

## Summary

### Less State, More Competition

#### – Markets for Health Care and State Aids in the Competitive System –

#### The Seventeenth Biennial Report 2006/2007

by the Monopolies Commission (*Monopolkommission*)

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

### Current Issues in Competition Policy

#### • Competition Policy in Regard to Rail Privatisation

1.\* The Federal Government has decided to enable private investment in the German Railways (*Deutsche Bahn AG – DB AG*) before the end of 2008. The companies that now operate freight, passenger and regional transport are to be grouped into a new company that will be responsible for transport and logistics. As the sole shareholder in this company – to date – DB AG is to sell up to 24.9 % to private investors. It will also continue to hold 100 % of the network operating company. In turn, DB AG will continue to be fully owned by the Federal Government. Therefore the infrastructure will remain in public ownership.

2.\* The Monopolies Commission assesses this part-privatisation concept as a clear advance on earlier plans for the integral privatisation of DB AG, including the network and the operations. Indeed, the new plan does not fulfil the Monopolies Commission's recommendation to separate the network and the operations, because the infrastructure and the transport companies will remain combined. However the part-privatisation model that has now been decided would certainly not prevent the concern being split up later into a railway company, a larger part of which could perhaps be privatised, and a separate infrastructure company. In the view of the Monopolies Commission such a split is still desirable to enable the network operator to occupy a neutral position in the competition between DB AG's transport company and its private competitors. Undistorted competition on the network is the most likely way to expand the share of rail transport on the transport market as a whole. This would also reduce the environmental damage, which comes mainly from road transport.

3.\* Admittedly, if the network and the transport operators are under the same management the risk of future discrimination of private competitors on the network will remain. This is a consideration not only in regard to competition policy but in regard to European law as well. The European Union's directives on the railways require the transport and logistics divisions to be de facto independent of the network division. The meaning and purpose of this requirement will be greatly jeopardised if a joint holding company is created. In the view of the Monopolies Commission the institutional links should not be further strengthened through personnel links. A joint management board for the network operator, the transport operator and the holding company would therefore be problematic in regard to Community law. The relations between these companies should be such that the network operator on the one side and the transport operator on the other each enjoy the greatest possible operational independence.

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\* The Monopolies Commission would like to thank Mrs. Eileen Martin for translating the original German text into English.

4.\* In the political arena there have been demands for a block on any changes to the privatisation model that has now been agreed. The Monopolies Commission opposes those considerations. DB AG must be able to attract private equity through further privatisations, beyond the currently agreed tranche of 24.9 %. That is the only way it will be able to meet the innovation and investment requirements it will face in the long term, if it wants to maintain its position in competition with other transport modes. A block on change would also be irreconcilable with the basic idea of Art. 87 e of the Basic Law, nor, the Monopolies Commission firmly believes, could it be introduced through a collective wage agreement.

5.\* The Monopolies Commission has doubts regarding the Federal Government's intended use of the receipts from the sale. Part of the funds is to flow into the Federal budget, part to be used for investment programmes and part to increase the equity of DB AG. The receipts from the sale will be collected by the DB AG, that is, the holding company. The Monopolies Commission points out that an allocation of funds to its subsidiaries of this state enterprise (the network operator on the one side and the transport operator on the other) fulfils the criteria of financial state aid in Art. 87 EC. Financial state aid of this kind is more likely to be approved on grounds of infrastructure under Art. 73 EC than if the funds were allocated to the transport operator. For in the latter case they would result in distortion of competition between the transport operator and its private competitors.

• **Proposals from the European Commission on Unbundling in the Energy Industry**

6.\* On 19 September 2007 the European Commission passed the third package of legislative proposals to promote the European Single Market in energy. A central aspect of the package is the separation of production and supply from transmission networks. This is to be done either through ownership unbundling or, alternatively, through the use of an independent system operator, ISO. The European Commission hopes that this will best counter the negative consequences of vertical integration on competition.

7.\* The European Commission prefers the unbundling of ownership, that is the network should be taken out of the value chain of a vertically integrated energy supply company. All the network's assets would be transferred to a third company that is independent of the original parent company. The ISO solution is a structural intervention of less intensity than ownership unbundling, because the transmission or long distance networks can remain in the hands of the vertically integrated energy utilities. However, the actual business operations may only be performed by an ISO, that is entirely separate from the vertically integrated company.

8.\* The plans put forward by the European Commission have met with different reactions from EU Member States. Great Britain, the Netherlands, Sweden and Denmark for example, support the proposal, while France and Germany, who will be mainly affected, reject it. These two Member States have worked out an alternative proposal, known as the third way (effective and efficient unbundling), which is supported by six other Member States. In the view of these eight countries effective separation of the network operations can be guaranteed already by ensuring by a number of safeguards that would make the existing regulations on deconcentration more stringent, without the need of unbundling as proposed by the European Commission. In view of the fact that the eight Member States who support this third way can block the desired agreement in the Council of Ministers, the European Commission is seeking a compromise solution. It suggests that the third way should be made much more stringent (e.g. with right of veto for the national regulatory authorities on personnel and investment decisions by the Supervisory Board) before the third way can be included as another option in the

legislative package. In June 2006 the Council of Ministers agreed to include the third way as an additional option in the legislative package for both sectors, electricity and gas.

As political opposition is preventing the European Commission from achieving its aim of ownership unbundling through the legislative process, the Commission seeks to achieve this aim by using its extensive powers in competition law as an executive organ. It seems that it has already achieved some success here. In February 2008 the German E.ON Company, fearing a fine of up to 10 % of its world-wide turnover, offered to sell its own transmission network to an operator who is not active in electricity generation or supply. E.ON would also like to offer about one fifth of its power station capacity for sale. In return the European Commission has indicated that the current cartel proceeding, with the threat of fines, would be stopped.

**9.\*** The Monopolies Commission does agree in principle with the view of the European Commission that the lack of competition in the electricity and gas market can be solved primarily with the use of structural policy instruments. Above all, vertical deconcentration can have positive effects in extending the cross border capacities. Nevertheless, the studies by the European Commission and the implications derived from them at the present time are not sufficient to justify such a severe structural intervention. The data used by the European Commission in its studies of the German energy market mainly refers to the periods before the Energy Industry Act (*Energiewirtschaftsgesetz – EnWG*) of 2005 came into force. In particular, the deconcentration requirements in the law had not then been fully implemented, the Federal Network Agency for Electricity, Gas, Telecommunications, Post and the Railway (*Bundesnetzagentur für Elektrizität, Gas, Telekommunikation, Post und Eisenbahnen*) had not yet been established as a regulatory authority in the energy sector, and consequently, there had been no *ex ante* regulation of the transmission charges. Hence it has not so far been possible to make a serious statement on the effectiveness of the German regulatory model that is now in force. The Monopolies Commission doubts that competition on the grid-connected energy markets can be vitalised at the present time exclusively by the two alternatives for deconcentration put forward by the European Commission.

**10.\*** In this context the Monopolies Commission points out that the deconcentration proposals and their implementation entail quite considerable economic risks and legal problems. There is a risk that the investment incentives for network operators will be remarkably reduced. Furthermore the effect of deconcentration on energy prices is uncertain. They could even rise after the deconcentration. In addition, unbundling of legal ownership in particular is a considerable intervention in private ownership rights. That can result in protracted legal proceedings, particularly as the Community's legislative powers on ownership are very doubtful. In addition, the European Commission's deconcentration instrument would have an asymmetrical effect in the countries concerned. For state-owned enterprises it would be sufficient that two separate public bodies exercise control over the gas extraction activities (or electricity generating and supply activities) on the one side and the transmission activities on the other. However, if the company in question is in private hands it should not retain any significant shares in the network operator following a vertical deconcentration.

**11.\*** Finally the desired vertical separation on the electricity market cannot directly solve the real problem, namely the high level of concentration of suppliers in electricity generation. At best it could only solve it in the long run. The Monopolies Commission has fundamental doubts in the effectiveness of the EU deconcentration instrument for the gas sector. Beside the fact that the suppliers on the gas market are in some substitution competition with the sup-

pliers of other commodities, the gas suppliers are primarily companies domiciled outside the EU. If companies like Gazprom were forced to split up their networks within the EU they could easily react by raising network charges/gas prices at the Russian border. If gas production, transport and distribution were separated the risk of double marginalisation would be very much greater than on the electricity market, as gas import prices can hardly be influenced.

**12.\*** Hence the Monopolies Commission recommends making the present network regulations more stringent in the next two to three years with targeted measures. Therefore it on principle welcomes the planned tightening of the so-called third way to intensify the present requirements on deconcentration in the Energy Law. But it agrees with the European Commission that the requirements for the network operators should be made even more stringent. In its Special Report on the Energy Market of November 2007 the Monopolies Commission argued that all the staff employed by the network operator should be forbidden from exercising any other functions in the corporate group. That would make it much more difficult to pass on confidential information and so put affiliated companies in a more favourable position.

**13.\*** In addition, the detailed bundle of measures which the Monopolies Commission proposed in its Special Report on the Energy Market should be implemented quickly. If after a period of about six years from the start of regulation serious structural shortcomings are still evident on the markets for network energies ownership unbundling could be conceivable as the ultima ratio.

- **The Transition from Regulation to Competition Supervision on the Telecommunication Markets**

**14.\*** As competition increases telecommunication markets need to be gradually taken out of sector-specific regulation and brought under general competition law. The institutional competence will then be transferred from the Federal Network Agency to the Federal Cartel Office. In the discussion over the transition into general competition law two aspects predominate. Firstly, there are complaints that in the examination of the need for regulation in accordance with § 10, Para. 2 of the Telecommunications Act (*Telekommunikationsgesetz – TKG*) too little attention is paid to the criterion of the insufficiency of competition law. As a result the regulation is cemented. Secondly it is argued that competition law is less efficient in prosecuting abuse than the *ex post* regulation under the TKG, and that the regulatory authority is the more appropriate authority to exercise supervision to prevent abuse in the telecommunication sector. Hence an interim stage is needed in deregulation.

**15.\*** The examination of whether general competition law is adequate to counter a certain market failure is part of the three criteria test in § 10, Para. 2 TKG. This insufficiency test is potentially the most important criterion for deregulation, but this is not evident either from the recommendation by the European Commission on markets or in the application of the three criteria test in practice. In regulatory practice the insufficiency of competition law is generally explained by differences that always exist between competition law and regulation law. If such differences are sufficient to justify sector-specific regulation the limiting effect of the third criterion ceases.

**16.\*** In the view of the Monopolies Commission high standards should be set for the examination of the insufficiency of competition law. It must be remembered here that the structural disadvantages of interventions under competition law, which can only be made *ex post* and are only possible on certain points, do not mean that competition law is always inadequate. This argument is supported, not only by the fact that regulation in the market economy must

be the justified exception, owing to the intensity of its intervention, but also that it cannot remove the most important cause of market failure on telecommunication markets, namely the existence of bottlenecks. Rather, it tends to cement them because access regulation reduces the incentives to invest in avoiding or duplicating bottlenecks. It would be helpful if the European Commission, which applies the three criteria test on Community level, would prescribe criteria for carrying out this test in practice on national level.

**17.\*** The Monopolies Commission refuses to implement an abuse supervision in the Telecommunications Act, which is independent of the examination whether a market may be subject to sector-specific regulation. It is doubtful that such a provision would be consistent with European law. The arguments that the Federal Network Agency is the more appropriate authority to exercise supervision to prevent abuse on telecommunication markets, and that the TKG enables more efficient and rapid intervention, are not convincing either. Even if it is correct to say that the Federal Network Agency has greater specific knowledge of the market in telecommunications, the Federal Cartel Office has more specialised knowledge in economic matters, owing to the large number of cases it handles, and with its many years of official experience it is the more appropriate authority to exercise abuse supervision over enterprises with a dominant market position. Moreover, the instruments in competition law for behaviour control have been made more stringent in recent years, and the powers of the cartel authorities have been widened. Another fact that supports consistent transition into general competition law is that the regulatory authority is more exposed to political influence than the Federal Cartel Office. This is partly due to the decision-making structures in the Federal Network Agency, and partly to the fact that the Federal Government is still both owner and regulator, which is bound to lead to conflicts of interests.

**18.\*** The Monopolies Commission as well refuses that the Federal Network Agency acts as a competition authority and applies cartel law to telecommunication markets as part of its abuse supervision. The parallel application of competition law by different authorities would induce problems in regard to the uniform application of the law. Similar problems will arise if the Federal Cartel Office and the Federal Network Agency have to agree consensually on the competence of regulation, following the concept of the “ladder of remedies”. The Monopolies Commission takes a positive view of the proposal to rely on the more economically oriented concept of the “ladder of remedies” in the question of “how to regulate”.

