardised, thereby accelerating proceedings. In addition, the model texts contribute to the efficient use of the staff and make it easier for the merging parties to enter into negotiations on possible remedies. However, if extensive clearance packages are due to industrial policy tendencies of the European Commission, this is to be firmly rejected.

204.* In a number of cases the European Commission received divestiture commitments. As structural measures, these are in principle the best way to clear up quickly and permanently any competition concerns. This positive effect is further reinforced if the Commission requires the merging parties to fulfil their commitments even before carrying out the notified merger. The up-front buyer model ensures that the conditions imposed on this clearance are actually fulfilled and prevents problems that could arise if unbundling is carried out retrospectively.

205.* During the period covered by the report, the Commission also accepted commitments which are clearly conduct-related, however. In the Newscorp/Telepiu proceedings, the merging parties committed themselves to allowing their competitors non-discriminatory access to their infrastructure facilities. The European Commission probably feels that its view of the matter has been endorsed by the Court of First Instance in the ARD/Commission proceedings. The Court established that clearances specifying the granting of non-discriminatory access to infrastructure facilities are an improvement on general abuse control pursuant to Article 82 EC-Treaty simply in that they transfer the burden of proof to the merging parties.

In the Siemens/Drägerwerk, GE/Instrumentarium and DaimlerChrysler/Deutsche Telekom/JV cases, the parties committed themselves to keeping open technical interfaces. In the view of the Monopolies Commission, the commitments made contain considerable potential for abuse and require ongoing control, possibly for decades. In addition, in view of the complexity of the commitments, it is hardly possible to monitor them efficiently in practice. Such commitments should therefore be accepted reluctantly if at all.

206.* The European Commission clearly also recognises the potential conflicts which might arise from the above-mentioned commitments. In its view, thus, effective control is essential. However, in most cases it deems unnecessary to control the conditions and obligations it imposes itself. Rather, it is increasingly transferring necessary monitoring activities to third parties, involving additional experts, national authorities and arbitration proceedings, as well as trustees. It remains to be seen whether this strategy of resorting to domestic authorities and private arbitration proceedings will be successful. What is likely to be decisive is whether the intended procedures guarantee final conflict resolution without any major delays and thus have a sufficiently deterrent effect on the merging parties.

207.* In some cases, there are doubts as to the appropriacy of the accepted commitments as they may not be able to fully resolve the competition problems that arise. Moreover, commitments always appear to be inappropriate when they are not made the subject of conditions and obligations, but are only "acknowledged". Here, the European Commission has no possibility of enforcing the commitments made, which means that their fulfilment ultimately depends on the cooperation of the merging parties.

208.* From the point of view of procedural law, it is especially problematic that the Advisory Committee's participation rights were once again greatly undermined in the period covered by the report and can therefore no longer fulfil their purpose. It

is difficult to avoid the impression that the European Commission has little interest in a substantive exchange of views with national competition authorities. In this regard, the so-called review clause in the model test on commitments is to be evaluated critically. The review clause allows the merging parties to apply for obligations or conditions in the clearance package to be dropped or amended. It seems to be of particular concern here that the text of the review clause is completely open, basically allowing any possible later amendment to commitments. However, the view of the Advisory Committee has only been heard on the original commitments and its approval relates only to them. The Federal Republic of Germany should enforce greater respect for the rights of its institutions at the European level, taking legal action at the European Court of Justice if necessary.

209.* The Court of First Instance has given important impetus to the further development of decision-making practice in a number of rulings on the European Commission's merger control decisions. Among other things, the Court of First Instance made clear that in principle, legal actions by third parties against referral decisions are permissible. The Court also granted the European Commission broad discretionary power as regards whether it wished to pursue proceedings itself when the statutory conditions were fulfilled or to hand them over to the national authority. In this way, the Court unnecessarily extended the European Commission's scope of action. In the past, the European Commission itself assumed that when the statutory conditions were fulfilled, additional reasons had to be given for its decision to refer or not to refer a case. This contributed to a certain self-commitment on the part of the Commission and to its decisions being more predictable.

In the Philips/Commission proceedings, the Court of First Instance established that neither the decision to refer the case nor the partial clearance by the European Commission had binding effect on the substantive decision by the national competition authority. While this is logical, it should nevertheless be considered that Member States may also pursue industrial policy or general political interests by means of an application for referral. It should be noted positively in this connection that the European Commission has certain sanctions to limit or prevent such conduct.

210.* The rulings by the Court in which it overruled three prohibition decisions by the European Commission were of particular importance. Almost without exception in these cases, public opinion concurred with the Court's criticism, which was sometimes harsh. It went almost unnoticed, however, that the rulings confirm the Commission's decision-making practice in some essential points. In the *Airtours* ruling, the applicability of the Merger Control Regulation to cases of oligopolist dominance is confirmed. In addition, the Court basically approved the criteria used by the Commission in examining oligopolist dominance. The Court used the *Tetra Laval* proceedings to follow the Commission in establishing the applicability of the Merger Control Regulation to conglomerate concentrations.

211.* In the *Airtours/Commission* ruling, the Court made a checklist of criteria for cases of oligopolist dominance. Firstly, the Court requires a certain level of market transparency, secondly, the members of the oligopoly have to have sufficient punishment options and thirdly, competitors and customers may not be in a position in which they could easily avoid the oligopoly. In a second step, the Court showed that the European Commission had made a large number of errors of judgement and had provided inadequate evidence on many points. One must concur with the Court that a reasoning that assesses punishment based on transparency is problematic when there is a lack of transparency. But the Court's argument that transparency is a necessary condition for collusion takes too narrow a view of this problem. The *Airtours/First Choice* case was the starting point of a broad public discussion on the form the substantive test should take in the ECMR, which ultimately led to the introduction of the SIEC test at the European level.

212.* In the Tetra Laval/Commission proceedings, the Court of First Instance made a statement on conglomerate concentrations for the first time. The case pinpoints certain problems in defining markets and differentiating between horizontal and conglomerate mergers. In the case of differentiated products, market definition, i.e. drawing a line between products for which an intensive competitive relationship is assumed and products which are presumed to be in a less intensive competitive relationship, is always somewhat arbitrary. In the present case, while the European Commission did assume strong horizontal relations between the markets for cardboard and plastic packaging, it did not regard the relationship between them as being close enough to classify them as being the same market. Accordingly, the formal reasons it gave for its decision to prohibit the concentration were its conglomerate effects, but the significance of these effects was substantively based on the horizontal relations between the individual markets.

