

# RECENT REGULATIONS FOR THE ABUSIVE CONDUCT OF MARKET DOMINATING ENTERPRISES<sup>†</sup>

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In Germany, abuse control of dominant companies has been embodied in competition law since the Act Against Restraints of Competition (ARC) entered into force in 1958.<sup>1</sup> Incidentally, the competition rules of the European Community came into effect in that same year.<sup>2</sup> Abuse control, together with the general ban on cartels (including restrictive agreements) represents the traditional foundation of German competition law. The instrument of merger control, on the other hand, was introduced in Germany fifteen years later<sup>3</sup> and not until 1990 in the EU.<sup>4</sup> The three main pillars upholding current German competition law are the enforcement of the ban on cartels, along with merger control and abuse control of dominant companies.

The ban on cartels is critically important in Germany because of the development of national competition and the structure of the German economy. Since the nineteenth century, cartel agreements have been widespread in the German economy. However, the ARC sought to end the cartel-related practices, some of which dominated entire industries. Agreements between companies aimed at eliminating competition have been prohibited since 1958 and are punished with substantial fines.<sup>5</sup> Restrictive agreements between competitors are allowed only in exceptional cases and subject to clearly defined criteria.<sup>6</sup>

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<sup>†</sup> Speech on the occasion of the International Conference on Competition Policy and Economic Development held by the Institute of Law Chinese Academy of Social Sciences on the topic on September 19, 2002 in Beijing.

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1. Gesetz gegen Wettbewerbsbeschränkungen [Act Against Restraints of Competition], v.27.7.1957 (BGB1.I 1081) (W. Ger.) [hereinafter ARC].

2. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Oct. 2, 1997, O.J. (C 340) 81 et seq. (1997).

3. Zweites Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen [The Second Law amending the Act Against Restraints of Competition], v. 3.8.1973 (BGB1.I 917) (W. Ger.).

4. Council Regulation 4064/89/EEC, Dec. 21, 1989, On the control of concentrations between undertakings, 1989 O.J. (L 257) 1.

5. An overview of the fines imposed on participants in hardcore cartels since 1993 can be found in the Biannual Report 2001/2002 of the Bundeskartellamt (table at 44) that can be downloaded from the Bundeskartellamt's website: [www.bundeskartellamt.de/tatigkeitsbericht.html](http://www.bundeskartellamt.de/tatigkeitsbericht.html), or from the German Parliament's website: <http://dip.bundestag.de/btd/15/012/1501226.pdf> (last visited Nov. 20, 2003).

6. See ARC v.27.7.1957, § 2-7 (BGB1.I 1081-82), as amended, latest official consolidated version: BGB1.I2521 (1998), latest amendment: BGB1.I2304 (2003).

Merger control was not addressed in the original version of the ARC. However, it was clear at that time that mergers often led to considerable competition problems. The acquisition of another company is often the cheapest and fastest path towards company growth. Merging parties hope to achieve a competitive advantage in terms of turnover—for example, by acquiring additional market shares—and in terms of costs, which they expect to decrease due to synergy produced by the merger.

Mergers do not always lead to success. On the one hand, they can increase the efficiency of a new entity, especially if markets are undergoing change, thus spurring competition. However, one should not rely on the idea that sheer size in the market guarantees entrepreneurial success. Studies show that quite the opposite is true in an excessive number of cases.<sup>7</sup> On the other hand, mergers between competitors may lead to market dominance or a monopoly. When competition is brought to a standstill, consumers are no longer ensured a benefit from increased efficiency.

The aim of merger control is to prevent the creation of dominant positions as a result of mergers and to secure competitive market structures. If this fails, the only recourse is abuse control of dominant companies.<sup>8</sup>

## I. INDIVIDUAL ISSUES OF ABUSE CONTROL

To illustrate the German experience with abuse control of dominant companies, this section will briefly outline three examples: (1) the ban on sales below cost price; (2) the control of buyer power in the public sector; and, (3) the control of state monopolies as suppliers.

### A. *Sales Below Cost Price*

A special feature of German competition policy is that abuse control applies not only to companies that have attained a dominant position, rather it also applies to those companies with a relatively powerful

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7. For an overview on post-merger studies, see for example, Gunther Tichy, "Fusionen und Übernahmen: Erfolgsaussichten von Fusionen," Wien 2000, available at [http://www.akwien.at/dat/3842\\_2.pdf](http://www.akwien.at/dat/3842_2.pdf) (last visited Jan. 3, 2004); Lajoux & Weston, *Do deals deliver on postmerger performance?*, MERGERS & ACQUISITIONS, Sept.-Oct., 1998, available at [http://www.findarticles.com/m6402/n2\\_33/issue.jhtml](http://www.findarticles.com/m6402/n2_33/issue.jhtml) (last visited Jan. 3, 2004).