- **Cooperation with the Federal Statistical Office and the Proposal for § 47 of the Law Against Restraints of Competition**

**19.\*** Cooperation with the Federal Statistical Office (*Statistisches Bundesamt*) was mainly positive in the past two years. Especially the preparatory work for this Biennial Report progressed in partnership and in a productive atmosphere. By providing the business register the Federal Statistical Office has enabled comprehensive cross-sectoral figures on concentration in the German economy to be compiled for the first time. That is a considerable improvement for the reports by the Monopolies Commission, although further developments in the method are essential to improve the quality of the data.

**20.\*** A particularly important development in the economic statistics, in the view of the Monopolies Commission, is the compilation of a data base on multinational enterprise groups as part of the EU EuroGroups Register project. This data will for the first time give an insight into European market structures and the economic interdependence between markets and companies on European level. This knowledge is essential for an assessment of the competition situation of the many companies in Germany that operate internationally. The Federal Sta-

tistical Office has so far taken a rather reserved position towards the EU project, as it has legal doubts. The legal conditions are now being created with ordinances. Greater involvement by the Federal Statistical Office to promote German interests in this field would be of the greatest importance, particularly while the data base is being built up.

**21.\*** The Federal Statistical Office and the Monopolies Commission have different views on the interpretation of § 47 GWB. The Monopolies Commission would like to undertake evaluations under § 16, Para. 6 of the Federal Statistics Act (*Bundesstatistikgesetz – BStatG*) in future. This regulation permits to use confidential information for research projects, and it would greatly improve the scope for analysis by the Monopolies Commission. The Federal Statistical Office refers to legal reasons for rejecting the application of § 16, Para. 6 BStatG by the Monopolies Commission. The Monopolies Commission does not agree with that interpretation of the law.

**22.\*** Both sides assess that a uniform interpretation of the application of § 16, Para. 6 BStatG is not possible on the basis of the present legislation. Consequently they agree that the present different interpretations can only be eliminated by changing the law. Moreover, the present wording of § 47 GWB is no longer sufficient for current procedures. So the two sides have jointly formulated the contents and aims of an amendment to § 47 GWB and the Monopolies Commission has put forward a proposal for the law to be amended accordingly.

- **Access to Files held by the Federal Network Agency**

**23.\*** Under § 46, Para. 2a of the Seventh Amendment to the Act Against Restraints of Competition the Monopolies Commission, in order to perform its legal task, was given right of access to the files held by the cartel authority. This includes confidential commercial and business information and personal data, insofar as this is necessary for the proper performance of its function. The new regulation describes the bases of current practice to date and insofar it merely clarifies the present legal position.

**24.\*** The legal task assigned to the Monopolies Commission has in recent years been extended far beyond the regulations laid down in the GWB. The additional tasks are laid down in the Telecommunications Act (*Telekommunikationsgesetz – TKG*), the Postal Services Act (*Postgesetz – PostG*), the General Railway Act (*Allgemeines Eisenbahngesetz – AEG*) and the Energy Industry Act (*Energiewirtschaftsgesetz – EnWG*). All these tasks entail observance of the regulatory practice in the network sectors covered by these laws. None of them envisaged right of access to files for the Monopolies Commission, and without a legal base the Federal Network Agency was not in a position to hand over confidential information on regulatory practice, as is done in the decision-making practice of the Federal Cartel Office, for example.

**25.\*** The Monopolies Commission had proposed that the legislature should also give it right of access to files on the regulatory practice by the Federal Network Agency. So far this has only happened in the TKG, where an appropriate regulation has been added to the law, analogous to the wording of § 46, Para. 2a GWB. There is no regulation on access to files in the other laws (PostG, AEG and EnWG).

**26.\*** Without this legal basis the Monopolies Commission cannot fully perform its legal tasks. Comprehensive assessment of regulatory practice is only possible on the basis of all the relevant information in the case files, including confidential matters. But establishing right of access to files for the Monopolies Commission in these laws would also be in the interest of the Federal Network Agency. The clause would provide clear authorisation of the Monopolies

Commission's powers to assess regulatory practice, and – unlike informal procedures – it would give the authority legal certainty that it is permissible to hand out information to the Monopolies Commission.

### ***Preliminary Remarks to Chapters I and II***

**27.\*** In Chapters I and II of its Biennial Report the Monopolies Commission regularly assesses the status and foreseeable development of corporate concentration in the Federal Republic of Germany, on the basis of § 44 GWB. For this purpose comprehensive and continuous statistics on concentration are kept, and this enables to observe the general trends in corporate concentration in Germany. The complete concentration tables as well as supplementary explanations of the method are published as annexes to this Biennial Report in the form of an attached CD-ROM.

**28.\*** The need for comprehensive and continuous statistics on concentration can only be met by establishing general structures. The extent of concentration is compiled exclusively for the national market and according to the sectoral classification or the classification of goods used for the production statistics. This does not adequately reflect the relevant geographical and product markets. Altogether, the analyses by the Monopolies Commission have shown that in times of globalisation reports that are limited to Germany are difficult to interpret. When national markets merge into a single European market, or a global market, the development in the national concentration of supply gives a distorted picture. Systematic difficulties in interpretation also arise when a large number of the companies covered operate on regionally limited markets, like hospitals, public utilities and disposals, daily newspapers and banks. The extent of concentration shown for these enterprises understates the concentration that is actually present on these regional markets. The European Commission defines relevant product markets by the possibilities for exchangeability or factor mobility of products. In this definition the relevant product markets are also subject to constant change, e.g. through technical progress or product innovations that cannot be covered by the available sectoral classifications. Moreover, the extent of concentration can only be one indicator among others to establish the intensity of competition on a market. Other indicators, like potential competitors or market entry barriers, are not shown in the statistics.

**29.\*** The Monopolies Commission attempts to take due account of this by evaluating additional information on individual sectors, e.g. for the first time foreign trade interdependences. It also intends to work out proposals to improve the reporting on concentration, to enable interpretations that are even more relevant for competition policy. In this connection the Monopolies Commission is also considering whether it would be better not to compile reports on the concentration in every sector throughout the German economy, and instead carry out more in-depth individual sector inquiries. It herewith offers all the interested parties the opportunity to comment on this.

### ***I. Statistics on Corporate Concentration and Groups in Germany***

**30.\*** The empirical basis for the Monopolies Commission's statistics on concentration for this Biennial Report is a data base from the Federal Statistical Office. For the first time this has been compiled from the business register and commercial data on corporate links. The use of the business register instead of the survey of investment used in the past enables a much better account to be given of the German corporate scene. Instead of the companies employing 20 persons or more in mining, manufacturing and construction, a total of about 51,000 units surveyed in the past, around 3 million units with an annual turnover of EUR 17,500 and more,

and/or at least one employee paying statutory social insurance in nearly every economic sector are covered. In addition, a number of surveys and specialised statistics from the Federal Statistical Office were consulted, like the statistics on production, foreign trade and the evaluation of public funds, institutions and companies, as well as data from other sources. The data currently available is for the report year 2005. Owing to the use of administrative data sources a report using more up to date figures will unfortunately not be possible in the foreseeable future.

**31.\*** The shares which enterprise groups account for in total turnover and number of persons employed are in some cases considerable, in the enlarged data basis as well. The study of the importance of corporate groups for the economy as a whole shows that 6.3 % of companies in Germany are part of a group. They account for around 66 % of turnover and 53 % of the workforce. These shares are particularly high in mining, manufacturing, energy and water supplies, and transport and communications.

**32.\*** The Monopolies Commission has examined the structure and distribution of the German enterprise groups in regard to a number of aspects. Companies in groups with members outside the area in question (e.g. from another economic sector or abroad) can affect competition despite a low market share. For instance, vertical links with exclusive supply contracts between companies upstream or downstream reduce the number of available suppliers or customers for the independent companies. In this case the degree of concentration, taking account of all the companies in a sector, would give a false picture of the competition structure. This kind of integration was particularly evident between enterprises engaged in sewage disposal, which is the responsibility of the municipalities, energy supplies and the large customers for energy. Links in the services sector for shipping and air transport services and other industries are clearly evident. Beside the vertical links conglomerates (outside the sector) or multinational interdependencies can increase the capital available to companies, enabling them to displace competition in the medium to long term. Companies linked in this way have particularly high turnover shares in the economic sectors 10, Coal and Peat (71.8 %), 23, Coking, Petroleum Products, Fissile and Breeder Material (88.2 %), 24, Chemical Products (53.2 %), 27, Metal Production and Processing (58.8 %), 35, Other Vehicles (Water, Rail and Air Transport) (66.3 %) and 40, Energy Supplies (69.4 %).

**33.\*** The importance of foreign control is analysed both by the headquarters of the parent companies and by economic sector. German companies in groups headed by a foreign company only make up 0.7 % of all companies, but they account for around 19 % of turnover and employ 10 % of the workforce. Enterprise groups headed by a US company have the highest turnover shares among all the multinational groups, followed by Great Britain, the Netherlands, France and Switzerland. In the assessment by economic sector companies in multinational groups in Sector 23, Coking, Petroleum Products, Fissile and Breeder Material have the highest turnover shares (87.3 %), followed by 21, Paper (40.6 %), 32, Communications, Radio and Television Sets (39.6 %), 30, Office Machines, DV Machines and Equipment (38 %) and 35, Other Vehicles (Water, Rail and Air Transport) (37.7 %).

**34.\*** The share of state-controlled companies in a sector can considerably influence competition, e.g. through direct subsidisation, advantageous financing (soft budget restrictions), tax concessions or regulations in sub-sections. In sectors that are still entirely or partly regulated (energy and water supplies, the railways and waste disposal) the turnover shares of state enterprises are particularly high. The development of concentration in these sectors as privatisation progresses will be of particular interest.



## ***II. The State and Development of Corporate Concentration in Germany***

**35.\*** The Monopolies Commission examines the state and development of corporate concentration in Germany on the basis of the concentration statistics. In the first part the state of concentration in Germany in 2005 is considered by economic sectors. The composition of sectors C, D and F has changed so much from previous publications owing to the inclusion of small companies that a comparative analysis was first made of the extent of concentration. This shows that up to the report year 2003 the extent of concentration in many sectors was overestimated, owing to the cut off point of companies employing 20 people and more. In some sectors, however, it is higher in 2005 than in 2003, despite the wider data base. This applies, among others, to the economic sectors 3410, Production of Vehicles and Vehicle Engines, 3430, Production of Parts and Accessories for Vehicles and Vehicle Engines, and 2416, Production of Plastics in Primary Form, which are also some of the biggest sectors in Germany, measured by turnover. In these sectors a real increase in concentration can be assumed.

**36.\*** Despite the difficulty of adequately reflecting the relevant geographical and product markets in the concentration statistics, the market structures in some sectors can be well represented with the available data. In manufacturing they include the foodstuffs industry, publishing and printing products that appear at most four times a week, the production of concrete, cement and plaster as well as products using these materials. These industries are for the most part also highly concentrated.

**37.\*** For an assessment of the data on all the sectors that appear in the concentration statistics for the first time comparative figures from branch reports, and from the associations and research institutes, are used first. They show that the quality of the data base does not as yet enable an interpretation of the data in many areas. In some sectors the number of units given is far too high. This is partly due to erroneous sector assignment and partly because enterprise groups cannot be systematically compiled owing to their organisational form. That applies particularly to the energy, retail trade, banking and insurance sectors.

**38.\*** In Sector I, Transport and Communications, the figures do give a good picture of the concentration that is still present, especially in some formerly state controlled areas or structural monopolies. The long term development of the concentration figures in these areas will be of particular interest. The same applies to other areas, where concentration data has been compiled for the first time, like the provision of services. Here the Monopolies Commission is expecting an increasing consolidation through the establishment of corporate chains.

**39.\*** The development in concentration in the mining and manufacturing sectors between 1995 and 2004 is traced using an investment survey. The branches which achieved a rise in turnover during the period observed are divided into four quadrants according to their level of concentration in the initial year 1995 and its development up to 2004 (cf. diagram).