In the view of the Monopolies Commission, it would be useful to base examinations of conglomerate mergers, too, to a greater extent on market structure criteria, as specified, for example, in Section 19 Paragraph 2 GWB. The Monopolies Commission considers it to be problematic if prohibition decisions are taken against mergers which do not lead directly to the creation or strengthening of dominant positions, but enable such creation or strengthening to occur for the first time on account of certain forms of conduct. If, on the other hand, one takes the position that in the case of conglomerate mergers, the creation or strengthening of a dominant position does not take place immediately, but only after a certain period of time and on the basis of future conduct, conduct-related commitments by the merging parties in order to avoid dominance are to be regarded as just as problematical as conduct-related commitments not to take advantage of a dominant position.

In its examination, the Court moved away from market structure control to a conduct-based examination of mergers, in which dominance results from certain forms of conduct. In this regard, the Court made very high demands on demonstrations of anti-competitive conglomerate effects. This careful attitude is confirmed by the experience that conglomerate concentrations often have a neutral or even a positive effect on competition. They may certainly have negative effects in individual cases, however. On the basis of the present ruling, it is unlikely that the prosecution of such cases by the authorities will be promising in future. The announced guidelines will provide new material for the debate on the treatment of conglomerate concentrations under merger control law. The European Court of Justice, with which the Commission has lodged an appeal against the present ruling, may also express a view on the problem.

213.* In all three rulings, the Court accused the Commission of major errors and gaps in its reasoning. The rulings issued in the period covered by the report allow to conclude that the European Commission's obligation to provide evidence applies equally to the core and to the peripheral markets affected by a merger and that the demands made on evidence are just as high in cases of clearance as they are when a merger is blocked. While the Court does appear to apply significantly stricter standards in the case of conglomerate concentrations, this impression may be mainly due to the fact that in the case of conglomerate concentrations, the addition of market shares does not have the same indicative effect as it does in horizontal mergers. As a result of the ruling, it is likely that the European Commission will have to carry out deeper and broader investigations in future. Also it will have to considerably improve the economic basis of its decisions and make it more comprehensible.

214.* In a number of cases, the Court's decision was made under the expedited procedure for which the parties have been allowed to apply since 1 February 2001. While this led to a considerable speeding up of the procedure, merging parties would welcome a further reduction in the length of the procedure. The implementation of

this requires measures to be taken within the Court, mainly increasing the Court's staff and setting up chambers specialising in competition law.

V. Competition in the market for non-mandatory pension schemes

215.* The market for non-mandatory capital-funded old-age provision is becoming increasingly important. Due to the current demographic development, characterised by low birth rates and an increasing life expectancy, the number of contributors to the public pay-as-you-go system relative to the number of pensioners will fall sharply in the coming decades. Thus, the current level of pensions cannot be maintained. Additional provision by people currently in the labor force is necessary so that they can maintain their living standard in old age.

216.* In spite of the difficult demographic conditions, we assume that the pay-as-you-go system will continue to be in a position to provide at least a minimum level of income in old age. As to the question of why and to what extent the pay-as-you-go system should be replaced by a capital-funded system, the Monopolies Commission refers to the 1998 report by the Scientific Advisory Committee of the German Ministry of Economic Affairs on a fundamental reform in the public pension scheme. The Monopolies Commission shares the Committee's view that the level of pensions provided by the pay-as-you-go system has to be reduced in the long term. Nevertheless, in this report it concentrates on how competitive conditions in the markets for additional and voluntary capital-funded old-age provision could be improved. This covers company retirement schemes involving a pension-for-salary arrangement (*Entgeltumwandlung*) and private provision, for example through endowment policies or a so-called Riester scheme. Riester schemes are old-age pension schemes that have been implemented by the government on the occasion of a public pension cut in order to give employees a possibility to compensate for the cut.

217.* The fact that public pension agencies started to send each insured person annual information about his future pension claims, along with the public discussion upon the introduction of the Riester pension scheme, helped to adjust people's ideas on how little they could expect from the public pay-as-you-go system. However, polls show that future pension claims are still overestimated by a considerable proportion of the population. It is also worrying that those who are aware that they should make more provision for their old age often leave it at that. One reason may be the complexity of the schemes itself and the complicated eligibility conditions for state subsidies. This makes it time-consuming to gather information and difficult to take a decision. The Monopolies Commission therefore suggests to introduce performance figures for old-age provision schemes to make comparisons possible, as well as to standardize and to simplify the eligibility conditions for subsidies drastically.

Company pension schemes too complex

218.* Additional capital-funded provision for old age can either be made in the form of a company pension or privately. In Germany, company pensions used to be financed exclusively by voluntary payments from employers. Since 1 January 2002, however, employees themselves also have a right to build up a company pension within the framework of a pension-for-salary arrangement. There are five different ways of doing this: direct entitlement, support funds, direct insurance, *Pensionskassen* (pension insurance funds) and pension funds. *Pensionskassen* are more heavily regulated than pension funds and invest only a small portion of their capital in stocks. In addition, there are 27 Supplementary Pension Funds for public sector and church employees. A company pension differs from private provision inter alia in that the payment generally takes the form of an annuity. Private

schemes, on the other hand, usually involve complete or at least partial capitalization upon retirement. A company pension involves little effort for the employee, as the employer offers a very limited number of schemes and handles the payment of premiums. The disadvantage of company pensions, however, is that there may be problems in having a contract taken over when an employee moves to a new employer. Moving between the public and the private sector is particularly difficult.

219.* The Monopolies Commission welcomes the simplification of the tax treatment of different kinds of company pensions planned in the Retirement Income Act. In particular, the arrangements on direct insurance were adapted in line with pension funds and *Pensionskassen*. However, the standardisation should also include public service supplementary pension funds, something which is not provided for within the framework of the current reform.