8. Of course, an instrument of control is also needed for cases in which a company achieves a dominant position through internal growth.

position.<sup>9</sup> For example, powerful companies may not unfairly hinder their competitors or those companies dependent on them by frequently selling their products below cost price, unless there is an objective justification for doing so.<sup>10</sup>

The following case illustrates how this special German policy feature is implemented. In 2000, the Bundeskartellamt (German Federal Cartel Office) examined the pricing strategy of three major trading companies that sold basic foodstuffs such as sugar, milk and flour below their respective cost prices over a considerable period of time, without any perceptible objective justification.<sup>11</sup> According to the Bundeskartellamt's findings, the three trading companies had superior market power over small and medium-sized independent food retailers due to their companies' sizes, market shares, and resources. As a result of these findings, the Bundeskartellamt prohibited the pricing practice of these trading companies. However, the issue here was not protecting individual companies from competition, but protecting overall competition and the long-term interests of consumers.

At first glance, it is not obvious why low prices can be unfavorable for consumers. Our examinations show, however, that the material benefit to consumers resulting from sales below cost price are, at most, temporary and marginal. The results for the consumers are temporary because market concentration will increase after the exit of small and medium-sized competitors. As a result, the remaining competitors will gain greater leverage to increase prices for not only a few basic foodstuffs, but also for all of the other thousands of products sold by the trading companies. The benefits for the consumers are marginal because expenses for the foodstuffs examined comprise only a very small share of an average household's budget, in some cases accounting for less than one percent. At the same time, the impairment of competition and market structures resulting from unfair hindrance of small and medium-sized companies is permanent and appreciable.

The competition authority's task is to maintain effective competition in the medium and long-term in the interest of consumers. Competition is the most effective instrument for ensuring alternative supply options and high

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9. ARC v. 27.7.1957, (BGB1.I. 2521 (1998)), § 20 (as amended).

10. *Id.* § 20(4).

11. See Decision of Sept. 1, 2000, Bundeskartellamt [BKartA] (Federal Cartel Office [FCO]), WuW/E [BKartA] B9-85/00 (Aldi-Nord), DE-V 314; Decision of Sept. 1, 2000, FCO, WuW/E [BKartA] B9-74/00 (Wal-Mart), DE-V 316 (see BUNDESKARTELLAMT, BIENNIAL REPORT 1999/2000, at 147 et seq.). Decisions of the Bundeskartellamt (since 1998) can be downloaded from its website: <http://www.bundeskartellamt.de/entscheidungen.html> (last visited Nov. 20, 2003).

quality products at low prices for consumers. This can only be achieved if independent businesses can operate efficiently under fair competition conditions and are not squeezed out of the market by large corporations with superior financial and market power that practice unfair strategies.

The issue is not about establishing a price control regime for trading companies. All the companies in the market are, in principle, free to calculate their own prices. Whether a company covers its procurement costs or not, or whether it makes a profit or loses money, are questions that concern the company's management, not the competition authorities; competition authorities only intervene in individual cases if there is a reasonable suspicion of market power abuse that affects competition.

It is crucial for effective enforcement of competition principles that the companies in a market are aware of the criteria by which a competition authority judges their behavior. As a result of its initial investigations, the Bundeskartellamt issues a notice (principles of interpretation) regarding sales below cost price, which details the assessment criteria that are applied.<sup>12</sup>

### *B. Demand by the Public Sector*

Private companies are not the only entities subject to competition law—the State has to respect competition law regulations if it purchases business services in the market or itself acts as a supplier.

For example, in 1997, the Bundeskartellamt intervened in a case because a regional government branch abused its position as a purchaser of construction work and impeded particular companies in an unfair manner.<sup>13</sup> The federal government branch in Berlin issued administrative provisions that ruled out wage levels as a competition parameter in the awarding of public contracts in the building sector. The court held that all companies submitting bids in a tender for a public building contract had to commit themselves to paying the collectively agreed upon wages applicable for Berlin, which were quite high. However, the Bundeskartellamt considered this to be an abusive hindrance for those companies not bound by the Berlin level of collectively agreed wages. The Berlin government's conduct was not necessary to achieve the original

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12. The notice is published on the Bundeskartellamt's website: <http://www.bundeskartellamt.de/merkblatter.html> (last visited Nov. 20, 2003).