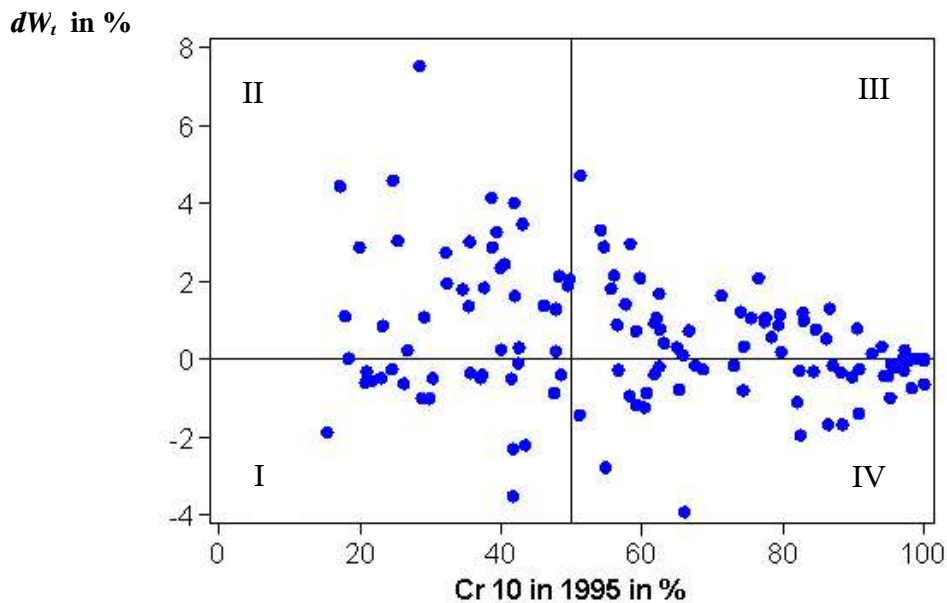
**40.\*** Altogether 148 branches in mining and manufacturing showed a rise in turnover in the period observed. Of these about 40 % are below a concentration rate of the ten largest companies of 50 % in the base year 1995 (Quadrants I and II in the diagram) and 60 % were above this (Quadrants III and IV). The average annual growth rate in the concentration rate of the ten largest companies (CR10) is positive up to 2004 in around 50 % of the branches (Quadrants II and III).

**41.\*** A time flow analysis identifies the branches where corporate concentration has risen considerably. They are 1513, Meat Processing, 2212, Newspaper Publishing, 3611, Production of

Office Furniture, and 2442, Special Pharmaceutical Products and Other Pharmaceuticals in Quadrant II. Of particular interest for competition policy are the branches in Quadrant III, which were already showing a high level of concentration in the base year, and which grew during the period observed. Among others they include 1512, Poultry Slaughter, and 3210, Production of Electronic Components. In 26 branches concentration is very high throughout the entire period observed.

**Diagram:**

**The Relation between the Level of CR10 in the Base Year 1995 and the Average Annual Growth Rate in CR10 ( $dW_t$ ) between 1995 and 2004 by Economic Branches**



Source: Compilation by the Monopolies Commission using data from the Federal Statistical Office

**III. The State and Development of Concentration among large Companies (Aggregate Concentration)**

42.\* The starting point for the Monopolies Commission's report assessing the state and development of aggregate concentration is the list of the hundred largest companies in the economy as a whole by domestic value added. In addition to the domestic concerns the Monopolies Commission also analyses world value added by the large companies. The study of the hundred largest companies by domestic value added also covers the ties between these companies in the form of shareholdings, personnel links and cooperation through joint ventures. The consideration of the hundred largest companies is supplemented by identifying the largest companies in the producing sector, trade, transport and services, banking and insurance, measured by their branch-specific volume of business.

43.\* Altogether the hundred largest companies showed value added of around EUR 281 billion in the year reviewed. This was a rise of 13.2 % from 2004. The value added by all companies in Germany rose during the period observed by 4.9 %. The contribution of the large companies to total value added by all companies thus rose to 18.0 % (2004: 16.7 %), reaching the highest level since 2000.

Account is taken of the increasingly international orientation of the production and acquisition processes through globalisation, and the consequent shifting of companies' divisions abroad, with an additional analysis of worldwide value added. This also enables the economic weight of the decision-making centres responsible for these companies to be adequately identified. The share of domestic value added in worldwide value added for the ten largest companies dropped slightly, from 57.7 % in 2004 to 57.3 % in 2006. The results suggest that the relative increase in outsourcing to foreign production plants, particularly of labour-intensive parts of the value added chain, or of the intermediate inputs which large companies buy from domestic or foreign suppliers, at least slackened during the period observed.

**44.\*** The ten largest companies accounted for 40.98 % of the value added by all the large companies examined, and this was below the figure for the previous period (42.45 %). The share of the twenty largest companies in the value added by the hundred largest companies also fell, from 61.78 % in 2004 to 58.88 % in 2006.

**45.\*** As far as data for the two years could be compiled, the development for the large companies between 2004 and 2006 was also analysed by number of persons employed, fixed assets and cash flow.

Eighty-eight companies that were among the hundred largest companies in both years were included in the examination of the number employed. Their share in the number employed by all companies was 13.40 % in 2006, compared with 13.98 % in 2004. The importance of the large companies as employers has thus fallen again, although the drastic reduction in the number employed by the large companies in the previous periods had clearly slackened in 2006, following corporate consolidation measures.

The moderate decline in the number employed combined with the clear rise in domestic value added led to an increase in the value added per person employed of 21.57 % in the 88 companies studied to an average of EUR 116,710 in 2006.

**46.\*** In addition to the value added branch-specific features taken directly from the annual financial statements are used to assess the size of companies. Turnover is used for industrial, transport and services companies, and for trading companies. The balance sheet total is preferred as a measure of the size of banks, while income from policies is used for insurance companies. But value added must be regarded as a better criterion of size, as unlike the above alternatives, which reflect the volume of business, it permits the comparison of companies across branches and also reflects the degree of their vertical integration. The study of the largest companies by volume of business is thus a supplementary study with the aim of throwing more light on the importance of large companies in the individual branches.

The growth in the volume of business of the largest companies was above the general market development in the producing sector and in insurance and banking. The aggregate concentration, on the other hand, declined in trade and in transport and services. Measured by the share of the ten largest companies in the volume of business of all the companies operating in a branch, insurance and banking still show the highest level of concentration.

**47.\*** The shareholders of the large companies are analysed first in regard to the shareholder structure of the companies in the group under consideration, and then the capital ties between the hundred largest companies are examined. In most of the companies studied the ownership had not greatly changed. As in 2004 the public authorities reduced their shares in some large companies (Deutsche Telekom AG, Deutsche Post AG, Fraport AG Frankfurt Airport Services Worldwide).

There were the following changes in the groups of shareholders who hold the majority in the large companies examined. The number of companies where a single foreign owner held the majority rose from 2004 by four to 28. In second place, with the same number, 21, were the companies with one individual, a family or family foundation holding the majority. Only slightly smaller (20 cases, as in 2004) was the number of companies whose shares were widely distributed. The fourth largest group, measured by the number of companies it contained in 2006, was the twelve (2004: twelve) large companies in which a public authority held the majority of the shares. Again in twelve cases (2004:14) it was not possible to show whether the majority of the equity was held by another large company, a single foreign owner, a public authority, individuals, families or family foundations, nor whether the shares were widely distributed or held by other shareholders. In two (2004: three) cases the shares held by the hundred largest companies amounted to more than 50 %.

**48.\*** During the period observed the number of interlinked companies rose from 35 in 2004 to 39. The slight rise is largely due to a change in the composition of the group surveyed. If the development since 1996 is taken a progressive tendency to deconcentration is evident. Where there were 39 interlinked companies in 2006 62 companies were interlinked through shareholdings in 1996. The total number of shareholders follows the same trend (1996: 39, 2006: 21), as does the number of subsidiaries (1996: 51, 2006: 29). The total number of holdings fell during the same period from 143 to 50. After inclusion of the data from the last Biennial Report it can also be stated that the total number of shareholdings in the hands of the largest financial services providers has fallen steadily from 75 cases in 1996 to 26 in 2006. Most of the shareholdings in other companies on the hundred largest companies list were, as in previous years, held by Allianz SE, with 16 (2004: 14). The decline in shareholdings can be seen as due to the progressive globalisation and the increasing importance of international companies. But it is also due to institutional changes within Germany. Beside deconcentration some of the reduction in the degree of interlinking may also be explained by mergers between formerly closely interlinked members of the hundred largest companies list.

**49.\*** In examining the personnel links only those ties between companies are included where one or more persons are on the management or control organ of at least two companies on the hundred largest companies list at the same time. In 2006 34 (2004: 34) companies of those studied had members of their management on the control organs of 44 (2004: 46) companies on the list. The total number of ties through management board members was 84 (2004: 86). The number of ties through management board members of banks and insurance companies fell by 20 %, from 30 in 2004 to 24 in 2006. Since 1996 the number has fallen by 76.2 %. The comparison over ten years shows, as in the case of equity ties, a steady decline in the role played by financial services providers in the network of personnel links.

**50.\*** The number of links through joint ventures between the twenty largest companies had fallen in 2006, to 30 from 35 in 2004. The degree of integration as the share of such links in the total number of possible ties fell from 18.4 % to 15.8 % in 2006. Altogether there were 58 (2004: 75) joint ventures. In some cases the contact between two companies was through several joint ventures. In one case more than two companies were involved in one joint venture.

Beside the twenty largest companies the eight (2004: seven) energy supply companies on the hundred largest companies list were also examined in regard to cooperation through joint ventures. The number of ties between the energy suppliers rose from nine in 2004 to eleven in 2006. The degree of integration of the seven companies that were studied in both years, 2004 and 2006, rose from 42.9 % to 47.6 %. The number of joint ventures fell during the same pe-

riod slightly, from 48 to 45. The companies in the energy industry were distinguished by particularly intensive cooperation in joint ventures, with 28 and 62 % of those operating in the same branch as their head companies.

**51.\*** In studying the involvement of the hundred largest companies in the mergers completed and reported to the Federal Cartel Office in accordance with § 39, Para. 6 of the Act Against Restraints of Competition the Monopolies Commission is stressing the importance for competition policy of the external growth of the hundred largest companies. Companies on this list were involved in 582 (2004/05: 661) of the total of 3,303 (2004/05: 2,541) mergers reported. So the share of companies on the hundred largest companies list involved in the total number of mergers fell again, from 26.0 % to 17.6 %. During the period reviewed, 2006/2007, 3,779 decisions to clear mergers were also given, of which 529 (14 %) involved companies on the hundred largest companies list.

**52.\*** Altogether the impression is of slightly increasing concentration during the period under review in the various size features and economic sectors examined. The share of large companies in total value added has clearly risen compared with the development in previous years. In the producing sector the process of increasing concentration, that was already evident in former years, continued. There was an increase in concentration from the previous period in banking and insurance, but the importance of the large companies in trade and transport and services fell. Contrary to the macroeconomic development the number of jobs provided by the large companies fell.

There is also a declining trend in shareholding ties and in personnel links between the hundred largest companies, and this led to the dissolution of most of the network of mutual ties. The slight rise in shareholdings is mainly the result of changes in the composition of the group studied. The number of links through joint ventures fell during the period studied, as did the participation of the large companies in the mergers reported to the Federal Cartel Office and in the number of decisions to clear mergers.

#### ***IV. Antitrust and Merger Control***

**53.\*** In its antitrust supervision the Federal Cartel Office conducted several proceedings of significance for cartel law during the period under review. Traditionally the energy sector accounts for a major part of the work of the Federal Cartel Office, and the amendment to the Energy Law affected the work of the Office during the period under review. With the start of regulation of the gas and electricity networks by the Federal Network Agency under the provisions of the amended Energy Industry Act, the Federal Cartel Office ceased to be responsible for prosecuting cases of abuse of network access and network connections under national law and in accordance with § 111 of the Energy Law. The main focus of the work of the Federal Cartel Office is now on the markets for purchases, production and sales, which are not regulated. On suspicion of abuse of a dominant market position the Federal Cartel Office acted i.a. against long-term gas supply contracts with onward distributors and against inclusion of certain cost elements based on CO<sub>2</sub> emissions trading in electricity pricing. The Monopolies Commission sees the ban on long-term gas supply contracts as an effective instrument to promote competition, but it advises taking note of the effects on the incentive structure for long-distance gas companies. When the ban expires it should be carefully considered whether the market situation at that time requires a renewed ban. The Monopolies Commission acknowledges the efforts made by the Federal Cartel Office to prove that the duopoly of E.ON and RWE, who have a very strong market position, are abusing this. But it holds the view that it cannot be proved that the inpricing of CO<sub>2</sub> certificates is raising prices in the elec-

tricity sector. The Monopolies Commission holds the view that the impricing is not only legitimate business practice but is on principle also essential for CO<sub>2</sub> certificates trade to function. The argument put forward by the Federal Cartel Office cannot be accepted unconditionally.