220.* The Monopolies Commission advocates not extending the current exemption of contributions to company pensions from social security payments, which is limited until 2008. From the employee's point of view, this so-called "exemption" is a two-edged sword in any case. In the case of contributions to health insurance, it merely involves postponing the obligation to make social security payments to the time when the employee receives his pension. In the case of contributions to pension and unemployment funds, the exemption also involves a reduction in claims. From the employer's point of view, the exemption is a real reduction of cost. However, if the aim is to relieve employers through reducing non-wage labour costs, this should be done directly, not indirectly by promoting company pension schemes.

Lack of demand for Riester contracts

221.* In the case of private old-age provision, the most popular options continue to be home ownership and endowment policies. In contrast, the demand for Riester schemes fell far short of the legislator's expectations. In 2003, only 520,000 Riester contracts have been started, in contrast to approximately 5 million home loan and savings contracts and more than 8 million life insurance policies. The Monopolies Commission considers the main reason for the Riester schemes' lack of success to be the complicated rules for government subsidies. These are a disadvantage both for the broker and for the customer. The broker does not receive any compensation for the extensive consultancy which is necessary for a Riester contract. The customer is hardly in a position to understand what he is letting himself in for. While the replacement of a yearly application for subsidies by a one-time application under the Retirement Income Act is a first step in the right direction, the scheme is still much too complex and should be simplified further.

222.* Due to women's longer life expectancy, the premiums they have to pay are larger in order to receive the same annuity as men. The introduction of compulsory so-called unisex policies for Riester schemes in 2006 will make the conditions of a Riester contract less attractive to men. Under European law, insurance brokers are obliged to point to the relative disadvantages of Riester schemes for male policyholders to avoid becoming liable for damages. Thus, the proportion of men signing up for a Riester pension will decrease. Since insurance companies take this into account in calculating their premiums, it is likely that the unisex premiums will be close to those currently paid by women. Thus, compulsory unisex premiums are unlikely to decrease premiums for women, but are expected to increase premiums for men. The Monopolies Commission therefore rejects compulsory unisex premiums. They undermine the aims of the Riester pension. In the end, the number of Riester contracts will fall further.

Greater transparency through better comparability of old-age provision schemes

223.* Old-age pensions are extremely complex products, even without complicated subsidy schemes. This is partly due to the fact that in many cases, as well as being a capital investment, old-age provision schemes also provide an insurance against the financial risk of an unexpectedly long life. In addition, old-age provision schemes are often sold in combination with other services, which provide insurance against other kinds of risks. As well as guaranteeing an old-age pension with a capitalization option for the policy-holder, for example, life insurance policies guarantee financial support for surviving relatives if the policy-holder dies before the pension is disbursed. In this respect, such an insurance policy has nothing to do with old-age provision. If the policy-holder survives, he can choose whether he wants to receive the money as an annuity or as a fixed amount of money at the end of the term of the contract. Only in the first case does the scheme clearly serve to provide for old age, since the accumulation of capital is linked with a pension which insures the policy-holder against the financial risk of an unexpectedly long life. In the second case, the product is only an old-age provision scheme to the extent that capital has been accumulated.

224.* The fundamental complexity of old-age provision schemes cannot be defined away. In order to make it easier to choose an old-age provision scheme, however, the presentation of the schemes and their individual components should be standardised. It seems that consumers have particular difficulties in evaluating capital investments. Every citizen should be put in a position to have a basic understanding of how capital markets work. In addition, capital investment schemes should be furnished with three parameters which are to be calculated in a standardised way. The first parameter indicates the scheme's cost, the second its expected return, and the third its risk. The *Bundesanstalt für Finanzdienstleistungsaufsicht* (Federal Institute for the Supervision of Financial Services) has to check that the parameters are calculated according to the same, generally binding rules for all schemes so that it is impossible for suppliers to manipulate them.

Simplification and standardisation of the eligibility conditions for government subsidies

225.* The complexity of government subsidy options for old-age provision makes it even more difficult to choose a scheme. For different kinds of old-age provision schemes different types of subsidies are provided, e.g. exemption from social contribution payments, tax deduction schemes or state allowances. Thus, it is almost impossible to compare the amount of government subsidies for different schemes. Universally valid comparisons cannot be made in any case, since subsidies depend on individual parameters, such as one's current and future income, marital status and number of children. Due to large differences between the subsidy options, the consumer's attention when choosing a scheme easily shifts from its inherent features to the possibilities of receiving a government subsidy. Thus, he may decide for a scheme that is unsuitable simply because it receives a larger subsidy. The high cancellation rates of Riester schemes and life policies are an indication of the great difficulties consumers have in selecting a scheme.

226.* In order to avoid this, the Monopolies Commission calls for the standardisation of the conditions attached to subsidies for old-age provision schemes. This could be realised by the subsidy no longer being linked to individual schemes, but to the purpose of an old-age provision. Thus, all schemes providing for the creation of capital over a certain minimum period of time and for a capital sum not to be disbursed before the person has reached the statutory retirement age would receive the same subsidy. Schemes that do not fulfil these conditions would not be subsidised. In addition, all schemes that have the characteristics of old-age provision should be exempt from the obligation to be dissolved if the person receives unemployment benefits or social welfare. The Monopolies Commission does not

consider it to be wise that the full amount of capital saved has to be paid out as an annuity. The prospect of receiving a sizeable amount of money at one moment in time is much more attractive than the prospect of receiving a small monthly allowance. The demand for old-age provision schemes is therefore likely to be greater if there is at least the option of partial capitalisation, possibly before the person reaches retirement age.

227.* Insurance brokers play an important role in the old-age provision sector as intermediaries between investment companies and customers. The vast majority of brokers are currently paid by the supply side. Thus, the commission systems are structured to give the intermediary a financial incentive to take the supply side's interests into account. From the point of view of the Monopolies Commission, it would be desirable for brokers to be paid by the consumer rather than by the supplier. The remuneration could be made on the basis of the advisory work involved, instead of being defined as a percentage of the premium. Thus, the broker would have a financial incentive to take the interests of the consumer into account. At least, consultancy costs should be indicated in old-age provision schemes, so that the customer is more likely to be aware of a broker's self-interest in promoting certain schemes.