13. Decision of Nov. 3, 1997, Bundeskartellamt, WuW/E [BKartA] Verg 7, B5-75123-VX-61/95 (Tarifreueerklärung).

aim of its regulation—to prevent so-called wage dumping—because this is prohibited in the construction sector by a separate legal provision.

*C. Market Behavior of a National Monopoly*

Germany's long-term policy is to withdraw from certain entrepreneurial activities in order to allow for privatization. For example, the German State once completely controlled the telecommunications and postal service sectors until these entities were transformed into corporations. Initially, the German State held 100 percent of these corporations' shares; these shares are now being gradually privatized. Another German state-run administration transformed into a corporation is the railway sector. Deutsche Bahn AG is the integrated railway company in Germany that provides rail transportation services and owns the necessary infrastructure—Deutsche Bahn is also owned entirely by the German State. Nevertheless, as a state-owned company, it is also subject to the provisions of competition law.

Accordingly, Deutsche Bahn, as the dominant operator of the railway network, is obliged to grant competitors non-discriminatory access to its infrastructure network. Competitors must pay Deutsche Bahn a fee for using its infrastructure and it is up to the company itself to develop an adequate pricing system, which must not be discriminatory.

In 2000, pursuant to complaints, the Bundeskartellamt examined Deutsche Bahn's pricing system. The investigations established that the costs incurred by Deutsche Bahn's own local transport subsidiary for using rail routes were on average twenty-five percent (in some cases more than forty percent) lower than those of its private competitors.

In the Bundeskartellamt's view, Deutsche Bahn, as the dominant provider of railway infrastructure, violated the ban on abusive practices because it unfairly hindered private railway companies in the market from providing short-distance passenger transportation. Due to the Bundeskartellamt's concerns, it required Deutsche Bahn to introduce a new pricing system that currently does not give rise to competition concerns.<sup>14</sup>

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14. The case could be closed without a formal decision. BUNDESKARTELLAMT, BIENNIAL REPORT 1999/2000, *supra* note 5, at 39-40, 151-52.

## II. ABUSE CONTROL IN THE ENERGY SECTOR<sup>15</sup>

### A. *Liberalization of the Network-Based Energy Sector*

Abuse control under competition law plays a key role in the network-based energy sector. Since the 1980s, there have been intensive discussions in Europe as to whether and how traditionally monopolistic sectors, such as electricity and natural gas supply, should be subjected to competition regulation. Meanwhile, the prevailing view in Europe is that electricity and gas networks are natural monopolies and therefore cannot easily be duplicated in an economically rational way. Consequently, creating competition by building a new infrastructure must be ruled out in most cases. Nevertheless, the supply of customers may well function under competitive conditions. Therefore, in the area of utility services provided by existing networks, there are no economies of scale or indivisibility factors that would render competition impossible.

In 1998, in the course of liberalization measures decided in Europe,<sup>16</sup> Germany abolished the legal hurdles that stood in the way of establishing competition, completely opened up its markets to competition, and took the steps necessary to push ahead with the creation of effective competition.<sup>17</sup>

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15. Recent important legislative developments regarding the energy sector include the amendment of the Energy Industry Act. Gesetz zur Änderung des Energiewirtschaftsgesetzes [Act to Revise the Energy Law] v.20.5.2003 (BGB1.I. 686). The Act made some major changes. First, Bundeskartellamt decisions ordering access to the grid will in theory be immediately enforceable (prior to the revision, legal action automatically suspended the decision). Second, the provisions of the most recent Associations' Agreement in the electricity sector have been given a quasi-legal status for a transition period until the end of 2003. They are presumed to reflect an acceptable standard unless it can be shown that they restrict competition. Furthermore, a report by the Ministry of Economics and Labor will address the question of regulation in the electricity sector. This report will form the basis for implementation of the new Energy Directives, European Parliament and Council Directive 2003/54/EC, June 26, 2003, Concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, O.J. (L 176), July 15, 2003, at 37; European Parliament and Council Directive 2003/55/EC, June 26, 2003, Concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, O.J. (L 176), July 15, 2003, at 57.

16. European Parliament and Council Directive 96/92/EC, Dec. 19, 1996, Concerning common rules for the internal market in electricity, 1997 O.J. (L 27), at 20.