**54.\*** In February 2006 the Federal Cartel Office concluded an antitrust proceeding against Soda-Club, a producer of equipment to add gas to drinking water. The company had tried to exclude competitors from filling the CO<sub>2</sub> cylinders needed for the final equipment by only leasing the containers to end-customers. The appeal against the decision has now been rejected by the Intermediate Court of Appeal and the Federal Supreme Court. The Monopolies Commission observes that this is also a case of sealing a secondary market, as the filling market is a part of the market for the cylinders. A similar constellation is known on other markets, for example the market for printers and printer cartridges. However, coupling a primary with a secondary product is not necessarily abuse if the constellation will lead to gains in benefit. The Monopolies Commission holds the view that objection cannot be raised on economic grounds to sealing off a secondary market under strict conditions. These conditions are active competition on the primary market and segmenting customers into groups that are characterised by a reciprocal relationship between the quantity in demand and price elasticity. But these conditions were not met in the case of abuse under consideration.

**55.\*** The Federal Cartel Office prosecuted Praktiker Baumärkte GmbH for undue hindrance in the vertical relationship between franchise customers and suppliers. The company, which both administers and supplies franchises, required some of its franchise customers to take 100 % of the building market goods they were selling from it but did not hand on to them its resultant purchasing advantages, which enabled the company's outlets to offer goods at much better prices than its franchise holders were able to do. In January 2008 the Düsseldorf Court of Appeal repealed the decision by the Federal Cartel Office. The Monopolies Commission sees the action by Praktiker as only partial restraint of competition, as its scope for action as supplier of franchises in the fiercely contested branch is still controlled by competition from other firms. However, there is some competition between the administration company and the franchise holders on the same geographical markets, where there is also some risk of a price-cost scissors movement. In the last amendment to the GWB a ban on such splitting of sales prices has been included in § 20, Para. 4, Sentence 2, No. 3 as a general example of undue hindrance. However, the Monopolies Commission only regards the amendment as partly meaningful, as the franchise supplier still has opportunities for creaming off the yields that the market still contains, while at the same time it must be feared that practices that will increase efficiency are being prohibited.

**56.\*** The ban on selling products below cost price has also been amended. § 20, Para. 4 GWB as amended in December 2007 now contains a general example in which the occasional offer under cost price is defined as undue hindrance for groceries in the meaning of § 2, Para. 2 of the Groceries and Animal Feed Code. The Monopolies Commission takes a critical view of the amendment, as of the ban on selling below cost price in itself, as de facto it does not lead to advantages for the customer. It also makes only a very limited contribution to the protection of small shopkeepers, as big chains can still charge lower prices simply owing to their purchasing advantages. The Monopolies Commission sees setting below cost prices as part of a mixed calculation as a regular parameter in competition, as long as the below cost price is not used as an instrument to restrict competition in a displacement strategy. Moreover, the Federal Cartel Office's practice in several cases shows that enforcing the ban on selling below cost is difficult. In the case of abuse involving Rossmann, a drugstore goods chain, a number of

discounts on individual products in the range had to be moved. It remains questionable here whether the advertising cost grant should only be applied to products actually purchased. The Monopolies Commission does not believe that a clear and economically correct assignment is possible, and so in a free society the supplier should himself decide on the assignment. But this also shows that a consistent implementation of the ban on below cost selling is not possible.

**57.\*** Finally, a case of abuse during the period under review concerned the boycott of commercial ticket vendors by state lottery companies. The emergence of private ticket vendors on the regulated market for lotteries ended the monopoly of the state lottery companies. This gave them the incentive to limit the activity of commercial ticket vendors within their radius of action. Deutsche Lotto- und Totoblock required its members not to accept tickets from vendors who had extended their activity to include terrestrial selling. The Federal Cartel Office took action against this as a boycott in the meaning of § 21 GWB, and its decision was very largely confirmed in the appeals procedure. The Monopolies Commission regards the action by the Federal Cartel Office as correct under the present law, but points to conflicts between the aim of combatting compulsive gambling on the one side and that of extending participation in the lottery to encourage competition on the other. Moreover, there is a risk that the intervention by the Federal Cartel Office will not benefit consumers but simply shift yields on monopolies from public to private suppliers.

**58.\*** The merger control statistics from the Federal Cartel Office shows a clear rise in the number of cases handled in the period covered by the Monopolies Commission's report, 2006/ 2007, compared with previous years. The number of new applications has risen again. Hence a further rise in the number of cases is to be expected for the next report period. In the past report period the Federal Cartel Office completed the main appraisal procedure for 65 cases, of which 38 were cleared without the imposition of conditions or remedies. 15 cases were cleared with conditions and remedies imposed, and twelve were forbidden.

The Monopolies Commission has considered the criteria for exercising merger control and has discussed possibilities of adjusting it to make it more efficient. In regard to the clause on associations in § 36, Para. 2, Sentence 1 GWB and the general threshold for exercising control in § 36, Para. 1, Fig. 1 GWB it must be stated that this heuristic approach to the obligation to report mergers to the Federal Cartel Office is intended particularly for critical merger projects. It is clear from the example of mergers involving public hospitals that the obligation to exercise control in this sector depends in a number of cases on which shareholdings the territorial authority responsible has acquired. The merger between the Greifswald University Clinic and Wolgast District Hospital initially required approval because the income to the State of Mecklenburg-Western Pommerania from enterprises, most of which comes from the State Lottery Company, was assigned to the University Clinic. In May 2008 the Düsseldorf Court of Appeal upheld the plaintiff's case. The yield on turnover earned by the State of Mecklenburg-Western Pommerania and associated enterprises must be taken into account, but in including the lottery turnover the prize money paid out must be deducted as reducing these earnings. If this method of calculating the yield on turnover is used the merger falls below the general threshold for intervention. In the merger between the Ludwigsburg-Bietigheim Clinics and the Enzkreis Clinics the inclusion of the yield on turnover earned by the Ludwigsburg Savings Bank was determinant in taking the merger to the turnover threshold where merger control law applies. The Monopolies Commission has pointed out that a qualitative distinction must be drawn between the consolidated turnover achieved by territorial authorities and that of private companies. Especially in mergers between public hospitals statutory control should be

initiated more frequently, and it should be less dependent on those enterprises that are assigned to the territorial authorities under the clause on associations. The Monopolies Commission regards greater involvement of merger control in hospital mergers as necessary, partly because these are largely regional markets, and partly because of the very high administrative barriers to market entry. It therefore proposes that the calculation of the yields on turnover on this market should be adjusted by adding the following clause to § 38 GWB: “For the turnover of hospital enterprises three times the yield on turnover is to be used.”

**59.\*** During the period under review the application of the clause on insignificant markets in § 35, Para. 2, Sentence 2 GWB has been concretised. In its decision on the appeal over the Sulzer/Kelmix/Werfo merger the Federal Supreme Court has clarified the question whether application of the insignificant market clause should depend on turnover on the domestic market or on the commercial market. In the latter case the relevant market could extend beyond the area where the GWB applies. Here the regulation indicates that only turnover on the domestic market should be considered. The Monopolies Commission welcomes the decision by the Federal Supreme Court, as it is in accordance with the meaning and purpose of the insignificant market clause, namely only to cover mergers of sufficient economic importance within Germany. However, a purpose-oriented interpretation of this kind is also appropriate if turnover from several materially relevant markets is added together, as the importance of a merger for the economy as a whole grows if a large number of markets is affected. But the Federal Supreme Court has set considerable barriers to aggregate turnover. The Monopolies Commission therefore recommends that the legislature should concretise the insignificant market clause to include the grouping of several domestic markets explicitly in the norm.

**60.\*** In this context the insignificant market clause must also be seen as an indicator of whether a merger is of sufficient importance in Germany at all. For under § 130, Para. 2 the GWB applies to all restraints of competition that have an effect within the area of application of the law, even if the cause lies outside that area. Accordingly, mergers between foreign companies also have to be reported in Germany if they will have repercussions here. The Federal Cartel Office forbade the mergers proposed between Coherent/Excel, CVS Ferrari/Cargotec and Phonak/GN ReSound, which are all foreign companies. Beside the insignificant market clause also the limit of EUR 25 million for domestic turnover serves to establish the genuine link to affect German merger control law. So far the turnover of one of the companies has been used as criterion. There has been some criticism of the criteria for exercising German merger control over projected foreign mergers, because this means that worldwide mergers have to be reported under several jurisdictions, and it is difficult for those involved to identify the threshold of the insignificant market, as it refers back to the definition of the materially relevant market. Proposals here aim to strengthen the criteria for exercising control by setting a second domestic turnover threshold that might also replace the insignificant market clause. However, the Monopolies Commission takes a critical view of this adjustment of the GWB, as it is to be feared that mergers that could contribute to considerable restraint of competition within Germany would be released from mandatory control. In regard to the above foreign mergers that were not cleared it should be pointed out here that if the present domestic turnover threshold of EUR 25 million was raised two of the companies involved would not have been covered by all the regulation.

**61.\*** In several cases during the period under review companies involved in mergers have argued that the GWB cannot be applied because it is overlaid by other norms. Chief among these were hospital mergers, where in many cases the parties involved assumed the GWB did not apply owing to the exclusion clause in § 69 of the Social Code V (*Sozialgesetzbuch* –



*SGB V*), or hospital planning law, which takes priority. In the mergers between Rhön-Klinikum AG/Bad Neustadt and Mellrichstadt District Hospitals, and LBK Hamburg/Maria-hilf Hospital, the parties all applied for ministerial approval under § 42 GWB. In its Special Report in accordance with § 42, Para. 4 GWB, which forms part of the procedure, the Monopolies Commission commented that it regards the GWB as applicable in these cases as well. On 16 January 2008 the Federal Supreme Court confirmed in its decision on the case of Rhön-Klinikum AG/Bad Neustadt and Mellrichstadt District Hospitals that competition law also applies to mergers between public hospitals. It was argued that competition law is overlaid in the merger procedure between the Hanover Regional Clinic and Hanover Region as well, as the merger was due to the municipal reorganisation of the territorial authorities in the Hanover region. In this case, too, the Federal Cartel Office did not regard the area of application of the GWB as limited. The procedure closed on 13 November 2006 with clearance for the merger.

**62.\*** Owing to the large number of hospital mergers during the period under review the Monopolies Commission has considered market definition in the hospital sector. The practice of the Federal Cartel Office shows that patients prefer to be treated close to their place of residence, and this often gives rise to small regional markets. I.a. the Office calculated a self-sufficiency ratio but it refrained from naming definite figures from which a geographically relevant market can be identified, preferring to base the definition on a number of criteria. The Monopolies Commission welcomes the exact method used by the Federal Cartel Office to define a geographical market. To define a materially relevant market the Federal Cartel Office regularly uses the entire market for hospital services, without differentiating by specialised departments. In one of its own empirical studies the Federal Cartel Office has identified strong ties between the specialised departments, and for this reason it regards using the entire market for hospital treatment of acute cases as adequate. However, it does draw a distinction when a psychiatric clinic is involved in a merger, as psychiatry differs from the physical hospital market in various respects. The Monopolies Commission regards definition by specialised departments as not appropriate in many respects. However, it proposes that only those diagnosis related group (DRG) cases should be included in which at least two of the hospitals involved have invoiced a minimum number of cases. In the view of the Monopolies Commission this will lead to better delimitation of the area affected by the merger.

**63.\*** During the period under review the Federal Cartel Office modified its definition of the market in the energy sector and adjusted it to current market developments. The Monopolies Commission, which was in favour of modification in the last Biennial Report, welcomes this action by the Federal Cartel Office. However, it warns that this market definition cannot reflect all market developments. It holds the view that insufficient attention has been paid to the regular energy market, and that the consideration of the distribution stage is insufficiently differentiated. The Monopolies Commission would have liked to see analyses by the Federal Cartel Office underpinned with quantitative economic studies, as it believes this would have yielded greater insight. The current discussion on defining a uniform heating market, in which gas should be included as a source of heating energy, could benefit from such a basis. The Monopolies Commission suggests that in defining the market in the gas sector a distinction should be drawn according to the competition policy measure that is based on it. It is in favour of a broad definition of the market when severe structural policy instruments are to be applied, like deconcentration of ownership, and it regards a slightly narrower definition, based purely on the gas market, as sufficient for merger and abuse control. Deconcentration is a considerable intervention in the ownership rights of companies, and so, in the view of the Monopolies Commission, it needs a very sensitive approach, with a comprehensive analysis of all

the forces of competition. So the Monopolies Commission would like to see a tendentially wider market definition here. In addition, the Monopolies Commission acknowledges the different view now taken by the Federal Cartel Office of competition between the various distribution routes in the foodstuffs retail trade.