Taking systemic risks into account

228.* Like all capital investments, old-age provision schemes also involve a return risk. Two types of risk may be identified here, diversifiable and non-diversifiable risks. Diversifiable risks are risks which balance each other out at least to a certain extent through a widely-diversified investment policy. Thus, part of the downside risk of investing in individual shares can be eliminated by having a widely-diversified portfolio. So-called collective, i.e. non-diversifiable risks cannot be eliminated by diversification, however. As all sectors in an economy are affected by an economic crisis it is impossible to avoid this kind of risk by investing in a variety of sectors. While the development of trade in financial derivatives now makes it possible to control the allocation of collective risks, this does not in principle reduce the overall amount of collective risks.

229.* In recent years banks' risk management has increasingly led to risk being passed on to third parties in recent years. Often, insurance or pension companies are the contracting parties of such transactions. This development is to be welcomed, insofar as these companies are in a better position to bear the risks involved on account of their different financing structures. However, new problems may also arise. When there are mutual dependencies between different institutions in a network of contracts, for example, the difficulties of one institution could have an effect on all its direct and indirect contractual partners, calling into question the workability of the system as a whole. This is referred to as systemic risk. In order to control and limit systemic risks, the banking and insurance regulatory authority needs to analyse the risk structures of whole markets. Focussing on the risks of individual companies, which is what has been done in the past, is unsuitable for recognising the dangers of systemic risk.

Sharing non-diversifiable risks among market participants

230.* Collective risks should not be kept secret and hushed up. Quite the reverse – it is extremely important that both sides of the market are aware of the risk and share it in a wise way. Defined contribution schemes and defined benefit schemes are extreme forms of risk allocation. In the case of defined contribution schemes, the premiums of the policy-holder are fixed and the pension is the sum of the premiums and the dividends achieved by the investing company in the capital markets. The risk lies exclusively with the consumer, since he alone bears the costs of poor performance on the capital market, as he gets a smaller rent. Apart from the one-

sided allocation of risk, this system has an additional disadvantage: The investing company has little incentive to manage the capital entrusted to it particularly well.

231.* In the case of defined benefit systems, the payment to be made to the policyholder is fixed. The premium derives from the amount the policyholder wishes to receive and the expected returns on the capital market. The investment risk lies with the company investing the capital, or, in case of this company declaring bankruptcy, with the pension guarantee corporation. The tax-payer ultimately also bears part of the risk, as it is likely that in the case of a major bankruptcy, the central bank would act as a lender of last resort or the treasury would bail out with cheap loans and tax breaks. Yet, while the increased risk of a riskier investment strategy is not borne by the investment company alone, it does not need to share potential risk premiums. Therefore, the typical investment policy under a system based exclusively on defined benefits will be too risky from an overall economic point of view.

232.* Hence, it is a good thing that most schemes in Germany are a combination of defined contributions and defined benefits. Nevertheless, many concepts are unsuitable for appropriately allocating the collective risk of a capital investment. When concluding a life insurance policy, the insurer guarantees the investor a certain interest rate – almost always the highest rate permitted by the *Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin* (Banking and Insurance Regulatory Authority). In addition, at least 90% of returns must be credited to the investor's account each year. In the view of the Monopolies Commission, the guaranteed or maximum interest should not be adjusted to the current interest level within the framework of a regulation, but automatically, in order to rule out delays in adjustment. In addition, the adjustment of the guaranteed interest should always apply to all current contracts, regardless of when the contract was concluded, not just newly placed contracts. Currently, the interest guaranteed in a contract depends on the interest level at the time when the contract has been concluded, and may be between 2.75% and 4%. Automatically adjusting the interest level for all current contracts protects the consumer better in times of rising interest rates, and particularly when inflation rates are high, than the current arrangement, which also represents a high risk for life insurance companies in times of low interest rates.

233.* The obligation to credit at least 90% of market returns to investors' accounts each year, and the rather high guaranteed payments in some cases, implies that the scope of insurance companies is severely limited. If shares are sold at a high rate in order to realise profits, at least 90% of these profits become obligations as a result of them being transferred to the investor. Only the remaining maximum of 10% is left to the company to build up reserves for times of low rates. These are required, however, in order to be able to pay the guaranteed interest in case of loss. Such a provision, which served to protect consumers before deregulation of insurance markets in 1994, is too risky for insurance companies in a competitive regime where profits are lower, and thus, it is damaging for the entire system. The minimum share prescribed by law should therefore be reduced.

234.* At first glance, the nominal value guarantee granted under Riester contracts also serves to protect consumers. Together with the commitment to spread acquisition fees over a period of at least ten years (five years from 2005) it thus guarantees that the policyholder at least gets back the capital he has paid in, even if no further payments are made a short time after conclusion of the contract. The Monopolies Commission considers a guarantee defined in real terms to make more sense than a nominal value guarantee, which is of no value if inflation rates are high. In contrast to the arrangement under Riester contracts, the first life insurance premiums may be used in full to pay the costs of concluding the contract through a broker. This makes it more attractive for insurance companies and brokers to sell life insurance policies than Riester pensions. In order to give the two schemes equal chances in competition, the arrangements for the allocation of acquisition costs over time should be standardised.

235.* In choosing between a pension fund and a *Pensionskasse*, the employer's decision is distorted in favour of the *Pensionskasse* because in the case of a pension fund, the employer himself has higher costs due to the higher risk of pension funds. Thus, employers offering a company pension in the form of a pension fund have to meet the fund's commitments in case of the fund's bankruptcy and make contributions to the *Pensionsversicherungsverein* (Pensions Guarantee Fund). This is not the case with *Pensionskassen*. However, the employee benefits from the higher expected returns associated with pension funds. It is unlikely that pension funds will become widespread in Germany as long as there is no possibility for the employee, who benefits from higher expected returns, to carry the burden of the additional risks as well.

More competition at the European level

236.* At the European level, there is currently no effective competition among insurance companies from different countries. Since insurance contract law in Germany is binding – diverging agreements may only be made to the benefit of the policy-holder – and the law of the policy-holder's country always applies in cross-border contracts, schemes of foreign insurance companies always have to be tailored to the German legal situation. That impedes the market entry of insurance companies from other EU countries to a considerable degree. Thus, an optional European insurance contract law should be created which, if selected by the contracting parties, supersedes national law. This would make it easier for insurance companies from other EU countries to operate as suppliers in the German market.