17. The relevant provisions in the Energy Industry Act and in the ARC were amended in Gesetz zur Neuregelung des Energiewirtschaftsgesetzes [Act to revise the Energy Law] v.24.4.1998 (BGB1.I 730); Sechstes Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen [The Sixth Law amending the Act Against Restraints of Competition], v.22.8.1998 (BGB1.I 2521).

### *B. Structure of the German Electricity Sector*

The German electricity sector is characterized by a large number of regional companies, some of which are vertically integrated, operating at different production and sales levels.

German energy suppliers used to have regional monopolies permitted by law and the structure of these monopolies has changed very little over the decades. At the time, there was practically no competition and it was only with the abolition of the application of special regulation to this sector that competitive pressure emerged. The opening up of the market and subsequent mergers of energy suppliers led to changes in the market structure. This process has recently become considerably more dynamic. In comparison with other European countries, however, the German electricity sector is still very fragmented—there are more than 800 companies distributing electricity in Germany.

### *C. Strategies to Create Competition in the Electricity Sector*

In April of 1998, Germany abolished all privileges under competition law for the network-based energy sector.<sup>18</sup> In particular, this put an end to the electric companies' right to exclude competition by means of demarcation agreements and terminated the right of municipal authorities to grant exclusive concessions to a single company for the supply of electricity in their territory. In opening up its markets, Germany clearly went beyond the minimum provisions of European law. From the outset, competition was possible at all market levels and for all customers: large industrial customers, smaller commercial customers, and households.

A decisive precondition for competition is that energy suppliers must have non-discriminatory and free or reasonably priced access to the networks of established energy providers. Only then will consumers be able to switch to a new supplier. In principle, two alternative approaches are possible under European law on an equal-rights basis: regulated network access and negotiated network access.

In the case of regulated network access, the state prescribes all of the relevant details for network access, particularly the fees for network use. Regulatory authorities charged specifically with carrying out this task, generally secure the practical implementation of these details.

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18. The Sixth Law amending the Act Against Restraints of Competition, BGBI.I 2521 (1998). The exemption for restrictive agreements, in particular demarcation agreements, in the electricity and gas sectors was removed. ARC v.27.7.1957, § 103 (as amended).

Germany, however, opted for negotiated network access: the State only prescribes general framework conditions, which were especially affected by the abolishment of former privileges under competition law. The negotiation of network access and transmission modalities is left to the market participants. In terms of competition, this approach to liberalization is secured by a consistent application of abuse control under competition law. Network operators are usually considered to be dominant companies required to grant other energy providers access to their networks.

This approach to liberalization lets the market decide. Primarily, market participants are most familiar with market conditions, and they ensure that the market process functions correctly, and are able to react more quickly to changing conditions in their negotiations than the state could, for example, through the promulgation of regulations. The liberalization strategy chosen does justice to the structural conditions of the German energy sector; in contrast to other European countries, no single monopolist provider ever existed in Germany. Instead, when liberalization was introduced, there were already a large number of energy companies that had market experience at all levels. However, these companies had yet to enter into intensive competition with each other.

Fundamental elements in determining transmission fees in the electricity sector are the so-called "Associations' Agreements." These agreements are decided by the representatives of important economic associations of both sides: the associations of the energy industry sector on the supply side, and the associations of the industrial energy consumers on the demand side.

#### *D. Results Achieved so Far by Opening Up Electricity Markets to Competition*

The purpose of opening up electricity markets is to increase the efficiency of services provided in the energy supply sector by means of competition. Initially, customers consuming a high amount of energy profit from this and private consumers ultimately also benefit from increased competition that results in lower prices. In fact, competition forces energy providers to pass on cost advantages to their consumers through lower prices.

In some electricity markets, particularly in the case of large energy consumption customers, competition has already produced good results. At times, electricity prices for industrial customers fell by as much as fifty percent. As end consumers, private households have also profited directly because of the reductions in electricity prices (although the reductions are

smaller than those for large energy consumption customers). End consumers have also profited indirectly because industrial electricity customers' cost savings are passed on to end consumers in lower product prices.

Nevertheless, there are problems in implementing competition, especially in the markets of small customers and households. Here, the control that established providers still exercise over end consumers proves to be a significant barrier for each new entrant.