**64.\*** The Monopolies Commission has undertaken a more exact examination of the Federal Cartel Office's material appraisal of the competition conditions in various merger procedures. In the procedure between the American companies Coherent and Excel, both of which produce lasers and precision optical instruments, the Federal Cartel Office forbade the merger because it would lead to a dominant position on the market for sealed-off RF CO<sub>2</sub> lasers up to 600 W. The companies would certainly have high market shares on this market after a merger, but it was striking that several small companies have entered the market for lasers up to 100 W recently. The Monopolies Commission therefore argued that in this case the competition from fringe suppliers should have been more carefully examined, as theoretically they might erode the dominant position of the parties to the merger. However, the Monopolies Commission also observed that most of the new entrants to the market were in the segment for lasers of low wattage, and no other decision could have been taken, if only owing to the market position in the segment for more powerful lasers.

**65.\*** The Federal Cartel Office also forbade the merger between Phonak and GN ReSound, which manufacture hearing aids, because it would create a dominant oligopoly on the market. The Federal Cartel Office has shown that owing to ties between suppliers through various associations, joint ventures and patent exchanges there is already largely parallel behaviour by the present oligopoly suppliers, and with GN ReSound the only actively pricing competitor would then be integrated in the oligopoly. It could be shown convincingly that the present oligopoly had a high degree of market transparency and effective sanction mechanisms, while there was no buyer power to act as counterweight and exert a disciplinary influence. The Monopolies Commission welcomes the fact that the Federal Cartel Office has based its examination strongly on the strategic possibilities for the protagonists, which could in future create more competition.

**66.\*** There has also been an increase in concentration in the air transport sector. During the period under review the Federal Cartel Office approved the acquisition of dba and LTU by Air Berlin. The takeover of Condor has been reported and is still under examination. It was already evident from the takeover of LTU that the merger would result in high levels of concentration on some medium haul routes to Spain. However, the Federal Cartel Office based its decision to allow the takeover largely on the low barriers to market entry in air travel, which make it easy for potential competitors to start operating on these routes. The Monopolies Commission, on the other hand, does not regard a very generalised reference to the potential competition in air travel as appropriate. If reference is made to the potential competition the likelihood of new entrants and the possibilities for individual competitors should be stated precisely. Analogous to the European Commission's decision on Ryan Air/Aer Lingus, for example, a distinction can be drawn between the barriers to market entry for competitors who already have a base at one end of the stretch in question, and those who first need to build one up or have to offer point-to-point flights.

**67.\*** The growing trend for electricity producers to acquire downstream companies has been stopped by the Federal Cartel Office. The two cases of E.ON/Stadtwerke Eschwege and RWE/Saar Ferngas brought an end to the trend. The Monopolies Commission welcomes these decisions, because they will counter further vertical concentration in the electricity sector. It

sees the forwards integration of the duopoly members as market sealing and a successive expansion of market power. In addition, in the view of the Monopolies Commission the vertical integration constitutes a considerable barrier to market entry, preventing potential competitors from establishing themselves on the electricity market if they cannot cover every stage of it. Moreover, should there be progressive vertical integration, through shareholdings in municipal providers, for example, the influence on the production capacities of the municipal providers, who are at present the only counterweight to the four associated companies, must be seen as undesirable.

**68.\*** In November 2007 the Federal Cartel Office forbade the State of Rhineland-Palatinate from taking over the state lottery company, Lotto Rheinland-Pfalz, as this would strengthen the dominant position of Lotto Rheinland-Pfalz in the state and would lead to stronger market positions for the lottery companies in Baden-Württemberg, Bavaria, Hesse, Saxony and Thuringia on the lottery markets in these states. Lotto Rheinland-Pfalz is at present the only German lottery company that is not controlled by the federal state on behalf of which it holds lotteries. The Monopolies Commission sees the merger as unique in that the State of Rhineland-Palatinate would be the only lottery organiser in the state even without the merger. That results from the new law on state lotteries in Rhineland-Palatinate, under which the state will only grant a concession to Lotto Rheinland-Pfalz if it holds the majority of its equity. Otherwise the State of Rhineland-Palatinate will transfer the organisation of lotteries to one of its own enterprises. Thus, if the merger fails because it is not cleared by the Federal Cartel Office the organisation of lotteries in Rhineland-Palatinate will pass to the state in any case. This throws a particular light on to the examination of the causality of a merger in establishing or strengthening a dominant position. The Federal Cartel Office has undertaken a short analysis here, in comparison with the observation of the effects in strengthening a dominant position, and it has affirmed causality. However, the Monopolies Commission sees a case of this kind as requiring particular examination, as it is unclear whether the merger would in fact strengthen dominance, and to ensure that a merger that would increase efficiency is not being forbidden. So the causality must be examined by a justified prognosis of whether the strengthening effects stated by the Federal Cartel Office would also occur should the lotteries be organised by the State of Rhineland-Palatinate.

**69.\*** During the period under review the Federal Cartel Office made use of the possibility to compare, within the framework of the assessment clause, the dominant market position that would be created by a merger with improvements in the competition conditions on other markets. The practice by the Federal Cartel Office was praised in two cases: The Monopolies Commission agrees with the arguments put forward by the Federal Cartel Office, which has cleared the creation of a joint platform for trade in secondary capacities for gas transport, trax, under the assessment clause. The Monopolies Commission also regards the merger as having positive effects on the number of companies participating, the volume of transactions, liquidity and the consequent creation of network effects. Similarly, the Monopolies Commission approves the clearing of the Kabel Deutschland/Orion-Gesellschaften merger in April 2008. Ending the artificial separation of network levels 3 and 4 in the German broadband cable network will help these networks to expand as alternative infrastructure for the supply of telecommunications services, and it will also create the condition for infrastructure competition with other fixed line operators on telecommunication markets.

**70.\*** During the period 2006/2007 there were a number of notable developments in European merger control. At 758 more cases were reported to Brussels than during the “merger wave” in 2000/2001. However, the European Commission – as in the preceding period – only forba-

de one (Ryanair/Aer Lingus). The possibilities for referral on the initiative of the parties introduced in the recent reform of the Merger Control Regulation, especially Art. 4, Para. 5, have again clearly grown in importance. In addition, the Spanish Government has contested the exclusive competence of the European Commission in the E.ON/Endesa and Enel/Acciona/Endesa mergers. In several cases when defining the market the European Commission has not adhered to the aim of making as clear and precise a definition as possible. The SIEC test has become firmly established, and it was used in the first “gap” case – T-Mobile Austria/Tele.ring. The criterion of market dominance is still important – as part of the new test. In some procedures the European Commission has considered the objection of efficiency. Efficiencies also played an important role in the discussion over the treatment of non-horizontal mergers, which resulted in guidelines from the European Commission in November 2007. The revised guidelines on remedies are still in the draft stage. The Court of the First Instance (the European Court) i.a. published its long awaited decision on Schneider Electric/European Commission concerning claims for damages in merger cases.

**71.\*** During the period under review the Spanish Government contested the exclusive competence of Brussels in the E.ON/Endesa and Enel/Acciona/Endesa mergers. Although the European Commission had approved both unconditionally Spain made the implementation of the mergers dependent on far-reaching conditions. The Monopolies Commission strictly rejects intervention by Member States in the competence given to the European Commission in the Merger Control Regulation. It expressly objects to a national policy that promotes the formation of domestic champions and subordinates the concerns of competition policy to industrial policy interests. In this context it recalls that such intervention is ultimately at the expense of consumers. In the view of the Monopolies Commission the European Commission should exhaust all the means at its disposal to induce Spain to revoke the conditions imposed and so also set a signal for other Member States.

**72.\*** In the distribution of competences between the European Commission on the one side and the national competition authorities on the other the referrals on the initiative of Member States under Art. 9 and 22 of the Merger Control Regulation are receding further and further into the background, while considerable increase is evident in the referrals upon application by the companies involved in the merger. Referrals from the national competition authorities to the European Commission are very much more frequent than vice versa. However, as was already to be observed in the previous report period, Member States hardly ever make use of their right of veto.

**73.\*** The development to a less rigid market definition that was evident during the period under review is striking. In several cases – i.a. the decisions on Omya/Huber, Glatfelder/Crompton and Travelport/Worldspan – the European Commission did define a materially relevant market – often explicitly excluding certain neighbouring products. But it stated at the same time that these neighbouring products do exert some pressure of competition on the parties to the merger, and must thus be taken into account in the further assessment of the competition. In the view of the Monopolies Commission it remains to be seen whether this approach will pass the European Court. It is doubtful particularly in cases where the European Commission has based its assessment of the competition on the criterion of market dominance. The question of whether a dominant position will be created or strengthened requires the definition of a materially and geographically relevant market as a clear frame of reference. Identification of considerable hindrance of effective competition also requires the decision to be practicable. As the outlines of the SIEC test are not clear it is particularly important for the justification and the consistency of the procedure to accord here.

**74.\*** Whereas the last period covered by the Biennial Report was still characterised by the transition from the market dominance test to the SIEC test, the latter has become finally established in the last two years. The introduction of the SIEC test was justified i.a. by possible gaps in the market dominance criterion in covering non-coordinated effects in an oligopoly. In the T-Mobile Austria/Tele.ring merger the European Commission has applied the SIEC test for the first time to a so-called “gap” case. As in the past, the European Commission has used economic studies and econometric analyses in its judgement of individual merger projects. This was done – e.g. in Omya/Huber, Inco/Falconbridge, Ineos/ BP Dormagen and Sea-Invest/EMO-EKOM and Ryanair/Aer Lingus – both for market definition and for the further assessment of competition.

But it must also be observed that the market dominance criterion certainly remained important in the SIEC test. In five out of ten conditional clearance decisions in the second phase the European Commission examined whether dominance would be established or strengthened. Finally the competition authority based its only ban on a merger during the period under review, Ryanair/Aer Lingus, on the aspect of market dominance. Market shares also still play an important role in the decision-making practice and they regularly form the starting point for further assessment of competition. In several decisions (e.g. Metso/Aker Kvaerner, Orica/Dyno and Renolit/Solvay, the European Commission has stressed that very high market shares of 50 % and more are in themselves an indicator that the parties in the merger hold a dominant position.

**75.\*** On principle the Monopolies Commission welcomes econometric analyses as a supplement to the traditional methods of examination, because this reveals sources of error and helps to improve the estimate of competition. However, the cases of Ryanair/Aer Lingus and Omya/Huber in particular give rise to the question whether the analyses did actually yield greater insight for the assessment of these mergers. In the view of the Monopolies Commission the European Commission should concentrate its scarce resources on real cases of doubt, in view of the high expenditure of personnel and time which economic analyses require.

**76.\*** During the period under review horizontal mergers were the main focus of decision-making. Only a few cases with vertical effects, like SFR/Télé2France and Thales/Finmeccanica/AAS/Telespazio, occurred. Conglomerate effects were also appraised only rarely – for example in the Metso/Aker Kvaerner and Danone/Numico procedures. In both these cases the European Commission took a positive view on principle of the increase in the product range. From the standpoint of the customer it is regarded as advantageous if the entire “range” can be purchased from one supplier. In the case of Danone/Numico, however, it seems questionable whether this advantage is actually due to the merger. It is also striking that the European Commission is not following up possible restraints of competition which the increase in the product range could entail.

**77.\*** In November 2007 the European Commission published guidelines on non-horizontal mergers. The Monopolies Commission shares the view that non-horizontal mergers generally pose fewer risks to competition than horizontal mergers. However, it points out that distinguishing between horizontal and non-horizontal mergers can cause considerable difficulties in practice. In view of this it is sceptical towards a purely behavioural approach in examining non-horizontal mergers. The Monopolies Commission has earlier stated that market structure criteria, as envisaged for example in § 19, Para. 2 GWB, should be taken into account in conglomerate mergers as well. The Monopolies Commission also objects to the examination of abusive practices as part of merger control.