VI. Development and perspectives of competition in the electricity supply

237.* April of this year marked the sixth anniversary of the opening of the market in the electricity supply industry in the wake of the 1998 amendment of the Energy Industry Act. The legislator's aim in abolishing the legally-closed electricity supply territories and introducing third party access to transmission and distribution lines under this amendment was to make the regulatory structure of the energy sector more competitive. Increasingly, the prevailing view, not only in Germany, but also in other European countries, was that the traditional organisation of the electricity sector, which took the form of vertically-integrated regional monopolies, could no longer be justified from the point of view of competition policy and that competition is possible in principle, at least in electricity generation and electricity trading. As international experience demonstrates, more competition through the stimulation of innovation processes, particularly in the generation sector, is likely to improve efficiency considerably. Following a phase of intensive competition in the first two years after liberalisation, however, the intensity of competition in electricity markets has meanwhile significantly decreased, caused by wrong directions in the development of the market structure and by a regulatory framework for the electricity sector which is not very favourable to competition.

238.* Unlike electricity generation and electricity trade, electricity transmission and distribution are to be classified as non-contestable natural monopolies. Electricity transmission is a natural monopoly, mainly because the system operator inevitably carries out its function centrally, while in the case of electricity distribution, it is due to the high capital investment involved in setting up a distribution network. System operation involves controlling the load flows in the transmission network by means of short-term technical coordination of the power plant input to balance out unplanned deviations between energy input and energy output.

Statutory framework and regulatory practice

239.* One necessary prerequisite for competition in electricity generation and electricity trade is access to transmission and distribution networks, and to the services of the transmission network system operator. This possibility was created by including a special statutory definition of third party access under energy and competition law in the amendment to the Energy Industry Act that came into force in 1998. The legislator did not interfere with the specific structure of the network access modalities, and in particular, it was decided not to set up a sector-specific regulatory authority to control network fees. During the period that followed, the relevant energy industry associations set the framework conditions for network access and the calculation of the fees for network use in the form of the so-called Associations' Agreements on Electricity under private law.

240.* Although anticompetitive arrangements for network access and the fundamental structure of network access fees were abolished under the Association Agreements, which underwent several modifications, there is still evidence of considerable impediments to network access in the electricity industry, due to the extremely high level of fees for network use in Germany. Within the framework of the Associations' Agreements, which do not contain any specific price specifications for network access, but only general principles of calculation, impediments to network access cannot be abolished. This is due to the fact that the pricing principles of the Associations' Agreement on Electricity II plus leaves the network operators considerable scope to set network prices. Thus, the control of abuse of a dominant position through the Federal Cartel Office has a key role to play in enforcing appropriate fees for network use.

241.* In the last two years, the Federal Cartel Office mainly has had to deal with impediments to competition due to excessive fees for network use. Two abuse proceedings, which set a precedent in connection with the effectiveness of general competition law in monitoring network monopolies in the energy sector, were concluded with a formal decision. Rulings by the Court of Appeal in Düsseldorf have already been issued concerning both cases. In the case of Thüringer Energie AG, the Federal Cartel Office's evidence of price abuse was based on an examination of the company's costs, and in the case of Stadtwerke Mainz, the Office applied the comparable market concept. In both cases, it prohibited the companies concerned from charging fees for network use in excess of certain revenue ceilings. The Court of Appeal lifted the orders in both cases. The reasons it gave for so doing included that the fees for network use under discussion, calculated in accordance with the pricing criteria of the Associations' Agreement on Electricity II plus, fall under the presumption of "good expert practice". The presumption of "good expert practice", if network fees are calculated in accordance with the pricing criteria of the Associations' Agreement, had been included in the May 2003 amendment of the Energy Industry Act. In addition, the Court considered it to be impermissible under competition law to use the total revenues from network operation as the yardstick of price abuse, which had to be based on an examination of individual prices. This view is not shared by the Monopolies Commission, which considers the use of total revenues from network operations to be a suitable approach in principle to do justice to the fundamental conceptual problem of allocating the fixed costs and the overheads to individual network services. The Monopolies Commission cannot understand the lack of connection between abusively excessive total revenues and abusively excessive individual prices criticised by the Court. Overall, the Court's interpretation of the law with regard to the repercussions of "legalising" the Associations' Agreement makes control of abuse of a dominant position within the framework of general competition law absurd.

The development of market structures and competition

242.* Even before liberalisation, the market structure of the German electricity industry was characterised by a high level of horizontal concentration at the generation level and by extensive vertical integration across all stages in the value chain. In addition, the intensive merger activity that took place immediately after the opening of the market has led to a considerable increase in concentration as a result of horizontal and vertical mergers. The market is dominated by the four transmission companies E.ON, RWE, Vattenfall Europe and EnBW, which own more than 80% of domestic generation capacities and have numerous shareholdings in regional distribution companies and municipal utilities. The Monopolies Commission is observing the development of market structures in the electricity sector with great concern. At the wholesale trade level, horizontal concentration processes have led to a collusive oligopoly. Through vertical shareholdings in municipal utilities, which secure the sales of the upstream transmission companies, electricity markets are being further foreclosed to market entry by third parties. Municipal utilities are thus largely absent as independent customers in the wholesale market. This is all the more serious with regard to the development of competition in energy markets since the competitive pressure exerted by household and small-scale customers is to be assessed as rather limited, as the small number of switches to competitors shows.

243.* The hopes of competition being boosted by new market participants from Germany and abroad have not been fulfilled. The electricity traders who entered the German energy market immediately after the market was opened up were unable to secure their market position and many of them have already left the market again, as their business prospects were insufficient. With the exception of small-scale, decentralized generation plants based on renewable energies and combined heat and power plants, no independent power producers have gained access to the electricity generation market. In view of the high level of concentration in the domestic generation sector, the most likely way to enhance competition in Germany would be imports by foreign suppliers. However, the currently limited capacities of cross-border interconnectors stand in the way of extending cross-border trade in energy at present. The proportion of energy imports thus constitutes a comparatively low proportion of gross domestic energy supply, at approximately 8%.

244.* Electricity prices for end consumers, which initially fell significantly for all customer groups after the opening of the market, began to rise from the middle of the year 2000, and for household customers, they have meanwhile reached the level they had before the markets opened. The increase in prices for end consumers is largely due to significant increases in wholesale prices as well as to additional burdens resulting from the Renewable Energy Sources Act and the Law Pertaining to Combined Heat and Power Generation. Once again net electricity prices in Germany are now higher than anywhere else in Europe.