#### *E. Abuse Control by the Bundeskartellamt in the Electricity Sector*

Germany's approach to opening up electricity markets via negotiated network access, which promises to be successful, is secured by the competition authorities' supervision. In the initial stages of liberalizing the electricity markets, the main problem from a competition point of view, was that established network operators refused to grant their competitors access to the electricity network. The Bundeskartellamt conducted several proceedings making it clear that a general refusal to open up networks is unacceptable.<sup>19</sup> Today, refusals to grant access have practically ceased to be an issue.

Other abusive strategies applied by established companies with the aim of hindering new entrants have also been successfully restricted. These strategies include the so-called "transfer fees" that certain providers previously charged customers who signed a supply contract with a new provider, claiming that customers wishing to switch over to a new supplier had to have a special electricity meter installed.<sup>20</sup>

The main problem has proven to be that network operators charge other companies excessive fees for network use, in particular network access for transmission purposes. It is undisputed that network operators are entitled to a fee if other companies use their networks for the transmission of electricity. The pivotal issue, from a competition point of view, is the level of this fee: if network operators charge unreasonably high prices, the effect will be similar to that of an outright refusal to grant network access.

With a new division specifically set up for this task in 2001, the Bundeskartellamt intensified examination under competition law of fees for network use in the electricity sector.<sup>21</sup> Following preliminary

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19. See Decision of Aug. 30, 1999, Bundeskartellamt, WuW/E [BKartA] DE-V 149 (Berliner Stromdurchleitung).

20. See BKARTA, BIENNIAL REPORT 2001/2002, *supra* note 5, at 139.

21. *Id.* at 37.

examination proceedings in which the fees of twenty-three network operators were reviewed, the Bundeskartellamt is currently conducting ten formal proceedings against network operators.<sup>22</sup>

It has become apparent during these proceedings that many unanswered questions remain. An important question relates to which standard a competition authority should apply in order to assess whether or not a particular fee is abusively high. In this respect, the Bundeskartellamt relies mostly on the comparable market concept. This means that the authority chooses one particular network operator that is considered to be efficient and whose network fees are deemed to be favorable as the standard by which other companies shall be judged. Corrective calculations must be made in individual cases as network and customer structures are far from being uniform enough to allow for an easy comparison of prices.

Naturally, it cannot be ignored that the fees charged by a company representing the standard may be considered excessive at a later date, requiring said company to adjust its fees for network use on the basis of an improved standard. Cross-border comparisons would be helpful in this context, but this will take time to develop. The Bundeskartellamt prefers this concept, which relies on a comparison of prices in the market as opposed to direct cost control, although it will resort to examining costs if deemed unavoidable.

There are further questions that will need clarification in future proceedings of the competition authority and of the courts, relating, for example, to the obligation of companies under examination to answer questions and the treatment of business secrets.

The examination of fees by means of abuse control under competition law proves to be a difficult yet indispensable task. There is no perceptible alternative solution that would be preferable to this approach in the case of the German electricity industry. The comprehensive regulation of fees and conditions for network use implemented in other countries does not appear to be practical in Germany. The sheer number of network operators in Germany (in the hundreds), would make the effort involved prohibitively high. In addition, a regulator cannot easily answer the key question, "What is the adequate price for network use in individual cases?"

Setting a wrong price poses considerable dangers: excessively high fees hinder new suppliers from entering the market and competition cannot help the industry evolve. However, if fees are set too low, the

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22. *Id.* at 166-68.

network operator will not be able to achieve an adequate return flow of funds for the maintenance and operation of its infrastructure, and necessary investments will not be made. The decentralized approach of negotiated network access leaves it to the market participants to find an adequate price for network use on the basis of a market-oriented procedure. Abuse control under competition law would only intervene selectively.

In the case of a comprehensive regulation of fees, a regulator must try to compensate for the overall knowledge within the market that influences the negotiated approach. Moreover, misdirected action by a regulator will have far-reaching consequences as its decisions, right or wrong, will very quickly affect all network operators.

### III. CONCLUSION

This overview illustrates the broad range of areas that are covered by abuse control under German competition law. Abuse control deals with the conduct of suppliers and purchasers, and applies to a wide range of sectors including public institutions, public enterprises, and private companies.

Despite all differences and particularities in individual cases, one principle always applies: the object of abuse control is to keep markets open by limiting the scope of action for dominant companies. Only then can competition be ensured as the most effective instrument to achieve optimum market results—quality service and low prices for customers—in a cost-efficient way and by using competition authorities' resources economically. This is a central precondition for economic growth.