**78.\*** A major innovation in Regulation No. 139/2004 is that under Preamble (29) the European Commission is to take account of efficiency gains that are substantial and likely. In several cases – Korsnäs/Carltonboard, T-Mobile Austria/Tele.ring, Inco/Falconbridge and Ryanair/Aer Lingus – the European Commission has considered possible efficiency gains. An in-depth examination was made in the second phase of the Inco/Falconbridge and Ryanair/Aer Lingus procedures. In none of the above cases was the result of the competition analysis revised as a result of the efficiencies claimed. In cases where the European Commission feared considerable restraints of competition the objection of efficiency was rejected because the necessary conditions were not fulfilled. The European Commission has therefore not yet had to really weigh between competition restraint on the one side and efficiency gains on the other.

**79.\*** The Monopolies Commission takes a critical view of the European Commission's procedure in the Korsnäs/Carltonboard case, which was cleared in the first phase without conditions and remedies. Although the competition authority stated right at the start that there were no fears for competition, it next considered the efficiencies claimed. The Monopolies Commission expressly favours separating the primary examination of any effects in restraining competition from an ensuing examination of efficiencies. An efficiency appraisal should only be undertaken if the competition analysis raises serious doubts about the merger. The European Commission used this approach in the cases of Inco/Falconbridge and Ryanair/Aer Lingus.

**80.\*** In the Ryanair/Aer Lingus case none of the efficiencies claimed meets all the necessary requirements, in the view of the European Commission. The decision makes it clear that simply claims or assumptions by the parties to the merger that the merger will create efficiencies are not enough for a positive decision by the competition authority. An important indicator of how serious the advantages claimed are can be found in documents drawn up before the actual merger and which support the arguments put forward. The decision also confirms that only those efficiencies will be taken into account that will result from the merger. Cost savings, on the other hand, which one of the companies could also achieve alone, will not count. Moreover, the European Commission also makes clear that only additional efficiency gains will be taken into account. For the companies concerned this means that they cannot argue in the merger control procedure that cost savings resulting from greater buyer power will promote efficiency.

**81.\*** During the period under review 31 first phase and 10 second phase decisions were taken with conditions and remedies imposed. In almost all the second phase procedures the European Commission accepted structural commitments. Some involved the surrender of supply contracts, trade marks or technology as well as the sale of production plant. But in isolated cases behavioural obligations also formed the main part of the measures imposed on the parties, as in the SFR/Télé2France case and Axalto/Gemplus. Only in a single case – Ryanair/Aer Lingus – did the European Commission regard the commitments offered as insufficient and ban the merger. The number of bans thus remained on a low level. The impression is strengthened that the European Commission is ready to accept extensive commitments rather than ban a merger. The Monopolies Commission takes a sceptical view of this, especially against the background of the shortcomings observed in the past in the implementation of the measures required. It also points to the risk that the competition authority may utilise the instrument of remedies in an active industrial policy.

**82.\*** In April 2007 the European Commission presented the draft of the revised guidelines on remedies. This was primarily in response to a study published in 2005 and that established considerable shortcomings in the implementation of commitments. The Monopolies Commis-

sion welcomes the initiative by the European Commission, particularly against the background of these shortcomings. A more stringent approach in accepting commitments, as is reflected in the draft, is needed, since in the past only about half the remedies have proved effective. This approach is particularly important in view of the fact that the European Commission is more inclined to impose extensive obligations than forbid a merger.

The Monopolies Commission shares the doubts which the European Commission holds on principle regarding behavioural remedies. But in this context it regards the comments on access obligations as insufficiently critical. It agrees with the European Commission in underlining the importance of the right buyer for the success of the remedy. It also supports the initiative by the European Commission to rely more on up-front buyer and fix it first solutions. Among other things, this will ensure that the merger is only completed if a competent buyer is found for the package to be sold.

**83.\*** The Court of the First Instance and the European Court have taken several important decisions during the period under review. The decision on Schneider Electric/European Commission deserves particular mention, for here the European Court commented for the first time on claims for damages in the merger control procedure, awarding Schneider Electric damages under Art. 288, Para. 2 EC Treaty. The European Court only affirmed adequately proven infringement of the law in infringement of the rights of defence under Art. 18 of the Regulation on Merger Control. The court refused to award further damages on the grounds that there would have been no reason to clear the merger even without the fault that was established. In confirming sufficiently proven infringement the court thus put the emphasis on formal aspects. In this way it strengthened the rights of defence of the companies concerned and ensured a fair proceeding. Where errors in the economic analysis are involved the European Court does not on principle exclude the obligation to pay damages, but it underlines several times the wide powers of discretion given to the European Commission. The court also stated that there is always insufficient causal connection if a ban would also have been possible even with the correct procedure. Against that background the obligation to pay damages for material errors in judgement should remain limited to a few exceptional cases.

**84.\*** The decision on Impala/European Commission also caused much comment, as the Court of the First Instance declared a decision by the European Commission to clear a merger (Sony/Bertelsmann) invalid. The court first confirmed the criteria it had established in the Airtours/European Commission decision for the examination of joint market dominance. Then it commented on the criterion for proving that joint market dominance would be strengthened. It refrained from direct proof of market transparency, regarding certain indications as sufficient. However, it is questionable whether the decision will in practice make it really easier to provide proof. For on a closer inspection the conditions for proving market transparency will not be easy to meet on the basis of the above evidence. That applies particularly to the “prices above competitors’ level” mentioned by the court, and to the “lack of other reasonable explanations for evident parallel pricing”. The Monopolies Commission does agree with the court insofar as parallel pricing alone is not sufficient proof of joint market dominance.

In addition, the court attacks the fundamental U-turn by the European Commission between communicating the points contested under Art. 18 of the Merger Control Regulation, the oral hearing of the parties to the merger and the final decision under Art. 8, Para. 2 Merger Control Regulation. In doing so it emphasises, as it was to do again later in Schneider Electric/European Commission, the importance of the parties’ procedural rights. In the view of the Monopolies Commission, after the remarks by the court on the points contested, the European Com-

mission must make greater efforts in future to give plausible explanations if it changes its opinion in the course of a merger control procedure. It must certainly be ensured that the parties can state their position on all the points that affect the decision.

**85.\*** The Monopolies Commission expressly objects to demands to limit the scope for third party suits by the regular application of Art. 10, Para. 6 Merger Control Regulation. The possibility of clearance under this article is an instrument to protect the parties from delays by the competition authority, it is not an instrument to avoid legal proceedings. Arguments against the proposed method are, firstly, the lack of transparency it would involve and the increased risk of political influence. Secondly, Art. 10, Para. 6 Merger Control Regulation evidently refers only to exceptional cases, and it cannot generally replace a decision by the authority under Art. 2 of the Regulation. Moreover, the Merger Control Regulation not only protects the institution of competition as such, it also protects third parties' confidence that competition will be maintained. So third parties must be able to rely, in the same way as the parties to a merger, on the correctness of the results and if necessary be able to contest them. Furthermore, an important instrument to guarantee correct decisions would be lost if the possibility of third party suits were removed. If there was no possibility for third parties to sue, ultimately competitors and other market participants would be less keen to ensure that the correct decisions are taken. A systematic delay in merger control procedures in order to uphold the assumption for clearance under Art. 10, Para. 6 Merger Control Regulation would, in the view of the Monopolies Commission, be a gross procedural error. It would also constitute a qualified infringement of the law, which under Art. 288, Para. 2 EC Treaty would make the Community officially liable.

#### ***V. Potentials for More Competition on the Hospital Market***

**86.\*** The German hospital market is undergoing major change. In recent years the financing method has been changed from daily rates for hospital treatment to lump-sum payments under the diagnosis related groups system. At the same time the gradual withdrawal of the public authorities from investment financing, which is due to the difficult situation in public finance, is continuing.

**87.\*** The constant rise in health care expenditure on the hospital market is due to numerous demographic and technological factors. It is also affected by special demand-side factors and extensive state regulation. The ageing of the population is a challenge to health care financing, and a further rise in cost pressure is to be expected in the hospital sector as well, at least in the medium term, owing to demographic causes. The legislature has made repeated efforts in recent years to limit costs on the health care market and to keep them down. All the legal measures involve dense regulation and they seem to leave very little room for the forces of competition. The Monopolies Commission is, however, convinced that what remains of competition should be strengthened and utilised to ensure efficient use of the available funds.

**88.\*** Technological factors are no less relevant. Technical progress in medicine can decisively improve diagnostics and therapy, and the cost can be covered by the preferences of patients and the willingness of the insured to pay. However, the providers of hospital services also have ways to influence patients' demand through their offers. For the demand for health care services develops in the relation between the patient and the doctor who is treating him. The providers benefit from the fact that the individual health care costs to patients are largely socialised in the present full insurance system, and that patients generally are not fully informed of what they will need if they are seriously ill.



**89.\*** The hospital operators are reacting to the changing economic and political conditions with constant rationalisation, more hospital mergers and the privatisation of public clinics. The reduction in political influence which privatisation brings strengthens the incentives for hospitals to align their services with commercial criteria, and in private clinics it puts much more emphasis on the business aspects of the work organisation and the use of resources. Whether private hospitals are at an advantage in taking up loans to finance investment, on the other hand, is doubtful. Since Basel II the examination of in how far the existing organisational structures of a hospital indicate low risks of default on the loan will play a much bigger part in the decision whether to lend.

**90.\*** Hospital mergers open up economies of scale and may lead to quality improvements due to doctors gaining more experience and routine through handling more cases. At the same time if the hospital has no local competitor its incentives to supply efficiently are lessened for all services. In general, therefore, it can be assumed that hospitals with a strong market position do not fully utilise the existing potentials for improving quality. However, as neither the direction nor the intensity of quality changes following a merger is by no means clear, it may certainly be possible that merger-induced advantages will predominate in an individual case, especially in a merger of relatively small hospitals, which involves considerable learning curve effects.

**91.\*** The role of merger control in the hospital sector is now largely established through jurisdiction and the public discourse that is part of the ministerial approvals procedure. Hospitals have to be treated as enterprises according to competition law. However, the Monopolies Commission points out that as most of the hospitals involved in mergers are small, many hospital mergers are below the turnover threshold for merger control under the GWB and so are not considered by the Federal Cartel Office. The low intensity of supervision can be regarded as problematic in that hospitals, as the providers of services, are typically dealing with largely regional demand, and so the restraints of competition due to hospital mergers can be of some importance in their regional environment, despite an evident lack of relevance for the market as a whole.

**92.\*** The Monopolies Commission therefore demands that the turnover threshold for merger control be lowered for the hospital market and the following clause be added to § 38 GWB: “For turnover by hospital enterprises three times the yield on turnover is to be used.”

**93.\*** Price competition on the hospital market is very limited owing to the tight regulatory control, and as most patients are fully insured. The DRG system, in which the running costs of hospitals are invoiced, does allow for differences in the price level between federal states, but it does not allow the hospitals to vary their charges to different health insurance institutes. Patients paying statutory health insurance in the present full cover system are entitled to treatment in all the hospitals in the system and all contract hospitals. § 39 of the Social Code V grants them largely free choice, which is only limited formally by the recommendations of the referring doctor, and this makes demand for hospital services largely price inelastic. The patients choose solely by quality standards and with no regard for costs. Thus, the regulation in the DRG system prevents market power created by mergers from being abused to raise prices at short term. And even for those hospital treatments where demand does react to prices, price-induced allocative efficiency losses do not occur that would otherwise result from market power following a merger.

**94.\*** As there is little price competition, and as patients generally prefer a hospital close to their homes, the location of a hospital and the quality of the services it offers are the decisive

competition parameters on the hospital market. Quality competition is relevant, especially in those areas where the patient can take decisions on the therapy himself, so typically the very broad area of elective hospital treatment that can be planned in advance. Empirical studies have shown that quality competition is effective wherever it is easy for patients to observe quality. But as there is little transparency on services on the German hospital market quality competition between the hospitals is limited. At present the obligations to publish certain quality indicators in § 137 Social Code V mainly affect the professional level. To enable patients to make more use of the quality information that is available care must be taken to prepare information on the quality of hospital treatment that is easy to understand and suitable for comparisons. It is worth considering to build up a quality register of hospital treatment that could provide systematic data on the hospitals, their treatments and the results. A quality register would firstly improve transparency on quality for patients and secondly offer greater scope for evidence-based medicine.