245.* Overall, the intensity of competition in the electricity markets has declined significantly. The oligopolistic price competition that initially arose between the transmission companies turned out to be a transitional phenomenon aimed at preventing market entry of new competitors and the switch of the municipal utilities to new suppliers. Short-term price competition was also to be expected on account of the existing overcapacities, but is not the rule in homogeneous oligopolies. Rather, the increase in electricity prices to be observed at almost the same time as the closing of generation capacities since 2001 allows the conclusion to be drawn that the phase of short-term price competition is over and has given way to collusion between the members of the oligopoly. Another factor that suggests this assessment is that the transmission companies have limited themselves to supplying electricity in their traditional sales areas, and have not made any competitive advances into each others supply territory. In parallel, the structural conditions for competition in the electricity sector have steadily worsened since liberalisation. In particular, the two leading members of the oligopoly, E.ON and RWE, are in the process of

extending their market power along the vertical value chain by means of a clever merger and acquisition policy. Vertical shareholdings in municipal utilities and local redistributors take the place of long-term supply contracts and serve to maintain the transmission companies' sales market for their generation capacities. Thus, the oligopoly is reinforcing its dominant position in the wholesale market before even having to face the challenges of competition. As a result, the transmission companies' investment policy leads to market structures similar to those of legally foreclosed regional monopolies before liberalisation.

Competition problems with network access

246.* The competition problems in the German electricity industry result from the interaction of natural monopolies at the network level, and the vertical integration and horizontal market power of the four large transmission companies. In economic terms, the electricity transmission and distribution networks are to be classified as non-contestable natural monopolies. It may be assumed that the fundamental impediment to competition resulting from the specific cost structures of operating electricity networks will remain in the long-term. Moreover, electricity networks are to be regarded as essential facilities, since third-party access to the distribution networks is a necessary prerequisite for competition in upstream electricity generation and downstream electricity retailing. Since monopolistic and vertically-integrated network operators have no incentive to provide their services at a competitive price or to give competitors network access on non-discriminatory terms, the network access fees should be subject to price regulation.

247.* The regulation of fees for network use aims to prevent abusively excessive network fees while enabling the network operator to receive sufficient proceeds to finance the operating and capital costs arising in the context of network operation. The regulatory authority faces a fundamental problem of information here, resulting from the fact that there are no competitive yardsticks to judge the adequacy of the network use fees, and so it is forced to examine the appropriacy of these fees on the basis of the network operator's costs. Generally, the regulatory authority is only able to judge to a limited extent whether the costs presented by the network operator are actually justified from the point of view of efficiency. In addition, fundamental conceptual problems arise from the fact that the cost structure of transmission networks in the electricity sector is characterised by a high proportion of fixed costs and overheads, which have to be allocated to the network operator's individual services. No generally-applicable economic rules exist here. Rather, various allocation procedures have been developed, each of which has specific advantages and disadvantages concerning its efficiency characteristics, its practicability with regard to the information required by the regulatory authority, and the remaining scope left to the network operator to set individual prices. Weighing up the pros and cons of alternative allocation procedures depends on the situation in the sector concerned and can change over time. However, undifferentiated allocation rules generally oversimplify the problem of allocating fixed costs and overheads and therefore are usually inappropriate to deal with the problem's complexity and can lead to inefficient market results.

248.* Mechanisms to regulate fees for network use can be differentiated according to the extent to which they are based on the actual cost of network operation when establishing prices. With cost based regulation, the determination of the price is done ex post on the basis of the cost accounts presented by the network operator. Deviations of the price from observed overall cost and thus monopoly profits can be avoided with cost based regulation. However, it is problematic that cost accounts can be manipulated and that cost based regulation provides no incentives for providing the service efficiently. Incentive regulation, in contrast, aims to remove the link between regulated prices and costs arising for network operation in the past, and by this gives incentives to provide an efficient service. Internationally, the variant of a revenue cap regulation is most frequently applied in the electricity

sector. With a revenue cap regulation the development of the total revenue a network operator is allowed to make in a specific period is tied to the development of the Retail Price Index and a productivity progress rate estimated ex ante by the regulatory authority, the so-called X factor. The permissible revenue ceiling, including the productivity progress rate, is re-established at regular intervals, taking into account the cost and profit development of the regulated network operator throughout the past regulation period. Such a regulatory mechanism creates considerable incentives for services to be provided efficiently, as the network operator may retain cost reductions in excess of productivity progress estimates as additional profits.

249.* The basic idea of the benchmarking procedure consists in obtaining information about the relative efficiency of a network operator through comparing the prices, revenues or costs of a number of network companies. The comparable market concept applied within the context of abuse control under competition law is a rudimentary benchmarking procedure. From an economic point of view, the comparable market concept is of relatively little information value, however, as it is based on a comparison of prices or revenues, which are only to a limited extent influenced by competition and may contain considerable monopoly rents. The problem of comparing monopoly prices can be avoided by means of a cost-orientated benchmarking procedure, based on a comparison of the costs of different network operators. The results of a cost benchmarking can be used in the context of price regulation proceedings to simulate a certain level of competition between the network operators. This is done by imposing stricter cost reducing conditions on network operators with comparatively high costs than on comparatively efficient companies. This creates incentives to reduce costs below the sector average.

250.* Insofar as the court's examination of decisions by the regulatory authority also involves a substantive examination of network fees, the courts, too, face the informational problems associated with controlling monopolistic network use prices and also the conceptual difficulties in monitoring and allocating costs. Due to the complexity of the decision-making problem, however, the courts may well be overtaxed by this task in principle. The Monopolies Commission therefore advocates handling the conceptual problems relating to the control of network use fees in a procedure consisting of a multistage system of laws, regulatory provisions and procedural principles issued by the regulatory authority, whereby the choice of the price regulation procedure should in principle be left to the regulatory authority. The court's examination of a regulatory decision should be limited to whether the decision in the individual case is consistent with the regulatory authority's procedural principles or to whether the procedural principles are consistent with the overriding legal and statutory provisions. There would be no substantive legal examination of individual fees by the court. The Monopolies Commission also advocates an ex-ante regulation of network prices in order to enable incentive-based regulatory instruments to be applied. International experiences, for example in England, highlight that efficiency can be substantially improved by means of incentive-based regulation.

251.* The electricity supply system in England and Wales was fundamentally restructured in 1990. The regulatory reforms covered the separation of ownership of transmission networks, which were assigned to the National Grid Company, from generation capacities, which were divided among three newly-founded companies, PowerGen, National Power and Nuclear Electric. Twelve regional electricity companies are responsible for operating the distribution network and supplying end customers. In the end-customer supply sector, the market has been opened up successively to competition. Since 1998, household customers have the option of choosing their suppliers. The Office of Electricity Regulation was set up as a sector-specific regulatory authority, and merged with the regulatory authority for the gas sector in 1999 to become the Office of Gas and Electricity Markets (Ofgem). As natural monopolies, transmission and distribution network operators were subjected

to ex-ante price regulation. The transmission and distribution networks are regulated by means of a revenue ceiling which is adjusted annually on the basis of the Retail Price Index, minus the productivity progress estimated by the regulatory authority (RPI minus X regulation). The revenue ceilings set for the first regulation period proved to be extremely generous, enabling the companies to make substantial profits. The regulatory authority therefore reduced the permissible revenue ceiling considerably in the two following regulation periods in order to adjust the level of the network fees to the fallen costs. Network access fees have fallen by 50% in real terms since liberalisation as a result of the incentive regulation practised in England. Both the National Grid Company and the network operators have been able to considerably improve their productivity, significantly surpassing general productivity growth in Great Britain. As the reports regularly published by the regulatory authority on the state of supply security show, the cost savings here have not been at the expense of quality.

252.* Besides network access, the competitive functioning of wholesale electricity markets is decisive for the development of competition in the electricity sector. The wholesale electricity market can be divided into the wholesale market per se and the market for trading balancing energy. Both markets are susceptible to the exercise of horizontal market power by suppliers when there is a lack of liquidity.

Competition problems in the wholesale markets

253.* Balancing energy is needed to even out short-term fluctuations in energy input and output and to keep the network frequency stable. Differences between the timetables announced on the previous day by market participants and actual consumption on the day of supply are inevitable on account of short-term changes in consumption, unforeseeable power cuts at power plants and natural fluctuations of input from wind energy. The balancing of input and output fluctuations is part of the system control function and is the responsibility of the transmission network operators, i.e. in Germany the four transmission network owners. They are the only customers for balancing energy in their respective balancing zones. In principle, balancing energy can be acquired through a competitive process. In Germany, the competitive opening of the balancing energy markets has been enforced as a result of obligations imposed by the Federal Cartel Office, requiring the transmission companies to acquire the balancing energy they require in their balancing zone by means of invitations for tender. The majority of the costs for balancing energy, approximately € 1 billion per annum, are invoiced to network users as a non-itemisable system service. The cost of balancing energy, a proportion of more than 40% of the entire transmission network fees, is a significant cost item for the use of the highest voltage network. The development of competition in the balancing energy markets to date has been less than satisfactory. The costs of balancing energy have increased considerably in recent years and, according to the transmission companies, were the reason for the repeated significant increases in the fees for network use at the highest voltage level. The significantly higher prices for balancing energy in comparison with the spot market prices of energy traded on the previous day are an indication of the currently less than efficient functioning of the balancing energy markets. In competitive balancing energy markets, large price differences between balancing energy and spot market prices would lead to a supply shift towards balancing energy markets and to an adjustment of the prices for balancing energy towards the spot market prices. Barriers to market entry in the balancing energy markets are the only explanation for long-term price differences.

254.* The fact that transmission companies formulate the technical criteria to be fulfilled in order to take part in the bidding process and also determine the details of the bidding process represents a major barrier to the competitive development of the balancing energy markets. They thus largely determine the market rules in the balancing energy markets themselves. Since the transmission companies have no incentive to promote the development of competition in the balancing energy

markets or to reduce the costs of acquiring balancing energy, which are included in the transmission network fees, it is unlikely that the market rules will be structured competitively. The small number of market participants currently taking part in the bidding process for balancing energy is another impediment to competition. Moreover, the majority of bids in a balancing energy zone are made by power plant companies which have conglomerate links with the respective transmission network operator. There are no competitive advances by one transmission company into the balancing energy zone of another transmission network operator. The low level of liquidity in the balancing energy markets is due partly to the inappropriate technical requirements set by the transmission network operators, and partly to the fragmented market, which is divided into four balancing energy zones. The Monopolies Commission therefore emphatically advocates the merging of the four balancing energy zones to form one single nation-wide market for the acquisition of balancing energy. The formation of one single balancing energy zone would lead the suppliers of balancing energy to converge on a single market. In addition, it would be more difficult for the four transmission network operators to collude and tacitly carve up the overall market along the borders of the balancing energy zones. Finally, the need for balancing energy would be significantly reduced, as positive and negative deviations from the balance could be cancelled out across balancing energy zones.

In the view of the Monopolies Commission, the interests of transmission network operators deriving from the vertical links between electricity generators and retail electricity trade also constitute a major impediment to competition. In their function as system operators, the transmission companies inevitably receive plenty of information relevant to competition concerning the current network load, network bottlenecks, the availability of generation capacities and the supply prices of individual power plants, giving them considerable strategic advantages vis-à-vis their competitors in the generation sector and in the electricity trade. In the view of the Monopolies Commission, the potential for discrimination associated with this monopoly on information can only be effectively removed by a systems operator who has no interest in electricity generation or electricity trade. It therefore recommends entrusting the management of a nation-wide balancing zone to an independent system operator which does not operate in the generation or trading sector, either directly or through affiliated enterprises. This would not mean a transfer of ownership, which would be problematic under Germany's constitutional law, since network ownership could remain with the present transmission companies.