**95.\*** The Monopolies Commission feels that the limits to permissible advertising in the hospital sector set by the Act on Advertising Drugs (*Heilmittelwerbegesetz*) and the Medical Practitioners Code (*Berufsordnung der Ärzte*) are at present too vague, and consequently tendentially too restrictive. To preserve legal certainty hospitals can be forced to be over-cautious in handing out information on quality to the general public. The Monopolies Commission also regards the increasingly tight contractual relationships between the in-patient and the ambulatory sectors as obstacles to quality competition in the supply of hospital treatment. They can contribute to economic dependencies and may hinder doctors fully performing their mediating function which they should play in the patients' choice of hospital.

**96.\*** The Monopolies Commission regards it as extremely important to protect what remains of quality competition in the hospital sector, as it ensures patient choice and is the only guarantee of high-quality services. The Monopolies Commission observes that in assessing hospital mergers under merger control law value must be placed particularly on maintaining the remaining quality competition. Structures for merger control on the hospital market must be maintained today that will provide the legislature with the opportunity of further strengthening the role of price and quality competition in future, to ensure a supply of high quality hospital services that suits patients' preferences.

**97.\*** The Monopolies Commission regards the central hospital planning by the Länder and promotion of investments for plan hospitals as a major obstacle to innovation and economy in the hospital sector. Instead it wants to see hospital planning that no longer focuses on ensuring a comprehensive supply of hospital services in every federal state but on ensuring only the minimum supply that is absolutely necessary. For all the other areas a financing system must be found that will enable the hospitals to direct their supply in competition to the local needs as expressed by the statutory health insurance institutes and the patients, and to keep developing this. The reason for this demand are the many distorting effects of the investment promotion procedure, which is also vulnerable to outside political influence. The promotion of investments by the state disadvantages hospitals outside the plan against plan hospitals in competition for private patients. Its centralist procedure does not make efficient use of information on the local need for hospital services that is available decentrally, it leaves possible innovative potentials unutilised and in individual cases it can prevent meaningful entrepreneurial activity by hospital authorities. Most important, however, is the fact that the investment steering in the hospital sector distorts investment decisions, as it separates decisions on fixed assets and technologies on the one side from decisions on work, namely treatment, on the other, and

does not pay enough attention to the economic relations between the cost and the earnings side of an investment project.

**98.\*** The DRG system gives the hospitals incentives to lower costs in the short term and it strengthens the transparency of the supply and cost structures in the hospital market during the convergence phase. For the German hospital system as a whole, however, this is still a cost-based regulatory system, in which the prices for individual hospital services are only dependent on society's willingness to pay insofar as the subsidiary constraint of still moderate health insurance contributions must be fulfilled. Hospital treatment is otherwise made solely dependent on the average cost of providing it. The DRG system therefore largely corresponds to a price-cap regulation, as it is common in the regulation of natural monopolies. Altogether it remains unclear whether the current financing regime encourages increasing the quality of the supply through greater transparency, or reducing it. For in the fixed price system the incentives for hospital operators to increase their own profits by lowering the quality of treatment, discharging patients too soon, selecting patients by economic criteria and carrying out unnecessary additional treatment have proven problematic.

**99.\*** Another cause for concern is the trend to pay for individual services, as is the trend to standardised treatment and procedures that prevents possibly heterogeneous preferences by patients for hospital treatment from being reflected in correspondingly differentiated and efficient supply. The DRG system runs the risk of wasting most of the advantages of the prospective remuneration with its increasing differentiation. Without explicit negotiations with cost bearers the hospitals are left with little scope to develop innovative treatments, which on the one hand are more expensive than established methods, but on the other would also further improve quality. The Monopolies Commission holds the view that the current disincentives will be difficult to control by further differentiation of the uniform financing system, or by more intensive regulation of the hospital market. The differentiation of the lump-sum payments should therefore at least be stopped, if not reduced in order to open up new scope for the hospitals to develop and implement innovative treatments.

**100.\*** In the view of the Monopolies Commission the possibility should be considered of re-introducing a monistic financing system on the hospital market, in which all the hospitals' operating expenditure and investment would be covered by lump-sum payments. After a return to the monistic system investment surcharges on top of the present lump-sum payments to cover operating costs would generate an incentive for investors to reduce the present backlog of investment. From an economist's point of view reducing the backlog of investment before introducing the monistic system is not essential. The direct transition to monism might be deemed unfair, since the current differences in the level of installed capital are not necessarily grounded on corresponding differences in performance in the past. However, the Monopolies Commission believes it would be difficult to reduce the investment backlog. It would have to be done through a compensation pool, and the transaction costs would presumably be considerable. Solutions that would provide for the payments to be spread over a longer period will continue to build up a cumbersome bureaucracy with an inherent risk of inefficient investment of funds by the state. Finally, any method of levelling the present imbalances would on principle pose problems, because the residual value of invested capital refers to the past, and is in itself of no relevance to decisions for the future.

**101.\*** The biggest obstacle to the introduction of monism would probably be conflicts between the Länder. In recent years they have performed their subsidisation obligations in very different ways, and so there is likely to be political controversy over who is to bear which

costs in a hospital system with monistic financing. If in future the Länder are to contribute to financing investment in the hospital sector at least to the same extent as hitherto, the conversion to a monistic financing system should not put a greater burden of contributions on the shoulders of those who pay statutory health insurance.

**102.\*** If a fully monistic system cannot be achieved at least the introduction of a partly monistic financing system should be considered. In this case individual hospitals would not have to apply for individual amounts, all the state funds would only be disbursed as lump sums. However, a suitable key would have to be found for the disbursement by the Länder. As the method practised to date of tying financing to the number of plan beds does not appear to produce positive incentives, since supply or process innovations in the hospital segment necessarily involve capacity adjustments, a key more suited to modern conditions needs to be developed. One avenue might be tying the financing to the hospital's turnover.

**103.\*** If the investment surcharges are correctly measured the resultant supply of market services should largely be the efficient level of supply. There might then be innovative adjustments in the form of structural market changes, for instance greater integration of out-patient treatment within the hospitals or the introduction of gateway clinics in less densely populated regions. That would ensure that emergency treatment would be given on the spot by a clinic in an association, while specialised in-hospital treatment could be taken over by supra-regional centres. The Monopolies Commission emphasises that in ensuring the public provision of hospital services the concern is not first and foremost to correct market failure but to provide a politically desired, non-discriminatory supply throughout Germany. And if this politically desirable supply does not correspond to the economically efficient supply, its provision can still be legitimate, for beside economic efficiency aims other values also play a part in objectives.

**104.\*** It does not appear meaningful to the Monopolies Commission to transfer the responsibility for providing and ensuring reserve capacities and emergency treatment to the statutory health insurance institutes, precisely because if these goods are provided on a community basis a problem with free riding could arise. Moreover, the sensitive area of ensuring a general supply is potentially exposed to a private provision problem. A centralised federal organisation for general emergency treatment does not appear appropriate either. It would be better, if the Länder, the municipalities and the district councils were responsible for this, as they can better meet local preferences and therefore achieve greater coordination between those paying and those receiving treatment. Additional supply could then be ensured efficiently by holding repeated competitive tenders. The tender procedures must be designed so that in every case the successful bidder is the one who can offer the desired quality and the desired amount with the least need for public grants. As a result again a form of dual financing would develop on the hospital market.

**105.\*** The Monopolies Commission proposes that a special optional rate for hospital treatment be introduced into the statutory health insurance system to widen the scope for steering by the health insurance institutes. They would sign selective treatment contracts at optional rates with individual hospitals, and the persons insured with them would have the possibility of opting out of the standard rate voluntarily. They would still be entitled to the full range of services available for persons fully insured, but they would not be free to choose the hospital for their treatment. To secure treatment for their members insured on the optional rate the health insurance institutes would have to enter into selective treatment contracts with suitable hospi-

tals for the entire range of services available on the standard rate and for treatment of all the diagnoses on the DRG list.

**106.\*** The limits to the optional model would need to be set by the legislature and subjected to continuous reappraisal. It must particularly be borne in mind here that the health insurance institutes would on the one hand have to be given sufficient scope to differentiate their charges qualitatively, and so gain advantages in competition with other health insurance institutes through differences in the services provided. To avoid hardship for persons insured on the optional rate it would appear meaningful for the regulator to specify the maximum permissible distance between the residence of the person insured and the nearest contract hospital. Moreover, the important problem of time inconsistency in long term insurance must also be taken into account. Young people generally underestimate the insurance they will need when they are old, and the Monopolies Commission believes that the optional model should initially limit access to the hospitals that are directly under contract to the health insurance institute. For the rest, the range of services for those on the optional rate should remain the same as those available on the statutory standard rate.

**107.\*** It would then be the aim of every health insurance institute to make its optional rate attractive to its members with an appropriate price and a superior quality compared with the offers from its competitors. To realise the savings potentials from selective contracting it should be permissible to bind persons insured on the optional rate, at least for a certain period of time. Otherwise the healthy would be able to enjoy free riding, which is undesirable. It should be the aim of the hospitals competing for contracts to be considered by the health insurance institutes for the optional rate. Their decision parameters are competitive prices on the one side and superior quality of treatment on the other. The Monopolies Commission holds the view that the competition between hospitals could yield particularly valuable results if the legal requirements for the contents of the contracts between the hospitals and the statutory health insurance institutes are not restrictive. In particular, the DRG remuneration system for the optional rates should only be of the nature of a recommendation. The contracting parties should on principle be free to agree premiums and discounts or even an alternative payments structure.

**108.\*** For the patients the choice of the optional rate would not mean any reduction in the level of hospital treatment. Each person insured would still be entitled to the full range of treatment available on the statutory standard rate. The health insurance institutes' rules on insurance abroad would be the same on the optional rate as on the standard rate. And in regard to guaranteeing high-quality treatment in emergencies, where the time needed to transport the patient to a hospital is a major factor in any later recovery, emergency treatment on the optional rate should be exempt from the restrictions in the selective treatment contracts. So in an emergency persons on the optional rate should be admitted to any hospital.

**109.\*** The legislature should also lay down framework conditions for price competition in the optional model. It must be made clear how the health insurance institutes may grant their insured members discounts for choosing the optional rate. One solution that would be politically easy to explain may be seen in lowering the optional contribution rate. A particular problem here is that beside its primary task of transferring the direct monetary risks of falling ill to the insured, the statutory health insurance system also performs parts of the function of asset balancing in the social system as a secondary redistributive task. Thus, if discounts were given on the optional rate in the form of lower contribution rates, that would mean that the attracti-

veness of joining on the optional rate could vary greatly for otherwise homogeneous groups of insured members, only because they differ in their income from employment.

**110.\*** On principle price differentiation is desirable if it sends the right economic signals on their choice to the insured. Ideally, therefore, they should be given reductions in the form of general discounts, if insured in the optional rate. It should also be considered whether discounts should be paid not only per contributor but per person insured. The possibility of regional differentiation of the premiums could also be considered. That would take account of the fact that hospital treatment is generally given in the patient's region and close to his home, and so the selective contract between his insurance institute and the local hospitals is particularly relevant for the insured.

**111.\*** It would be detrimental to economic incentives, if cost savings which a health insurance institute solely achieved from successfully introducing its optional rate were benefitting those insured on a standard rate via solidary redistribution in the risk structure compensation scheme. In the view of the Monopolies Commission, therefore, it is to be recommended that the risk structure compensation for the optional rates should be separated from that for the statutory standard rate, subject to taking into account the necessary additional bureaucratic expenditure this would entail.

**112.\*** Finally, the demand power of dominant health insurance institutes should be subject to competition supervision in order to enable competition for contracts between the health insurance institutes. Concerning the legal relations between the health insurance institutes and health care providers § 69 of the Social Code V is comparable to an area of exception from German cartel law and the law against unfair competition. This legislation gives health insurance institutes the opportunity of collectively signing contracts with providers instead of individually. Coordination among and across market sides would disrupt the mechanisms of competition and undermine improvements in price and quality which those insured in the statutory health insurance system may enjoy in the medium to long term. The formation of a bilateral oligopoly is to be feared with medium to long term tendencies to excessive price increases, restricted supply and sub-optimal quality. However, in regard to the economic aspects of competition policy it is not possible to generally approve the logic of § 69 of the Social Code V, under which the bundling of purchasing power should lead to lower costs and reduce excessive profits in the health system. In the view of the Monopolies Commission the contracts between the statutory health insurance institutes and the hospitals should therefore be fully subject to the rules of competition law and antitrust control.

## ***VI. The "More Economic Approach" in European State Aid Control***

**113.\*** The European Commission has announced comprehensive reform of European control of state financial aids. In its State Aid Action Plan (SAAP), published in November 2005, it states that the main aim of this reform is to apply a "more economic approach". In its endeavours to adopt a more economic approach the European Commission has for some years now been attempting gradually to reform the European competition rules that apply to companies (Art. 81, 82 EC Treaty and the European norms on merger control, here as EU cartel law). The more economic approach is the focus of numerous research studies and is a subject of controversy in legal circles and between economists. However, there has so far been much less scientific discussion on the opportunities and risks of a more economic approach in the control of state financial aids.

**114.\*** State aid control as laid down in Art. 87 ff EC Treaty forms the second component of European competition law beside EU cartel law. While Art. 81 and 82 EC Treaty are intended to control private restraints of competition Art. 87 ff EC Treaty deal with an important case of state restraint of competition, namely aid granted by Member States. European law refers to subsidies as state aid if they fulfil the five criteria listed in Art. 87, Para. 1 EC Treaty. In this definition measures are state aid if they

- firstly include favourable conditions, that is, an economic advantage for the recipient
- secondly are granted for certain companies or production branches, that is, if they are selective
- thirdly if they are state aid, or granted using state funds
- fourthly if they distort competition or threaten to do so and
- fifthly if they restrict competition between Member States.

**115.\*** Granting state aid can cause considerable distortion of competition on the product and services markets affected in regard to allocation, production and dynamic. In this case the possible restraint of competition has not been caused by companies and market actors but sovereign states. Beside the motive to prevent cross-frontier restraint of competition delegating aid control to a supranational body like the EU can on principle also enable the external appraisal of the efficient use of public resources to be appraised externally. State aid can not only have considerable negative consequences on competition, it can also lead to more costs for the economy as a whole and inefficiencies. As a transfer pattern is characteristic of state aid it initially involves direct financing costs. Moreover, the grants are made from tax revenue, which in turn involves loss of benefit in other areas (the shadow price of taxation) or could be used elsewhere (opportunity costs). Moreover, erroneous prognoses and free riding can also cause aids to be a waste of public funds. And there is the risk that the political decision-makers will use aid for publicity effect and in support of particular interests, to ensure their own re-election or election victory for their own party.

**116.\*** The position of these clauses in the legal system and the wording of the ban on aids make it clear that Art. 87 ff EC Treaty are intended to cover competition on the Single Market and not to instigate external control of national budgets. The regulations on aids control were introduced in 1958, they were intended to promote the formation of a uniform single market and to prevent Member States from using financial aids to counter the reduction of barriers to trade and the realisation of the basic European freedoms. The European Commission does not have powers to control national budgets under Art. 87 ff EC Treaty. On the contrary, Member States are required to create effective control mechanisms and a stringent system of control within their national borders to prevent the waste of state funds as a consequence of excessive subsidisation.

**117.\*** European state aid control performs an important and fundamental function in protecting cross-frontier competition on the EU single market. Non-European states often lack corresponding protective mechanisms, so that the granting of aids by their political decision-makers is not subject to strict control as it is in EU Member States. Consequently, when there is international bidding for major projects, it is possible for non-EU states to offer companies higher amounts in grants (subsidies) than EU Member States can offer, who are bound by Art. 87 ff EC Treaty. Nevertheless, in the view of the Monopolies Commission there should be no restriction or relaxation of the EU rules on aids in such situations. The aim should rather be to establish better standards of protection and to introduce more stringent rules on subsidisation on international level (especially in the WTO). However, the aids granted by the EU itself should also be subject to more stringent controls, for unlike the aids granted by Member

States they are not subject to Art. 87 ff EC Treaty. In the view of the Monopolies Commission the possibility should be considered of transferring control of national and EU subsidies to a new, independent European supervisory authority that can act free of political influence.

**118.\*** Under Art. 87, Para. 1 EC Treaty financial aids by Member States are on principle incompatible with the Common Market. However, this ban on financial aids does not apply absolutely, for the treaty provides for a large number of exceptions and reasons to justify aids (especially in Art. 87, Para. 3). The European Commission decides whether to exempt, and it has wide powers of discretion here. The Member States are required to inform the European Commission of any aid which they intend to grant or alter, in sufficient time for the European Commission to respond (obligatory notification in Art. 88, Para. 3, Sentence 1 EC Treaty). As long as the European Commission has not been notified and has not made a final decision the Member State may not grant the aid (ban on implementation, Art. 88, Para. 3, Sentence 3 EC Treaty).

**119.\*** Several measures have now been taken to implement the reform announced by the European Commission in SAAP. They show that in establishing a more economic approach in aid control the European Commission does not intend to refrain from using *per se* rules and assumptions in future. Rather, it has extended the area of application of the *de minimis* regulation and raised the upper limit for exempt aids to EUR 200,000 (for a period of three years). It has also proposed a general group exemption regulation that would free more aids than hitherto from obligatory notification and create a uniform legal framework.

**120.\*** The European Commission's more economic approach does not start on the level where aid is defined (Art. 87, Para. 1 EC Treaty) but only on the level of justification (Art. 87, Para. 3 EC Treaty), where the Member States are responsible for proving that the aid in question is, by way of exception, compatible with the Common Market. The European Commission intends to carry out a three-stage assessment test as part of the appraisal of compatibility, and concretises this further in secondary legal acts for certain kinds of aid (e.g. for research, development and innovation). In Stage 1 of this test the European Commission will examine whether the aid serves an exactly defined objective of common interest that cannot be achieved through the free play of market forces. It wishes to see the removal of market failure as a primary objective. This is the classical economic ground for justifying aid. In Stage 2 of the assessment test the European Commission is to examine whether the aid is a suitable instrument to achieve the objective common interest, that is, to remove market failure or to pursue another objective that is worth protecting. In Stage 3, finally, the European Commission will examine whether the disadvantages – especially the distortions to competition and trade – are limited, so that the positive effects will predominate.

**121.\*** As the grounds for justification in Art. 87, Para. 3 EC Treaty are very broadly formulated the Monopolies Commission regards it as positive on principle that the European Commission has concretised its procedure for assessing compatibility. This has increased the transparency and strengthened the economic foundation of the assessment on the level of justification compared with earlier practice. In connection with the criterion of market failure as a ground for granting aid it should be observed that in the ideal case aid can help to reduce market failure. However, if there is market failure by way of exception, the initial situation is not generally improved by granting aid. On the contrary, there is a risk that state aid will not have the desired effect and that competition will deteriorate (second best problem). The main reasons for state or policy failure in granting aid may be asymmetric information, erroneous analyses and prognoses, delays in the decision making process, lagging effects of policy mea-



asures and disincentives in policy and the public administration. So any market failure should be weighed against the risk of state failure. Finally it should be remembered that granting aid is not justified by market failure, it is only justified if the aid is particularly suited to correct this market failure.

**122.\*** On the preliminary level of the facts (Art. 87, Para. 1 EC Treaty) and in regard to the restriction of international trade the Monopolies Commission believes that it should be an unwritten condition, as in cartel law, that the restriction must be “perceptible”. That will prevent the area of application of the ban on aid also extending to cases of minor international importance and of purely local concentration.

**123.\*** The Monopolies Commission also recommends that the objective likelihood of an aid distorting competition should be examined on the level of the facts under Art. 87, Para. 1 EC Treaty and that here, too, as in cartel law, it must be shown to be “perceptible”. With respect to distortions of competition the European Commission so far only undertakes a general sector-specific inquiry, which is clearly less than the standard traditionally applied in EU cartel law, and which the European Commission would now like to widen by including flexible economic criteria. The European Commission’s way of tackling reform, namely through a closer examination of the initial market structure and the competition situation, but only on the level of justification, and here to carry out Stage 3 of the assessment test outlined above, appears problematic, as in many cases the examination will never be made. For if an intended aid should not pass one of the earlier stages of the test – either because it is not designed to end market failure (Stage 1) or is neither suitable nor necessary for this (Stage 2) the test will not be completed. Accordingly, even with the new approach cases are conceivable where the European Commission forbids an aid without examining its negative effect on competition on the EU single market. This approach may not convince, as the European ban on aids will only take effect and justify intervention by the European Commission if a risk of distorting competition on the Single Market has previously been established.

**124.\*** The Monopolies Commission regards it as quite appropriate, for certain forms of aid by Member States, to assume distortion of competition (for instance rescue and restructuring aid). But as the definition of favourable treatment is very broad in Art. 87, Para. 1 EC Treaty, a general assumption does not appear justified in every constellation. In the view of the Monopolies Commission, moreover, a test of perceptibility should be introduced that can be refuted, and that would allow for a simplified exemption for aid below a certain threshold (e.g. EUR 1 million) with reference to certain criteria. Should neither the perceptibility test nor other assumptions apply the European Commission should be required to undertake a closer examination to clarify whether the measure in question will distort international competition. So several factors need to be taken into account that affect both the aid and granting it (aid criteria) and the relevant markets, the foreseeable effects on competition and the market position of the company receiving the grant (market criteria).

**125.\*** This method would not necessarily make it more difficult for Member States and national courts to assess whether a measure has to be reported under Art. 88, Para. 3 EC Treaty, or whether it infringes the ban on implementation. This could be prevented by retaining the low requirements for proof applying so far under Art. 88, Para. 3 EC Treaty and only imposing on the European Commission a greater obligation of proof under Art. 87, Para. 1 EC Treaty. The fact that the European courts are responsible for interpreting whether a ban on aid applies in the final instance for interpreting whether a ban on aid applies, and that they traditionally have set a very low standard for establishing that competition was being distorted, does not counter

the above approach, as a statutory clarification would be possible. Moreover, it is conceivable that a change in the practice of the law would suffice if the European courts were to abandon their traditional jurisdiction.

**126.\*** The procedure applied in the control of state aid should, in the view of the Monopolies Commission, be reformed and in certain points aligned with European cartel procedure. In this context the procedural rights of competitors and recipients of aid should be strengthened, the scope for examination of companies by the European Commission improved and shorter, binding deadlines for approval introduced. Instead of the legality principle applied so far by the European Commission, as in cartel law, the possibility should be considered of allowing the European Commission to exercise discretion over whether to take up a case, if the aid does not exceed a certain amount. That would enable the European Commission to set priorities and concentrate on important cases of financial assistance. The judgement whether to take up a case could be flanked by the introduction of a private action for a declaratory judgement. The Monopolies Commission recommends permitting actions before the Community courts by recipients of aid, affected competitors and their associations also over general regulations on state aid. In addition, competitors should be able to acquire legal protection on European level more easily. Legal protection on national level should be regulated coherently and take due account of the requirements of the law on state aid. Associations in particular should have the right to bring an action, analogous to cartel law (§ 33, Para. 2 GWB). What minimum standards need to be created for this in Member States could be the subject of an EU directive. In addition, the delaying effect of legal proceedings in cases where the state demands return of the grant should be excluded and an efficient legal protection system created. This system could be designed akin to the legal protection system in the law on public procurements (§§ 104 ff GWB).

**127.\*** If European control of state aid is reduced to protection of cross-frontier competition its area of application will be limited compared with the present administrative practice of the European Commission. In the view of the Monopolies Commission it is necessary to create effective complementary control mechanisms on national level at the same time. Otherwise there is a risk that with too low a density of control state aid could be granted on an inefficiently high level that will harm the economy as a whole. While the competence of the European Commission in state aid control is limited to the protection of cross-frontier competition the Member States are called upon to take into account the entire economic costs – including the financing costs and opportunity costs – in granting aid, and weigh these against the expected benefit.

**128.\*** In the view of the Monopolies Commission national aid programmes should be subject to regular success control and in serious cases, where the individual grant or the state aid programme exceeds a volume that needs to be more exactly defined, *ex ante* control of the effect on the economy should be carried out by an independent national body. Moreover, state aid should on principle be given in an open and transparent procedure. State aid designed right from the start for individual companies or a specific branch should be banned and only be permitted in exceptional cases as part of national *ex ante* control. In addition to fixed time horizons for state aid programmes and a degressive design of long term aids, from a certain volume state aid should be published on a central internet platform by the public authority concerned. Besides, an efficient system of legal protection and subjective rights for potential recipients of state aid for competitors affected and for their associations should be created.

**129.\*** The Monopolies Commission's proposals to reduce supervision by the European Commission to those state aids that are relevant to competition and to create national control mechanisms are a package of measures that should only be implemented as a whole. The European and national controls of state aid are interlinked, and this is the only way to ensure that granting aid will be effective.