255.* Competitive wholesale markets have major economic functions in liberalised electricity markets. In the short term, they ensure the efficient use of power plants and send price signals for investments in generation capacities. In addition, the wholesale markets are of crucial importance for the market participants' risk management. When long-term full supply contracts are replaced, at least in part, by short-term trading in liberalised electricity markets, a need arises both for energy generators and for purchasers to safeguard themselves against fluctuating electricity prices. Thus, various forms of commodity and financial futures are made available in wholesale markets as hedging instruments. The allocation and risk management function of electricity wholesale markets, particularly energy exchanges, is limited, however, if the wholesale prices can be manipulated by participants with market power. Wholesale electricity markets are particularly susceptible to the strategic supply conduct of powerful generators due to the inelastic demand and the limited elasticity of supply at peak load periods. Even when supply prices are excessive in the extreme, there is unlikely to be any great decline in the amount demanded or any loss of market share. Thus, even suppliers with a relatively small market share have considerable market power during peak load periods. Price manipulation through strategic pricing was at least partially to blame for the exorbitant increase in wholesale prices and the resulting collapse of the Californian electricity market in 2001, for example. The price increases were to a considerable extent brought about by an artificial shortage of supplies, created by

power plants being taken off the network for maintenance work. Isolated cases of price peaks in the German energy exchange indicate that there are too problems with market power and strategic price manipulation in the German electricity wholesale markets, as in the view of market participants, these price spikes cannot be explained exclusively by changes in market fundamentals. The assessment of the Monopolies Commission is that the competition problems in the wholesale electricity markets could be considerably aggravated in the future by the announced dismantling of generation capacities. Intensified monitoring of competition in the electricity wholesale market, a task which could be assigned to the future regulatory authority for the energy sector, would be required to deal with market power problems in the electricity wholesale market.

256.* The scope for strategic price manipulation is exacerbated by the lack of price transparency and the asymmetrical distribution of information among the market participants. In Germany, the transmission companies are much better informed than other market participants about planned and actual load flows, the availability of their own and third-party power plants, grid bottlenecks and cross-border electricity flows. As international experience shows, better-informed market participants have a wide range of possibilities to influence wholesale prices through excessive pricing, strategically declaring the existence of grid bottlenecks, unplanned power plant overhauls or manipulative trade practices. The transmission companies should therefore at least be placed under the obligation to provide price-relevant information to the public in advance or in real time about planned and actual grid load, planned and unplanned power plant overhauls and the use of cross-border interconnector capacities.

257.* The effects of market power in electricity wholesale markets may be reinforced by the introduction of trade with emission certificates, as planned for CO₂ emissions within the European Union from January 2005. The exorbitant price rises for SO₂ certificates for example were partly responsible for the increase in wholesale prices during the Californian electricity crisis. Rising wholesale electricity prices may be due both to the conscious restraint or buying-up of certificates by powerful suppliers in the energy markets and to a shift in the shortage situation in the certificate market. In California, for example, the weather-induced shortage of hydro-electric energy led to an increased requirement for electricity generated by fossil fuels and thus, to an increased demand for emission certificates. At peak load times, when capacity restrictions take effect in electricity wholesale markets and powerful suppliers have considerable scope to set prices, high prices for certificates impede the market entry of other suppliers. In order to prevent powerful electricity generators from using the trade with emission certificates trade as an additional lever to increase their scope of conduct, the Monopolies Commission proposes that a flexible government intervention system be introduced in the form of an open-market policy for emission rights, which would balance out large, unforeseen price increases in certificate markets through the sale of additional certificates.

258.* England, too, has had many years of experience with market power problems in electricity wholesale markets. In England, the wholesale trade was carried out through the Electricity Pool of England & Wales, which was obligatory for all suppliers. Due to ongoing criticism of the lack of competition and the diverse possibilities for abuse by powerful suppliers, the pool was replaced in 2001 by a bilateral trading system. After privatisation, the market structure in the wholesale market in England and Wales was characterised by a high concentration of suppliers. The two generators National Power and PowerGen, which owned more than 80% of the generation capacities and, above all, the peak power plants that set the pool price, formed a dominant duopoly. The pool regime, in combination with a market characterised by the existence of two dominant suppliers, gave cause for concern with regard to the competitive development of wholesale prices at an early stage and led to almost annual examinations by the regulatory authority. On repeated occasions, these established that price manipulation in the form of excessive price

bids by the suppliers had taken place, and that power plant capacities had been strategically held back. This led to the modification of the pool's pricing rules on a number of occasions. In addition, the regulatory authority succeeded in significantly reducing the concentration of suppliers in the wholesale market under pressure from the threat of examination by the Monopolies and Mergers Commission and by imposing obligations in merger cases. The large number of new generators entering the market also helped to reduce concentration.

259.* The success of liberalising the English electricity industry has been considerable. In the generation sector, considerable efficiency gains were achieved through the closure of inefficient old power plants, extensive new investments and increased productivity. The costs of electricity transmission and distribution have fallen considerably since liberalisation, as have the system operating costs. At the same time, security of supply gives no cause for concern, either with regard to transmission or generation capacities. There is an extraordinarily high level of competitive dynamism in the end-users' markets. Both industrial and household customers have benefited from the efficiency gains in the energy sector through falling electricity prices. Ofgem's regulatory policy made a key contribution to this success. Its wide-ranging powers enabled the British regulatory authority to react flexibly to the market development in the wholesale trade and to further develop the regulation of natural monopolies against the backdrop of practical experience.

Reform of the regulatory framework

In contrast, the draft bill for an amendment to the Energy Industry Act in Germany presented by the Federal Ministry of Economics provides for the future regulatory authority to have only very limited scope. In line with expectations, the Ministry decided against an ex-ante regulation of network fees. Only the methods for determining the network fees are to be decided upon ex ante, and, moreover, they are to be laid down largely by the Ministry of Economics itself in regulations. The first drafts of a network fee regulation currently available suggest that there will be wide-ranging standardisation of cost calculation methods on the basis of the pricing principles of the Associations' Agreement on Electricity II plus, leaving the regulatory authority little scope to further develop incentive-based regulatory procedures. The concept of rational operational management in the electricity sector is a central benchmark to judge the appropriacy of network fees. It stands in a tradition of cost-plus-orientated price regulation on the basis of actual costs in the past, which, in the view of the Monopolies Commission, is a method ill-suited to meeting the demands of efficiency-orientated network fee regulation. To this extent, the Monopolies Commission cannot see any substantial improvement of the regulatory framework for the electricity sector in the present bill. It therefore proposes at least replacing the term rational operational management in the electricity sector by the term efficient provision of service, a term also used in the field of telecommunications regulation, and to include in the law an explicit obligation of the regulatory authority to develop incentive-orientated price regulation procedures.